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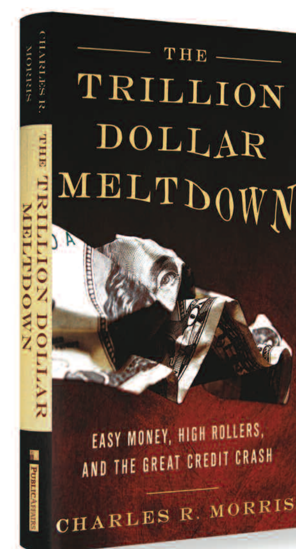
The Trillion Dollar Meltdown

Easy Money, High Rollers, and the Great Credit Crash



by Charles R. Morris

THE SUMMARY IN BRIEF

According to acclaimed financial writer Charles R. Morris, we are living in the most reckless financial environment in recent history. Morris warns that the sub-prime mortgage crisis is only a preview of the havoc that will play out across the full spectrum of financial assets.

Morris warns that a quarter century of free-market zealotry that extolled asset stripping, abusive lending and hedge fund secrecy will go down in flames with it. He also predicts that the required restructuring will be at least as painful as the very difficult period of 1979 to 1983.

The Trillion Dollar Meltdown explains the arcane financial instruments, the chicanery, the policy misjudgments, the dogmas and the delusions that created the greatest credit bubble in world history. It also warns that continual denial and concealment could cause the crisis to stretch out for years if financial and government leaders continue to downplay the problem. Morris helps readers understand how the world economy has been put on the brink — and the radically reshaped political/economic landscape that will define the post-crash era.

IN THIS SUMMARY, YOU WILL LEARN:

- How to grasp the breakdown in financial markets that affects the entire world economy.
- How America's shift from a creditor nation to a debtor nation affects Americans and the rest of the world's population.
- What two paths can be followed to raise the savings we need to invest and grow.
- How the American government and finance executives continue on a course to disaster by tending to downplay and conceal problems.

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THE COMPLETE SUMMARY: **THE TRILLION DOLLAR MELTDOWN**

by Charles R. Morris

The author: Charles R. Morris has written 10 books, including *The Cost of Good Intentions*, one of *The New York Times'* Best Books of 1980; *The Coming Global Boom*, a *New York Times* Notable Book of 1990; and *The Tycoons*, a *Barrons'* Best Book of 2005. A lawyer and former banker, Morris' articles and reviews have appeared in many publications including *The Atlantic Monthly, The New York Times* and *The Wall Street Journal.*

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The Death of Liberalism

In its modern sense, liberalism is a theory of government posing as a branch of economics. Adam Smith and David Ricardo called their discipline *political economy*, a useful term. "Political" was dropped from the name when the 20th century marriage of economics and advanced mathematics fostered the illusion that economics is a science. But the empirical underpinnings of public economics, the branches that seek to inform government policy, are often so fragile that they are better understood as ideologies.

The Keynesian version of political economy that John Kennedy ostentatiously brought to Washington in 1961 was an expression of faith in the potential of high intelligence employed in activist government. Built in part from nostalgic exaggerations of the accomplishments of the New Deal and the war administration, its central premise was that an economic intelligentsia could reliably employ government levers to achieve specific outcomes in the real world.

In practice, Kennedy's economic policies were cautious. The economic centerpiece of his short administration — generating a recovery with a tax cut — was implemented only well after a recovery was already under way. For Richard Nixon, the central attraction of Keynesian activism was how well it played with the public. The main goal of Nixon's radical centralization of economic controls in 1971, after all, was a landslide re-election.

Faith in a Puppet-Master Government

It is hard to exaggerate the faith of 1970s- and 1980s-vintage liberals in the power of a puppet-master government. An early-1980s survey of America's industrial decline concluded that America's woes came down to a lack of industrial policy. A Massachusetts Institute of Technology study of Japan concluded, "Without a strong central state and a top professional bureaucracy — the two preconditions of industrial policy — America is doomed to economic decline."

