

The Political Forum

*A review of social and political trends and events
impacting the world's financial markets*

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THEY SAID IT

"A great civilization is not conquered from without until it has destroyed itself within. The essential causes of Rome's decline lay in her people, her morals, her class struggle, her failing trade, her bureaucratic despotism, her stifling taxes, her consuming wars."

The Story of Civilization, Volume III, *Caesar and Christ*. Will Durant.

THE EUROPEANS ARE DIFFERENT FROM US. I have no polling data on this, of course, but I get the impression from the media and from personal conversations over the years that most Americans believe that the differences between themselves and Europeans are largely superficial, related to such things as habits, customs, manners, fads and the like. In other words, they believe that Americans and Europeans are different in the same way that Texans are different from New Englanders.

They are of the opinion that the average European is virtually indistinguishable from the average American when it comes to defining the importance and the meaning of such fundamental concepts as morality, ethics, individual freedom, personal responsibility, property rights, the role of government in human affairs, and the notion of "truth." After all, Americans seems to feel, we are all products of Western Civilization, or what used to be called Christendom. Right?

I think these Americans are wrong. In fact, I think they have it exactly backward. I think that the real differences between Europeans and Americans are in their philosophical and moral beliefs, and that it is the striking similarities between Europeans and Americans when it comes to the issues related to popular culture that have kept these more important differences from being better recognized and understood.

Furthermore, I believe that most Europeans are similarly ignorant of the real differences between themselves and Americans. And I think this is why both Europeans and Americans get so

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frustrated, and resort to name calling when their leaders find themselves at odds with their counterparts across the Atlantic over important geopolitical matters.

Now I am aware that I cannot adequately support a thesis as complex as this in one short newsletter. I am also aware that attitudes toward philosophical and moral issues vary widely between various European nations. And I am further aware that I am dealing in sweeping generalities here, which is always intellectually hazardous.

Nevertheless, I thought it would be fun to try to make the argument this week that the current, high profile disagreements between the United States and the two largest and most influential continental European powers, France and Germany, can be explained by deep-seated differences over transcendental issues, and that these differences relate to profoundly dissimilar historical influences, which date back over 500 years. And to add to the fun, I thought I would do this in seven pages (single space, Times New Roman, 12).

The origins of these fundamental differences between Americans and the French and Germans can be traced to two historic periods, which occurred approximately two centuries apart.

The first began on October 31, 1517, when Martin Luther tacked his 95 theses on the church door at Wittenberg. For purposes of this article, this event marked the beginning of the Reformation, which ultimately assured that America would be settled by Protestants, who were deeply imbued with the Protestant notion, first “discovered” by Luther in an obscure passage in Ecclesiasticus, that each individual is given certain talents by God and that it is a person’s duty to God to make use of these talents.

Luther referred to this new theological notion as a “calling.” In his classic work, *The Protestant Ethic and the Spirit of Capitalism*, Max Weber described it as the belief that the “fulfillment of worldly duties is under all circumstances the only way to live acceptably to God.” And he pointed out that this “moral justification of worldly activity” was in sharp contrast to the Catholic view, as outlined by Thomas Aquinas among others, that such activity was a natural condition of life, and thus morally neutral, like eating and drinking.

While it was Luther who first developed this theological concept of a “calling,” it was John Calvin, who made it one of the central themes of his religious teachings. Calvinism, of course, was the foundation for Puritanism, which lies at the very heart of American culture. And this, as Max Weber explains, is why the roots of entrepreneurial capitalism run so deep in America, having been planted on the day that the first colonists landed and nurtured by religious fervor.

Moreover, Weber noted, this idea that everyday worldly activity has religious significance, quickly became a secular hallmark of American society, popularized by Benjamin Franklin (“a penny saved is a penny earned,” “early to bed, early to rise” . . . etc.) and revered by one generation of Americans after the other right up to today.

