

# 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

“In good times people are relaxed, trusting, and money is plentiful. But even though money is plentiful, there are always many people who need more. Under these circumstances the rate of embezzlement grows, the rate of discovery falls off, and the bezzle [described as “the inventory of undiscovered embezzlement”] increases rapidly. In depression all this is reversed. Money is watched with a narrow, suspicious eye. The man who handles it is assumed to be dishonest until he proves himself otherwise. Audits are penetrating and meticulous. Commercial morality is enormously improved. The bezzle shrinks.”

--*The Great Crash 1929*, John Kenneth Galbraith.

**CORRUPTION BEGETS REGULATION BEGETS CORRUPTION.** Most of them are self-described conservatives, you know, who frequently can be heard railing loudly and sagaciously at cocktail parties about the evils of big government and the importance of free enterprise. Some are self-described liberals, of course. Certainly, many of those from Boston and all of those from Newark are liberals. But I think it is safe to say that even the liberals would boisterously join the conservatives in offering a strong defense of the importance of the American financial markets.

Who am I describing, you ask? Why, the big shots at the mutual funds in Boston, Newark, New York, and elsewhere, whose recent collective actions not only kicked open the door, once again, for the enforcers and the regulators to issue their subpoenas and make their deals, but further bolstered the argument often made by their would-be partners in Washington that America's great financial markets are too important to be left to the private sector.

I have long thought that corruption will be the death of America's free, self-regulated financial markets, which are the cornerstone of the global marketplace, the last best hope for worldwide prosperity. Not petty corruption, the kind that sends ordinary thieves to jail, but high-level corruption, which often isn't even illegal, just unethical, and stupid; the kind of corruption that is driven by a form of greed that can only be understood by people who don't need the money. This is the kind of corruption that turns bureaucrats and politicians into majority partners.

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I have been harping about the dangers that corruption poses to American democracy and capitalism for so many years and in so many stories that it is difficult to find either the first or the most comprehensive reference. But in reviewing several dozen articles dating as far back as one published March 15, 1989, entitled “Prolonged Good Times Produce Sticky Fingers and Happy Legislators.” I find recurring themes when the topic of corruption is broached.

The first of these themes, as referenced above in the “They Said It” section, is borrowed from John Galbraith’s book *The Great Crash of 1929*, in which he noted that theft and corruption increase during periods of prolonged economic prosperity. The second recurring theme is borrowed from Adam Smith’s admonition in *The Theory of Moral Sentiments* that corruption among businessmen is the greatest threat to the social and economic benefits of free markets, and that a combination of law and a moral society are necessary to protect against this threat.

Then there is my own oft-stated observation, which I first wrote in a piece dated July 12, 1995 entitled “Democracy and Capitalism Can Always Use A Little Moral Support,” namely that corruption “may well be the most dangerous enemy to U.S. society in the 21st century, replacing the communist threat of the last half of the 20th century.”

I repeated this theme six years later in the first article that I wrote for Lehman Brothers, where I was employed for a brief time after being fired from Prudential. It is dated April 16, 2001 and entitled “Challenges Ahead for Capitalism.” The purpose of that piece was to offer Lehman clients “a brief overview of two themes that have fascinated me for several years.” The first of these two was “global corruption,” which I described as “the biggest threat today to liberal democracy, capitalism, and thus, to the investment business,” adding that “it is incumbent on all Americans, but most especially the nation’s business community and its politicians to be scrupulously honest in their dealings, both here and abroad.”

The threats that corruption brings to American capitalism are many fold. First there are the outright losses suffered by victims of illegal and unethical activity, which can consist of direct costs to individuals as well as to society via bankruptcies and business failures. Second there are the costs connected to the gross inefficiencies that corruption creates in everything from the production process to the allocation of capital. Then there is the trust factor, which can be seen as a huge tax on transactions. And finally, there are the hidden costs of added regulation and government interference, both of which follow corruption like hyenas do a lame gazelle.

One of the most common laments from financial market people who have been on the receiving end of federal investigations is that the enforcers and the regulators with whom they have to deal “don’t know the business.” Charges include that they make impractical demands; that they propose “solutions” that would make things worse; and that they find certain routine practices suspicious because they don’t understand the fundamentals of how financial markets work.

I would imagine that there is some truth in these complaints. But I suspect that the real problem in these situations is not so much that the enforcers and the regulators don’t understand, but that they are simply coming at the business from a different perspective, with a different goal. Theirs is not to worry about tweaking the existing system to make it work better or more honestly. Their concern is about how to insinuate a greater government role into the process.

Over the years, they have been enormously successful at this, always because of the actions of a small group of individuals who let the system down; who violate the trust placed in them to run these great and enormously important markets with the integrity that self-regulation requires. And slowly but surely over the years, governmental oversight has begun to turn into governmental control. And just as surely, governmental control will eventually result in a different kind of corruption, a much more destructive kind, the kind that destroys competition, entrepreneurs, small producers, innovators; the truly insidious kind of corruption that always occurs in those public-private partnerships in which the government is the controlling partner.