The infatuation with Japan's strategies for America reached its peak just about the time Japan was entering an economic slough that was to drag on for 15 painful years. Prolonged declines in both Germany and France during roughly the same period, if not as serious as Japan's, provoked widespread worries over incurable "eurosclerosis" caused by excessive governmental economic steering.

With the eclipse of Keynesian liberalism, the day had finally dawned for an alternative paradigm that had been waiting patiently in the wings — Milton Friedman's "monetarism."

Friedman's Monetarists

Monetarists taught that the supply of money was the product of the *stock* of money — the sum of coins, bills, checking accounts, etc. — times its turnover rate, or its *velocity*. Most important, by establishing rigid rules for monetary management, officials' meddlesome impulses would be constrained.

While Keynesians prayed to the idol of the quasi-omniscient technocrat, the Friedmanite religion enshrined the untrammeled workings of free-market capitalism. (Friedman opposed almost all forms of government regulation, including safety regulation for pharmaceuticals.)

Ronald Reagan's election in 1980 signaled that Keynesian liberalism was dead. Vaguely, inchoately, but

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service@summary.com
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Rebecca S. Clement, Publisher; **Sarah T. Dayton**, Editor in Chief; **Chris Lauer**, Senior Editor; **Chris Bienick**, Graphic Designer

A Feast of Low Points for the American Economy

For connoisseurs of misery, the 10 years from 1973 through 1982 provide a feast of low points. The rate of economic growth was one of the worst for any comparable period since the end of World War II. The country endured one of the worst periods of inflation in American history and foreign investors fled the dollar as if it were the Mexican peso.

The Japanese humiliated American standard-bearers in one flagship industry after another. Layoffs and short shifts spread through heavy industry. America's once-humming industrial heartland transmuted into the Rust Belt.

unquestionably, voters had signaled their readiness for a change of ideological horses. The theorists of the free market would get to run their race.

Wall Street Finds Religion

Few people had ever heard of the World Wide Web and the Internet before a startup company called Netscape — it sold the first Web browser that ordinary people could use — executed its public stock issuance in August 1995. The stock tripled on the first day, and within a few months, Jim Clark, a Silicon Valley veteran who was Netscape's primary investor, was the world's first dot-com billionaire. The tech stock boom was on.

Alan Greenspan

As the frenzy fed on itself, Federal Reserve Chairman Alan Greenspan worried publicly about "irrational exuberance" in 1996, then reversed himself a year later, cautiously accepting the possibility of a "new paradigm" — presaging an era of technology-enabled noninflationary growth. It was a remark almost guaranteed to increase the giddiness.

Bubbles are almost always anchored in real developments. The Web and the Internet were truly revolutionary and probably as important as the railroads. Secure Web-enabled communication flattened out organizational charts in big companies, blew away layers of bureaucracy, tied together customers and suppliers, and allowed seamless outsourcing of non-core tasks. Productivity growth in the last half of the decade ran at an extremely high annual rate of 4 percent plus.

Greenspan, something of an antiregulatory zealot, has never believed that asset bubbles are the business of the Fed. In the late 1990s, he refused to tighten stock margin rules to take some air out of the tech bubble.

Clinton's Legacy

The implosion of the tech bubble came only after President Bill Clinton had already turned over the White House keys, allowing him to leave office with a gaudy set of economic accomplishments. Over his entire administration, real growth had averaged 3.7 percent, the best postwar record except for the Kennedy/Johnson years. During Clinton's last three years in office, the government ran surpluses in excess of $300 billion, the best performance in the postwar era.

How did he do it? The official line, pushed especially hard by Robert Rubin, the head of the Domestic Policy Council and late of Goldman Sachs, is that it was through the application of "Rubinomics" — cutting deficits to lower interest rates. It is the same order of nonsense as the supply-sider's insistence that all booms are rooted in tax cuts. Rafts of studies by both liberal and conservative economists show that big deficit reductions move long-term interest rates by a few tenths of a percent, if at all. The deficit-cutting effort by Clinton's tax increase, in any case, was overwhelmed by the upsurge in gains taxes from the riotous stock market.