The second period to which one can trace the origins of the fundamental differences between continental Europeans and Americans began late in the first half of the 18th century, when the already famous Voltaire and his mistress the Marquise du Chatelet began the systematic, scholarly, textual demolition of the Christian Bible as the basis of an acceptable religion.

This historically portentous venture burst into public awareness in 1762, when Voltaire issued his famous cry “Ecrasez l’infame!” (“Crush the infamous thing!”). This call was aimed at the Catholic Church specifically and Christianity generally, which he described in a letter to Frederick the Great as “assuredly the most ridiculous, the most absurd and the most bloody [religion] which has ever infected this world.” It was also in 1762 that Rousseau published *Émile*, in which he strongly attacked the Catholic Church as a cult of miracles and superstition.

Neither Rousseau nor Voltaire intended to crush all religious belief. Their anger was directed at the Church establishment in France, which Voltaire considered to be not only intolerant and brutal, burning books and condemning people to death and imprisonment for their beliefs, but stupid as well, having denied France the benefit of a half million industrious and intelligent Huguenots, many of whom, it is worth noting, ended up in America. Nevertheless, the combined attacks on the Gallican Church by these two brilliant, enlightenment philosophers made anti-clericalism and atheism not just acceptable but popular in France.

Their writings were, of course, also instrumental in fanning the flames of the French Revolution, which began with the high-minded cries of idealists and ended with the slaughter of thousands of innocent individuals, including hundreds of priests, and the virtual destruction of the Catholic Church in France.

Rousseau, in particular, must bear considerable responsibility, or credit if you will, for the revolution, even though he died 10 years before it began. In fact, during the revolution itself, his ashes were transferred to the Pantheon in Paris, where the remains of Voltaire and Mirabeau were entombed, at which time the president of the National Convention proclaimed that “It is to Rousseau that is due the health-giving improvement that has transformed our morals, customs, laws, feeling and habits.”

During this time, the American colonies were experiencing what became known as The Great Awakening, a period of heightened religious enthusiasm, prompted in part by the enlightenment-inspired attacks on religion in Europe. It began about the time that Madame du Chatelet and Voltaire, shacking up together at her husband’s estate at Cirey, began their “research” into the Bible, and ended about the time that Voltaire announced his famous motto.

This movement was driven by men who were brilliant thinkers and propagandists, in much the same way as Voltaire and Rousseau, but who were almost perfect philosophical opposites; men like John Wesley, the founder of Methodism, and his associate, the charismatic George Whitefield, whose oratorical powers were said to be so great that he could reduce listeners to tears by simply uttering the word “Mesopotamia,” and about whom Samuel Johnson once said he “would be followed by crowds were he to wear a nightcap in the pulpit, or were he to preach from a tree.”

As in France, this period was the prelude to revolution. Only in the America, the revolutionaries were virtually all deeply religious and strongly committed Christians. Even the so-called Deists, men such as Benjamin Franklin and Thomas Jefferson, who were unenthusiastic about any particular organized faith, were not antagonistic toward Christianity.

In fact, in a letter to a friend, Franklin once said the following about Jesus: “His system of morals and his religion [are] the best the world ever saw or is likely to see.” He expressed some reservations about Jesus’ divinity, but then added that he saw no reason to “busy myself” with this question now, “when I expect soon an opportunity of knowing the truth with less trouble.”

In short, while French intellectuals were lighting the fire of a revolt against both their King and the Church, and helping to create a chaotic hell on earth, formally referred to by historians as “The Reign of Terror,” America’s colonial leaders were revolting against their King in the name of Christian principles, and creating a government that was proclaimed by one of its authors, John Adams, to have been “designed only for a moral and religious people.” To which he added, “It is wholly inadequate for the government of any other.”

Most history books maintain that the principal consequence of the French revolution was to create a social, cultural, spiritual, and leadership vacuum that could only be filled by a strong military leader, which in turn led to the devastation of all of Europe by Napoleon.

I would argue that the historically more important impact of the revolution was to prepare the way for the birth of such utopian ideologies as socialism, communism, and eventually fascism, which in later years proved to be even more destructive to Europe than the actions of the murderous Corsican.