That point has not yet been reached. Indeed, it may be a long way off. But then again it may not. One thing is certain. It will happen smoothly, when it happens. In fact, few people will realize that the take over has occurred until it is completed. Some very smart people in the private sector, people from the lofty heights of places like Goldman Sachs, who have learned to operate in both worlds, travel comfortably between them, and revel in combining Washington power with Wall Street money, will make the deal. And one day only a few old timers will remember that the greatest financial markets in the world used to be run by the private sector, always with a respect for competition and free enterprise, and, for the most part, honestly.

**JAPAN IN THE NEW WORLD ORDER.** There is no question that President Bush has had a good two weeks and, barring a serious terrorist attack, can probably expect to enjoy the holiday period very much. As you well know, late Friday afternoon, the President followed up Sunday's spectacular capture of Saddam Hussein with what would have been a similarly stunning revelation about Libya, had his newfound bother-in-arms Tony Blair not spoiled the surprise by disclosing the good news a few minutes earlier. In any case, the Libya report was excellent news, both in the greater war on terror and for the President personally. In fact, it prompted the notoriously dovish and anti-Bush editorial board of *The New York Times* to admit that it had been wrong and President Bush right. To whit:

Over the past five years, by turning over two suspects for trial, acknowledging its complicity in the Lockerbie bombing and paying compensation to victims' families, Libya finally managed to persuade the United Nations Security Council to lift the international sanctions that had shadowed its economy and its international reputation for more than a decade. Those sanctions were lifted in September. This page recommended lifting American sanctions as well, but President Bush left them in place pending further steps, most notably Libya's decision to end its unconventional weapons programs. *It is now clear that he was right to do so.* The added American pressure worked just as intended. (emphasis added)

And while no one can dispute the importance of these spectacular victories against radical Islam, as is wont to happen in the often esoteric world of foreign policy, other recent important and powerful triumphs have gone largely noticed, drawing barely a sigh from the disinterested and unimaginative mainstream media, preoccupied as it were with the flashier news emanating from the Middle East and North Africa. Specifically, I am referring to two announcements made in the past two weeks by Japanese Prime Minister Koizumi, which notably bolster the Bush administration's strategy for dealing with the oft-forgotten third leg of the Axis of Evil, North

Korea, and which could conceivably hold the potential to alter radically the future balance of power in the Far East, to the benefit of the United States.

The first announcement, made two weeks ago tomorrow, was that Japan would, sometime in the near future (most likely in February), send 1,000 soldiers to Iraq to assist the United States and its other allies in the pacification and reconstruction of that nation. And while that may seem like something less than earth shattering, it is, in truth, rather significant, particularly when coupled with the second announcement, which came late last week. On Friday, the Japanese government announced that it would proceed with plans to further its cooperation with Washington and to introduce an American-developed anti-ballistic missile defense system designed to protect against attack from, most notably, North Korea.

For nearly 60 years now, the Japanese state has, as part of the terms of its surrender at the end of World War II and its post-war constitution, been pacifistic. But with the threats in the region growing ever more ominous, the Japanese government appears to be rethinking this approach to foreign affairs. And it appears to be doing so with Washington's blessing.

While the Koizumi government denies that it is taking steps toward remilitarizing, domestic opposition parties believe that that is precisely what is happening. And they are not alone. On December 10, the day after the announcement that troops would be sent to Iraq, China's state-run Xinhua news agency suggested that the move by Koizumi and company "underlined its [Japan's] intention to become a military power and to secure oil interests." Specifically, Xinhua opined, "The Japanese government is advancing the Self-Defense Forces dispatch overseas step by step to show the international community Japan is a major nation that has not only economic power but also military capabilities." And I, for one, am inclined to agree.

Surely the Japanese government realizes that the nature of the threats the nation faces has changed significantly over the past few years, and will likely continue to change for the foreseeable future. In addition to the obvious problem of how best to deal with the weird little fellow in Pyongyang, the Japanese must also be concerned about Chinese ambitions. Over the next several years, China will not only continue to flex its muscles in hopes of becoming the regional hegemon, but it will also clash with Japan over access to precious and scarce natural resources, most notably oil. Add to that the volatile and potentially hostile nature of the regime currently running Japan's other mammoth neighbor, Russia, and it is no wonder that the Japanese might feel more secure if they were more able to contribute directly to their own defense.

Additionally, it has almost certainly not been lost on the Japanese that the nations of Europe that have fared the best in the "new world order," which is part and parcel of the war on terror, are those that are both able and willing to aid the United States in their own defense. While regional military powers like Great Britain and Poland have won the admiration and respect of Washington, the feeble and reluctant regimes, whose leaders hang out in such places as Paris, Berlin, and Brussels, have earned nothing but scorn and contempt from both the United States and many of their neighbors as well. And while the Japanese appear neither to want nor to need as strong a relationship with the United States as the British have, they certainly understand that pulling at least some of their own weight in the future will be extremely helpful to them in maintaining their position in the global community.