Broader Forces

The 1990s boom, in fact, was rooted in the confluence of a host of much broader forces that almost ensured solid growth. The baby boomers, the generation that had so decisively stamped its imprint on every decade since the 1950s, were entering their 40s and 50s — the years of greatest work output and savings. There was a productivity boom in American factories. The boomer generation of managers not only absorbed Japanese practices but also drew on uniquely American developments in distributed computing and digital communications that were just coming into full flower.

After a decade of overinvestment in real estate, the vast flow of liquidity in pension and mutual funds was shifting back to stocks and bonds. The senior population was flat, military spending was falling and new surpluses from a 1983 Social Security tax increase were cutting into the big Reagan-era deficits. Put all that together, and falling interest rates and strongly rising financial markets looked inevitable.

Then there were the 40 years of government investment that designed and implemented the Internet, including most of its core technologies, built it into a working worldwide system and developed the strategy and organizational model for shifting the Internet from government to private-sector control in 1995. Compared to such tidal developments, the Rubin tax increase was background static.

Conservative Convictions

Despite its unevenness, the 1980s and 1990s economic experience strengthened conservative conviction in two core principles. The first, which had been amply demonstrated by the recoveries of the early 1980s and the 1990s, was the great power of free markets. The second was the importance of almost fully deregulated financial markets, which was odd because multiple market bubbles were a strong argument to the contrary.

Bubble Land: Practice Runs

Although exciting new technologies fueled the dot-com boom, the bubble itself was a standard case of stock market hype and overshoot. But the decade from the late 1980s to the late 1990s also saw three other, much different boom-and-bust cycles. There was a big crash in residential mortgages in 1994 and two big trading-based crises — the 1987 stock market crash and the 1998 Long-Term Capital Management crisis, which the Federal Reserve at one point feared might bring down the entire global finance system.

All three of those episodes arose from fundamentally new investment technologies, enabled by breakthroughs in desktop computing and by an influx of mathematics Ph.D.s to Wall Street. Large-volume computerized trading could exploit tiny changes in interest rates. Very broad new classes of complex, structured investment instruments revolutionized wholesale banking. All the new technologies and strategies harbored dangerous flaws that tended to reveal themselves only at points of great stress. Bigger, better, even more far-reaching versions of these strategies have now, in 2008, placed the entire global economy at risk.

Geologic Shifts

Three episodes illustrate the tectonic shifts in the financial markets of the 1980s and 1990s, and expose some of the seismic fault lines in the new terrain.

First, the relentless deregulation drive that started during the Reagan administration steadily shifted lending activities to the purview of nonregulated entities, until by 2006, only about a quarter of all lending occurred in regulated sectors, down from about 80 percent 20 years before.

A second fault line is a worsening of the “agency” problem — or the problem of ensuring that an employee, a contractor or a company performing a service doesn’t act against your interest. A young trader named Nick Leeson destroyed Barings Bank in 1997 by taking exorbitant trading risks. By consensus, that was Barings’ own fault.

Alan Greenspan’s Implausible Argument

Dogmatic market capitalists hailed the deregulation trend, none more enthusiastically than Federal Reserve Chairman Alan Greenspan. In 1995, for example, Greenspan argued against margin — or minimum capital — rules on derivative positions. He claimed, implausibly, that a *lack* of margin requirements would “promote the safety and soundness of broker-dealers, by permitting more financial alternatives and, hence, more effective liquidity management.”

Highly compensated traders playing with the house’s money are an extreme, and well-known, case of the agency problem, so most trading houses have developed elaborate risk-control procedures to protect themselves. Barings didn’t, and paid for it.

Finally, a third dangerous trend is the increased dominance of investment decisions by mathematical constructs. The mathematics of big portfolios analogizes price movements to models of heat diffusion and the motions of gas molecules, in which uncountable randomized microinteractions lead to highly predictable macro results. Although it’s theoretically possible that all the air molecules in a room will shift to one corner, or that a torch applied to a metal bar will heat only one side, the laws of large numbers ensure that the actual frequency of such events is way beyond never.

Large securities portfolios usually do behave more or less as the mathematics suggest. But the analogies break down in times of stress. For shares truly to mirror gas molecules, trading would have to be costless, instantaneous and continuous. In fact, it is lumpy, expensive and intermittent. Trading is also driven by human choices that often make no sense in terms that models understand.