Rousseau sowed the seeds of these malevolent, destructive ideologies with his claims that private property is the source of all social crime, and that competition destroys man’s inborn communal sense and encourages his most evil traits, including his desire to exploit others. As Paul Johnson put it in his book *Intellectuals*, “This was a thought deposit Marx and others were to mine ruthlessly.” Even more important to the growth of these utopian ideologies, Johnson notes, was Rousseau’s related idea of “cultural evolution.” Johnson explains it this way.

“To him [Rousseau], ‘natural’ meant ‘original’ or pre-cultural. All culture brings problems since it is man’s association with others which brings out his evil propensities: as he puts it in *Émile*, ‘Man’s breath is fatal to his fellow men.’ Thus the culture in which man lived, itself an evolving, artificial construct, dictated man’s behaviour, and you could improve, indeed totally transform, his behaviour by changing the culture and the competitive forces, which produced it -- that is, by social engineering.”

And thus we find, socialism and communism being spawned in the slums of post-revolutionary Paris, emerging over a period of several decades from dozens of secret organizations, with names like the Society of the Seasons, the Conspiracy of Equals, the League of the Just, and from the feverish dreams of such rabid radicals as Gracchus Babeuf, Armand Barbes, Martin Bernard, Philippe Buonarrotti, and Louis Blanqui. And eventually spreading to Germany by the likes of the little Communist tailor and early leader of the German working class Wilhelm Weitling. And always this onslaught was marked anti-Christian pamphleteering and rants.

During the late stages of this embryonic development of socialism and communism, the United States began what later became known as the Second Great Awakening, in direct response to the socialism and anti-Christian movement in Europe. It is worth noting here that this movement was also referred to as the “shopkeeper’s millennium” because, as it is explained in the *Readers*

Companion to American History, “nascent capitalists used church membership and the admonition to work and avoid sin as a means of instilling discipline in workers accustomed to being independent artisans.”

It is also worth noting that while socialism crossed the channel into England in the early 19th century, it was of a gentler nature than the French and German brand; of the kind advocated by Robert Owen, who dreamed not of bloody revolutions but of vast utopian communes of workers. Part of the reason for this was that the anti-Christian elements of the movement in continental Europe were simply not tolerated in England, as evidenced by the poet Shelley’s expulsion from Oxford in 1811 as a response to his authorship of a pamphlet entitled *The Necessity of Atheism*.

In the 1840s, the European socialist/communist movement swung into high gear under the querulous leadership of such men as Ferdinand LaSalle, Pierre-Joseph Proudhon, Mikhail Bakunin, and most importantly, Karl Marx and his circle of radical, intensely anti-religious, neo-Hegelians associates.

Besides Marx, this group included such stormy insurgents as Max Stirner, the original nihilist; Ludwig Feuerbach, whose book *The Essence of Christianity* was said by Engels to have freed him from his religious beliefs; Moses Hess, who was said to have been one of the first men to appreciate Marx's genius and who converted Engels to Communism; and Bruno Bauer, who argued that the New Testament was a fraud, that Jesus never existed.

While Marx and his “friends” were writing treatises against religion and creating a bloody, totalitarian ideology, America was being described by Tocqueville as follows:

“I do not know whether all Americans have a sincere faith in their religion -- for who can search the human heart? -- but I am certain that they hold it to be indispensable to the maintenance of republican institutions. This opinion is not peculiar to a class of citizens or to a party, but it belongs to the whole nation and to every rank of society . . . While the law permits the Americans to do what they please, religion prevents them from conceiving, and forbids them to commit, what is rash or unjust.”

In the same book, *Democracy in America*, Tocqueville was saying this about the men who were running France at the time.

“When these men attack religious opinions, they obey the dictates of their passions to the prejudice of their interests. Despotism may govern without faith, but liberty cannot. Religion is much more necessary in the republic which they set forth in glowing colors than in the monarchy which they attack; and it is more needed in democratic republics than in any others. How is it possible that society should escape destruction if the moral tie be not strengthened in proportion as the political tie is relaxed?”