All three of those trends — the shift of financial transactions to unregulated markets, the steady worsening of the agency problem and the pretense that all finance can be mathematized — flowed together to create the great credit bubble of the 2000s.

A Wall of Money

By 2003 or so, mortgage lenders were running out of people they could plausibly lend to. Instead of curtailing lending, they spread their nets to vacuum up prospects with little hope of repaying their loans. Subprime lending jumped from an annual volume of $145 billion in 2001 to $625 billion in 2005, more than 20 percent of total issuances. More than a third of subprime loans were for

100 percent of the home's value — even more when the fees were added in.

"Negative amortizations" were loans with initial payments that didn't cover interest, but the unpaid interest was added to the principal at killer rates. Gross overcharges for fees and brokerage were buried in the loan principal. The standard lender escrow accounts to ensure the payment of taxes and insurance were eliminated. Borrowers thought their monthly payments were smaller and quickly defaulted on insurance and tax payments. "Yield spread premium" fees for brokers were bonuses for originating high-rate loans for borrowers who qualified for better deals.

The industry's underbelly became viciously predatory: A mortgage might include several different loans at teaser rates that quickly reset to double or triple the initial rates. The new monthly payments frequently were higher than the borrower's total income.

Falling House Prices

As of the end of 2007, the industry borders on catastrophe. The housing boom is over: The widely followed Case-Shiller index of home re-sales shows that real home prices have fallen steadily throughout 2007. (As late as 2006, the forecasting consensus was that house prices never fall.) Chasing the numbers down, most economists now anticipate a real national price drop in the 10 percent range, although outside estimates are creeping toward 30 percent.

Pessimism is fully warranted. Some $350 billion worth of subprime and near subprime loans closed in 2005 and 2006 will reset, most at much higher interest rates over the next year or so. Delinquencies have been rising rapidly and, given the very low quality of recent-vintage loans, can only accelerate.

Extreme Leveraging

The extreme leveraging in the financial sector started to come undone in October, when the big banks and investment banks reported some $20 billion in losses, $11 billion of it at Citi and Merrill, primarily in subprime-based collateralized debt obligations (CDOs). The first reaction was relief that the banks were finally coming clean. But within just a couple of weeks, banks revised their loss estimates to more than $45 billion, including recalculations of the third quarter and new losses in October. Some $20 billion was reported by Citi and Merrill. Merrill's CEO, Stan O'Neal, was fired, and Citi's Chuck Prince resigned.

As of late November, the market bottom is rapidly receding into an endless black hole.

Why isn't the Fed stepping in much more aggressively? The sad fact is that there isn't much the Fed can do. All the years of working the liquidity pump has sucked out everything but the brine. The "wall of money" that has kept American markets afloat also created a global dollar tsunami that has left a waterlogged world in its wake.

A Tsunami of Dollars

The standard fever chart of a country's financial position vis-à-vis the rest of the world is its "current account," a kind of international profit and loss statement. Although the current account captures all international spending flows, such as tourist spending and earnings from overseas companies, the numbers are dominated by exports and imports. American exports, or everything we sell overseas, go on the plus side of the ledger, while the goods and services we buy from abroad are entered on the minus side.

For about 75 years starting in the mid-1890s, the American current account was always strongly in the black. Even during the 1970s oil crisis, the deficit never exceeded $15 billion. The strong flow of earnings from overseas assets usually offset about half of the oil bill.

Shifting Trade

The trade account deteriorated steadily through the 1980s and 1990s, before suddenly tilting into a free fall around 1999. The 2006 trade deficit was more than $750 billion, and the total current account deficit topped $800 billion.

The accumulated deficit for 2000 to 2006 is about $4 trillion. Under pressure from the falling dollar, trade numbers improved in the second half of 2007, but the full-year deficit will still be a humongous $650 billion or so.

The $800 billion net outflow in 2006 was more than 6 percent of American GDP. Where did that money come from?

The answer, of course, is that our deficits are being financed by foreigners — in 2006, the American current account deficit consumed about 70 percent of the rest of the world's surpluses. Most of it comes from private investors — although "private investors" from Russia, China and the Gulf countries are frequently government fronts — but an increasing amount comes from official sources, mostly central banks. That is a big change. In 2000 and 2001, official sources supplied only about $35 billion a year, but by 2006, the official sources line had ballooned to $440 billion. Much of that, it is safe to assume, are investments made for policy reasons, not because short-term U.S. Treasuries offer unbeatable returns — and policy decisions can be reversed.

At the end of 2006, America's net investment position showed a balance of $2.5 trillion in favor of foreigners.

Trillions Abroad

One concern is the large concentrations of cash-like dollar assets held either directly at central banks or other government-controlled bodies. And they are very concentrated. China has $1.2 trillion, as does the rest of non-Chinese Asia. The accumulations in the OPEC nations are perhaps $600 billion. Russia has about $400 billion and even traditional debtor countries such as Mexico and Brazil have large dollar balances. Total foreign- held dollar reserves as of the end of 2006 were somewhere in the neighborhood of $5 trillion.

For several years, some very smart people have been arguing that there was little cause for concern because the current dispensation could be maintained indefinitely. But the rapid fall of the dollar in the last half of 2007 suggests that such hopes were wishful thinking.

Two Paths

There are only two paths to raising the savings we need to invest and grow. The first is to make deep and wrenching changes in the way Americans use their money. The second is to attract some if it back from abroad. As a practical matter, we will have to do both. But the days when foreigners were willing to finance our deficits for free are gone forever.

All in all, it's hard to imagine a worse outcome — the United States, the "hyperpower," the global leader in the efficiency of its markets and the productivity of its businesses and workers, hopelessly in hock to some of the world's most unsavory regimes. But that's where a quarter century of diligent sacrifice to the gods of the free market has brought us. ●

The Great Unwinding

Lenders or companies that want to get risky assets off their books could package and sell them as collateralized debt obligations, or CDOs. Suppose you own a portfolio of high-yield bonds with a below-investment-grade rating. To construct the CDO, you put the portfolio into a trust and create a family of bonds with different claims to the portfolio's cash flows. The top-tier bonds, which might be 80 percent of the total, get first dibs on *all* cash flows. Since those bonds are almost certain to be fully paid, they get a top credit rating, and conservative investors, like pension funds, are happy to take them off your hands. The rest of the bonds are queued up in the payments "waterfall," with each successive layer bearing greater risk, paying higher yields and getting lower ratings.

Credit default swaps can be used to create synthetic CDOs. A credit default swap allows the holder of the risky asset to lay off the risk to a third party, without having to sell the asset. With imagination, some advanced math and some computer wizardry, a family of credit default swaps can be constructed that will generate exactly the same risks and cash flows as a real reference CDO portfolio but without the trouble of actually assembling the loans — a synthetic CDO.

Synthetic CDOs

The growth of synthetics means that the actual supply of real subprime mortgages or highly leveraged corporate loans is no longer a limit on creating CDOs based on those instruments. There is also a tendency for synthetic CDOs to distribute only the riskiest, highest-yielding layers to outside investors, so they may increase the proportion of high-risk paper in the market.

The limiting factor in creating CDOs is finding buyers for the bottom tranche — the equity tranche, or toxic waste — that absorbs the first dollar losses from an entire portfolio. The enormous scale of the CDO industry suggests that somebody's been buying a lot of toxic waste. Who is it?

It's the hedge funds. And the entire industry is dancing to their tune.

Hedge Funds

Hedge funds are unregulated investment vehicles that cater to institutions and wealthy individuals and promise extraordinary returns. There are few limits on how they invest, what kind of risks they take and how much leverage they use. The top performers truly have achieved spectacular results, some over very long periods. But as the field has gotten ever more crowded, average returns have been decidedly lackluster, especially given the industry's outsized pay packages. As of mid-2007, hedge funds deployed an estimated $2 trillion to $2.5 trillion of equity capital and much higher economic capital due to their aggressive use of leverage.