Neither Germany nor France succumbed to the communists. But both nations, each in its own way, avoided this fate by becoming what was for all practical purposes socialist states.

Bismarck fought the good fight against socialism, arguing at one point that what he called “social democracy” could never be killed by “social reform;” that someday Germany would be

compelled to “kill it with bullets.” But in the end he recognized that the best way to stop the communists was to grant the workers the socialism they demanded, via a host of government programs, including what amounted to the world’s first government pension plan.

According to his biographer, Emil Ludwig, Bismarck explained his concessions this way: “A great price is not too much, if therewith we can make the disinherited satisfied with their lot . . . Money thus spent is well invested; it is used to ward off a revolution, which . . . would cost a great deal more.” But Ludwig notes, “Because Bismarck completely misunderstands the significance of the socialist movement, he gains nothing by this State-socialist measures. Red votes multiply until they have to be counted by millions.”

Unlike the Germans under Bismarck, the French made no significant effort to fight socialism. In fact, after several revolutions and countless new governments, and a humiliating defeat in the Franco-Prussian war, they overwhelmingly endorsed the idea that the government should take responsibility for their welfare, since they no longer had the energy to do it themselves. And the socialists, happy to oblige, created a huge, permanent bureaucratic state, linked it closely with the nation’s industries, and produced a corrupt, behemoth, mercantilist state, which virtually assured that France would never again experience “la gloire.”

In fact, by early in the 20th century, the great French social philosopher Georges Sorel was able to describe the French political leadership as “parliamentary socialists,” for whom the “reinforcement of power of the State is at the basis of all their conceptions.” He further noted that religions “constitute a very troublesome problem” for these men, “for they can neither regard them as being without historical importance nor can they explain them.”

During this long period in the second half of the 19th century, the French and the Germans searched for something meaningful to replace the Christianity they had set aside. And they never found it. Nietzsche and Kierkegaard offered contrasting alternatives to the radical crisis that confronted these spiritually debilitated societies. One said to recognize the reality that “God is dead,” and move on. The other recommended a return to the “pure” Christianity of earlier times. Oddly enough, both led to the same place, an overarching nihilism from which European society has never fully recovered. Nietzsche’s route was direct. Kierkegaard’s undermined society’s already shaky belief in established Christianity and gave rise to the existentialist movement, which became as nihilistic as anything Nietzsche proposed.

In the end, Marx provided the answer that most Europeans adopted. He argued that modern man needed to emulate the Promethean rebellion against God; that only by doing this could he create a world in which man would be his own master.

While France and Germany were seeking this philosophical utopia, warring with each other, and serving as the battlegrounds for socialists and communists to test the strengths of their various warped and warping philosophies, Americans were building a powerful capitalist nation. They spanned the continent with a railroad, cleared millions of acres of land between the coasts for farming, built cities and towns in the mountains and on the prairies, and dotted the landscape with church steeples all along the way.

And they did this with the help of millions of industrious and energetic European immigrants who had had enough of wars, revolutions, philosophical gyrations, and economic stagnation, and were anxious to build a life and raise a family in a society that honored property rights, paid large dividends for hard work, and respected their religious beliefs.

The opening of the 20th century revealed a European world in the midst of what was called an “armed peace.” Germany, largely through the efforts of Bismarck, had become a powerful military industrial state. France, largely through the efforts of the socialists, had gone steadily down hill, and its feelings were hurt. The United States, largely through the efforts of the capitalists, had become a world power, although no one really knew it yet.

The result was two World Wars that devastated Europe, socially, financially, militarily and spiritually, and which elevated the United States and Russia to the roll of rival super powers, pitting capitalism against communism. In the end, it was no contest.

And this brings us to today, a time when the media gurus and ordinary people across the United States in the barbershops and grocery stores and street corners are openly wondering why the Germans and the French don't see eye to eye with Americans on matters of extreme importance. Didn't we fight side by side in two wars? Don't they like the same music, clothes and television programs? Don't they have neat castles and stuff. And great food. So what's the problem?