A large subsegment of hedge funds now concentrates in CDOs and credit default swaps. These hedge funds account for about 60 percent of all trading in credit default swaps — that's a $45 trillion market — and for about a third of CDO trading. All the evidence is that they are especially concentrated in the riskiest classes of credit-related products.

The appetite of hedge funds for the riskiest positions has made them a major source of liquidity in the CDO and credit default swap markets. Their willingness to employ leverage to maximize those positions amplifies their impact. Their persistent demand for higher-yield products is pushing the industry up the risk ladder into CDOs constructed from second-lien loans, bridge

financing, private equity and other less liquid assets, often with minimal protections for higher-tier buyers.

These are very risky investments that can turn very quickly. If only a single CDO was in trouble, a hedge fund would probably have no problem stumping up the required extra margin. But since CDOs are often representative of an asset type, a raft of similar CDOs is likely to be experiencing similar problems. And now we're into a replay of the June 2007 Bear Stearns subprime hedge funds' liquidity confrontation. The bank demands its cash, the hedge fund pleads straitened circumstances, the bank seizes assets and tries to sell them, and the doors blow off the market.

Ponzi Firms

"Ponzi" firms must borrow to meet all their interest payments, so their debt burden continuously increases. At some point, a disruptive event occurs, like the collapse of the United Airlines LBO in 1989 or the Russian bond default in 1998, and markets abruptly re-price — the further along in the cycle, the more violent the re-pricing.

The total of global financial assets, which essentially are claims on GDP, was about the same as global GDP in the early 1980s. At the end of 2005, according to a recent International Monetary Fund analysis, global financial assets were about 3.7 times as high as global GDP. In other words, outstanding financial claims not only cover this year's GDP, but the next several years' as well.

Financial derivatives, which represent claims on financial instruments, were a relatively rudimentary market in the 1980s. Their notional value by the end of 2005, however, was three times higher than the total of all financial instruments and more than 10 times higher than total global GDP. When those numbers are totted up for 2007, we undoubtedly will find that they have ratcheted up much higher still, with the upward curve tilting more toward the vertical.

Unstable Tower of Debt

In this class of instruments, a relatively small number of institutions, basically the global banks, investment banks and credit hedge funds, do most of the trading. In effect, they've built a huge Yertle the Turtle-like unstable tower of debt by selling it back and forth *among themselves,* booking profits all along the way. That is the definition of a Ponzi game. As long as a free-money regime forestalled defaults, the tower may have wobbled, but stayed erect. But small disturbances in any part of the structure could bring the whole tower down, and the seismic rumblings already in evidence portend disturbances that are very large.

The American financial sector today is far more powerful than it was in the 1970s. And to date, its response to the looming crisis has been, overwhelmingly, to downplay and to conceal. That is a path for turning a painful debacle into a decades-long tragedy.

Winners and Losers

Billion-dollar dividends to opportunistic takeover artists are just one wavelet in a long-term and, for many, an increasingly disturbing tidal shift in American society — a widening disparity of wealth and income not seen since the Gilded Age.

The argument about whether the past several decades have seen growing inequality in America was effectively closed by Federal Reserve Chairman Ben Bernanke in a wide-ranging speech delivered in February 2007. Reviewing all the evidence, Bernanke took the fact of growing inequality as settled and challenged economists to discover why.

Explanations of "why" disparity is growing include, variously, the declining real value of the minimum wage, the globalization of work and the decline of unionism, the widening dispersion of education and other skill differentiations within the labor force, and the effect of cheap computer power in enhancing the productivity of highly skilled people.

For most of the past decade, business and government have offered a depressing spectacle: The massive frauds of the Enrons and the WorldComs. The eager self-delusions and conscious deceits that underlay absurdly misrated CDOs. The shameless selling of the government. The monetary helium from the Federal Reserve that fed asset bubbles, fueled a bread-and-circuses consumer binge, floated Wall Streeters into the financial stratosphere and perhaps irrevocably debased the dollar.

A less apocalyptic reading is that we are witnessing the final days of another quarter-century political/ideological cycle — the last gaspings of the raw-market, Chicago-school brand of financial capitalism that moved into the vacuum created by the 1970s collapse of the Keynesian/liberal paradigm.