Well, the problem is, as I stated earlier, the French and Germans are different from Americans. Their dreams, their heroes, their philosophers are different. Their economic system is different. Their attitude toward work is different. And most of all, they are different spiritually.

When the French economy collapses, the solution dreamed up by the “Employment and Solidarity Ministry” is for people to work fewer hours. When Germany faces severe economic troubles, the answer is to raise taxes, even though, as Art Laffer put it recently, “everything that walks, crawls, runs, flies or stands still” is already taxed at staggering levels.

Both German and France are cesspools of confiscatory taxation, and rather than recognize the problem and do something about it, they have joined in an effort they melodiously call “tax harmonization,” which would reduce all of Europe to their sorry economic state, although they claim it would put an end to harmful tax competition.”

The French foreign minister's hero is Napoleon, whose forces raped and pillaged all of Europe. Germany's foreign minister is a former socialist street thug. Both men dream of restoring their nation to its glorious past, but neither understands how those glories were achieved.

The Washington Post summed it up this morning by noting that European dislike for President Bush is rooted in his “blunt manner and frequent references to religion.” Yes, indeed.

THE POLITICAL FORUM

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From The Sidelines

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It's all about valuation

My investment outlook has periodically hinged on a sudden epiphany in my thinking. The piece I wrote about the shift in individual asset allocation to long-term financial assets called, modestly, "The Greatest Financial Story Ever Told" was a key one. But there have been others, less flashy. The piece on REIT's and total return was one that I wrote in 1999. That was early but has worked wonderfully the last three years. The last one I had was in the summer of 2001. I even remember where I was at the time. I had been doing a lot of reading about the surprising shift in demographic trends. We all knew that the world, at least the economically developed part of the world, was about to get older because of the aging baby boomers. But what was less well known was that world population growth was suddenly slowing. No one seemed to know why or whether it was sustainable. But it was happening nonetheless.

At 69th street and Columbus Avenue it hit me that this new development could have serious implications for stock market valuations. In a connection of the dots I strung together the following. I had been working on valuation models that indicated stock market valuation, price-earnings ratios of 12-month forward earnings, had a much higher correlation to long-term earnings growth projections than any term of interest rates. We had just experienced five years of rising consensus earnings growth rate projections that looked to be leveling out. The rising earnings growth rate projections had many contributing factors. The fall of the Berlin Wall made capitalism safe for worldwide investments and marketshare gains by U.S. companies at a time when U.S. companies were very competitive. Saturation of technology and many consumer product markets worldwide was relatively low. The U.S. economy was enjoying an unusually long growth cycle of its own. The U.S. individual investor was putting gobs of capital into equities, institutions were putting gobs of capital into venture and private equity, and foreign investors were doing a good job of helping out too. It seemed to me that all of this was not only unsustainable but about to change.

What does all of this have to do with demographics you might ask? Well, that was the connection that suddenly hit me. Markets such as mobile phones seemed to be getting saturated surprisingly quickly; solving the millennium problem had brought forward significant capital spending, and the cheapness and

abundance of equity and debt capital worldwide made for surplus capacity in some industries for years to come. Think telecom as a good example. All of these issues would make for a surprisingly difficult cyclical downturn but so what? After a brief but scary downturn, investors would go back to thinking about a cyclical recovery and a resumption of the growth cycle again. And the same or even greater growth rates with similar or greater valuations for the growth companies that made it through.

This is where the demographic story comes into play. First let me deal with the idea of whether it is true that birth rates are slowing and if it is sustainable. Simply, the answer is yes. The problem of the seismic shift in demographics is complex. Part of the problem is that better health care and nutrition are allowing people everywhere to live longer. Better is relative to their own history. People are having fewer children. Fertility rates are falling just about everywhere, except Pakistan; in some cases it is government policy such as in China. In many situations it is cultural and technological. In India for example, religious leaders of all stripes are condemning the practice of female foeticide, sex selective abortions, now made possible by modern medical technology. According to the *Financial Times*, a bridal dowry can cost on average about \$3000 versus the cost of an ultrasound and abortion which would cost less than \$30. This in a country where average income is about \$600 per year. The net result is that India has 933 women for every 1000 males. In the U.S. there are 1029 for every 1000 men.

There are many other examples but the general pattern is that birth rates are dropping just about everywhere from Africa, Asia to Latin America. All developed countries are virtually all ready to start shrinking their populations with the possible exception of the U.S. because of the higher birth rates of new immigrants. However, developing and underdeveloped countries are also seeing the same trends.

Which leads to the problem of how do we get consumer spending growth rates back once we get the cyclical recovery. We probably don't. At least not for most companies.

Let's start at the top. Governments will have big problems with their social spending commitments. The social spending obligations of all governments have

depended on growing populations and improving incomes to fund growing benefits and entitlements. A guy in Massachusetts, Charles Ponzi, once got arrested for a similar idea. Developed countries are wealthy enough that by cutting benefits and entitlements and raising taxes they can probably get by. But only if the populations decide to take some cut in their standard of living. Given that we are all heavier than we probably should be and could generally be comfortable with a little less, it might even be okay. Unless you are increasing your investment in commercial real estate or are trying to sell us something material. No, I don't mean there will be no new building or shopping but we probably have reached the point where we finally are over stored. You better be very good at selling us stuff, in the right places and at the right prices.

But what about the rest of the world? As Mohammad Nizamuddin, director of the United Nations Population Fund for Asia and the Pacific put it so nicely, "In Europe, countries became rich before they became old, but in the developing world, countries are growing old before they are rich." The developing world with sharply slowing population growth and the cost of an aging population will probably look for an alternative to the economic discipline that successful capitalism requires. The end result, I believe will be generally fewer opportunities for business growth worldwide.

What about keeping all of these old people healthy? If you can do it cheaply, then you have a wonderful opportunity and somebody, somewhere will probably do it. We will need more, maybe millions more nurses, physical therapist and who knows what else. But, remember, we will have to be able to afford it.

The really important story here is that when the cyclical recovery unambiguously begins, we will have to confront some very strange issues. The cycle itself is unusual. U.S. consumer spending has held up very well despite significant job loses in manufacturing and services. Can we get a post World War II type recovery? Probably not, since we have little deferred spending, certainly not in important areas such as housing and vehicles. Remember, it has been the U.S. consumer that has carried world demand.

Once the recovery does reach solid ground, the world growth opportunities will be nothing like they were in the 1990's, Iraq or no Iraq problem. Higher energy costs are tax increases and there is less mortgage "refi" opportunity to offset the higher cost. We could still have energy problems in South America and possibly even Mexico as the world sours on capitalism. This is virtually assured by the demographic problems. What politician wants to try to get elected on telling people that they have to get less from the government and pay more for it? Last guy to try that was Jimmy Carter. No one could currently get elected on that platform anywhere, but they could be on the fast track for a Nobel Peace Prize.

My conclusion by the time I got to 71st Street was that valuations had to suffer a secular decline even if inflation was low and interest rates went lower. I also concluded that investors lured into the stock market by twenty plus returns would lose interest as they lost money. Again, probably on a secular basis. The best way to manage through this adjustment period would be to try for modest total returns and be patient. The winners in markets like these are the ones that are slow to act and are very disciplined about valuations. There will be opportunities, maybe big ones—but not many.

Last week,* I mentioned that there was a brewing problem for teen retailers. The weakness in employment is hurting the opportunities for teen employment. Through the past couple of years, financially comfortable parents kept their teen or college kids immune from not having enough spending money but now that's getting harder. Even those that are finally out of college may not get a job. There are currently about 5.5 million young adults out of school and out of work. According to the NY Times, that's up about a million in the past year. At some point the young adult market may feel the pain. Till next time.

* See *From The Sidelines, So where have I been?*, February 14, 2003.

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