On the Cusp

Political cycles turn when an extended period of either conservative or liberal hegemony brings the baser, more self-seeking or barmiest elements to the fore. The market and regulatory reforms introduced by economic and monetary conservatives in the 1980s made a major contribution to the recovery of

American competitiveness and economic energy in the 1980s and 1990s. But as the more unsavory impulses in the conservative understanding have asserted themselves, the country has been brought to the brink of financial, economic and, in politics, moral disaster. All the signs are that we are on the cusp of a turning of the cycle, much the same as in 1980.

Assuming we face our issues squarely and get through the next couple of years in much the same way we did in 1979-82, we can start addressing the detritus of knotty problems left over from the cycle's turn.

Recovering Balance

It is a canon of Chicago-school economics that government resource allocations always reduce productivity. As a blanket proposition, that's evidently wrong. The federal government lavishes a great deal of money on the semiconductor industry and the Internet, for example, and we're clearly much better off for it.

Since the beginning of the republic, public works investments — canals, railroads, highways, airports — have generally paid high returns. In the 19th century, a British parliamentary commission identified America's greater investment in public education as a major competitive advantage. Government spending, in short, is productive or not, depending on what it's spent on.

But there is a substantive truth behind the detestation of public spending. It is that any privileged industry — and public enterprises are prone to become privileged — will eventually fatten to the point where it becomes a drag on, or even a threat to, the health of the economy. But that's a general argument about privilege, whether it arises from tax subventions or some other source. The financial meltdown chronicled here was to a great extent the consequence of coddling our financial industry, fertilizing it with free money, propping it up with unusual tax advantages for fund partners and anointing it with fresh funds whenever it stumbled or scraped a knee.

The real premise of the Chicago-school argument for shrinking the public sector is the much shakier one that free markets always achieve the best outcomes. That claim, however, presupposes that economists can identify best outcomes.

No Perfect Markets

Some of the world's greatest economists have tackled the distribution problem and have produced many interesting ways of framing the issues. But no one has come up with much that is of practical use. The data are intractable, analytic results are often self-contradictory, and even believers in the quest concede that the models make sense only in perfect markets, which are not places where real people live.

The fallback among free-market economists, therefore, is usually to adopt a total output measure, such as GDP growth or national productivity, as a best-outcome proxy. But that reduces competition among social systems to the principle that the country with the most toys wins, which is ridiculous.

France, for example, has had lower economic growth than the United States for a number of years, even though hourly output per worker is roughly the same — it was a hair behind America's in the last competitive survey and was a hair ahead in the previous one. The French middle-class citizens have smaller houses and cars than their American peers, but better diets, considerably more leisure time and much more economic security, while the distance between the top and the middle is not nearly so wide as here.

France is hardly a perfect country. Its unions and public sectors seem much too privileged, and racial issues are becoming much more intractable. But all in all, a lot of Americans, especially those who are not at the top of the food chain, might think it's a pretty good trade.

The Other Direction

In other words, it comes down to taste as well as balance and judgment. The 1980s shift from a government-centric style of economic management toward a more market-driven one was a critical factor in the American economic recovery of the 1980s and 1990s. But the breadth of the current financial crash suggests that we've reached the point where it is market dogmatism that has become the problem, rather than the solution. And after a quarter-century run, it's time for the pendulum to swing in the other direction.

RECOMMENDED READING LIST

If you liked *The Trillion Dollar Meltdown*, you'll also like:

1. ***Biography of the Dollar* by Craig Karmin** To understand the dollar's current position it is important to understand how the dollar achieved its exalted status in the beginning. *WSJ* reporter Craig Karmin explains.
2. ***Greenspan's Bubbles* by William A. Fleckenstein with Frederick Sheehan** MSN *Money* columnist and hedge fund manager William Fleckenstein takes a critical look at Alan Greenspan's 19-year tenure as chair of the Fed.
3. ***Transparency* by Warren Bennis, Daniel Goleman and James O'Toole** Three essays look at this urgent issue and offer leaders practical advice on how to embrace transparency as a good thing, even if it's not an easy one.