Now, on the flip side, many on the dovish portion of the political ledger, both here and in Japan, will argue that while remilitarization may bring closer ties to Washington, it will also make others in the region, most notably the leaders in Pyongyang and Beijing, more than a little unhappy, perhaps to the point of destabilizing all of East Asia. And while there is little question that such action on the part of the Japanese carries some risk, in my opinion, it is unlikely to contribute too terribly to instability in the region.

For starters, the region is already unstable, owing to the personal instability of Kim Jong II. While upsetting him may not be the most productive thing Japan could do at this point, to be perfectly blunt, no one really knows what will or will not set the little weirdo off anyway. For all we know, he may already be secretly planning to attack the United States because he's upset that his chief rival for the affections of Jodie Foster is now free to leave St. Elizabeth's Hospital here in Washington for unsupervised daytrips.

More to the point, regarding China, Japanese remilitarization is more likely to have a beneficial effect on the region, as it will almost certainly compel China to step up its pressure on the aforementioned Kim Ding Dong. The Chinese understand that if this process is allowed to proceed to its natural conclusion, nuclear North Korea will be joined in the region by nuclear Japan and, possibly, nuclear Taiwan. And while a little remilitarization is one thing, full-blown nuclear status is, obviously, something quite different. One doubts seriously if the Chinese regime, as desperate as it is for regional hegemony, will allow one lone lunatic to push the region to that point and thereby to so severely compromise its ambitions. A little saber rattling (or more accurately, saber building) from Japan may well have a positive effect on the region.

Finally, there is the very real and solemn question of whether Japanese remilitarization is something that the rest of the world, the United States in particular, should be eager to see. After all, there is a reason the Japanese were disarmed after World War II, namely that Imperial Japan possessed both a formidable and a brutal military, which committed some of the most vicious atrocities in world history.

That said, modern Japan is not Imperial Japan. Nearly six decades of peaceful and democratic governance have had a notably sobering effect on the nation, rendering the repetition of such brutality highly unlikely. Equally important, even if Japan were somehow culturally inclined to rev up the war machine again (and I don't believe that it is), it is demographically disinclined to do so. With a median age of 42 years, Japan is the world's oldest *real* country (trailing only tiny Monaco). Even in the age of smaller armies aided immeasurably by technological wizardry, Japan's swiftly aging population makes it unlikely that the nation would be able or, more to the point, willing to invest the resources, human and financial, that would be necessary to build from scratch a world-class offensive military force. Any worries that Japanese remilitarization could get out of hand ignore both the character and the demographics of modern Japan.

So, while the Bush administration basks in the brief glory of its successes in Iraq and Libya, and while the administration's would-be opponent, Howard Dean, is busy showing off his affinity for recycling by naming tired old Carter and Clinton retreats to his aspirant foreign policy team, much of the real work of building a safer future is taking place virtually unnoticed. The two recent announcements by Japan are, in my opinion, very positive steps from a potentially very influential ally. President Bush has, indeed, had a very good couple of weeks.

**POLITICS AND TERROR.** As noted above, President Bush has had a very good couple of weeks. But with yesterday's announcement that the federal government was raising the terror threat level to "Orange" (High) and, more specifically, with Homeland Security Secretary Tom Ridge's declaration that "the strategic indicators . . . are perhaps greater now than at any point since Sept. 11," events threaten to spoil the President's recent run of luck.

For a long time, whenever Mark and I wrote about the President's good fortune and about his prospects for re-election next year, we prefaced our comments with the phrase "in the absence of any unforeseen catastrophic event," thereby indicating that another terrorist strike on American soil could, like the last such strike, radically alter the political status quo. We have, perhaps out of laziness or perhaps out of a desire not to have to insert that awkward phrase over and over again into every political story we write, stopped using this caveat. But that doesn't mean that it does not still apply. While the most significant impact that another domestic terrorist strike would have is the terrible personal toll it would exact from many Americans, devastating friends, families, and entire communities, in addition to taking many lives, such an event would almost certainly have secondary political ramifications as well.

Now, both conventional wisdom and conspiracy-driven lunacy has it that such an event would, again like the last one, serve the President well. He would have the opportunity to rally the nation, much as he did after September 11, and to solidify himself as the *only* choice American voters could make next November. If we are still under attack, such logic suggests, then Bush could and would use that to intimate further that Democrats are just too soft on national security to be trusted with proverbial keys at such an important juncture in our nation's history.

And while I certainly believe that President Bush is at his very finest when he is defiantly defending this nation and its way of life against its enemies, and further believe that he is the man I would want in the Oval Office should such another crisis arise, I think it is quite possible that another terrorist crisis could endanger his political future rather than help it.

Already, the 9/11 investigation being carried out by former Republican Governor of New Jersey Thomas Kean has unwittingly given ammunition to those who would accuse President Bush of failing to do all he could to prevent the attack on 9/11. And while Kean has said that the President himself is far from culpable in the tragic events of that day, he has also indicated that somebody, somewhere is, in fact, at fault. Specifically, he has said that "This was not something that had to happen," and that "as you read the report, you're going to have a pretty clear idea what wasn't done and what should have been done."

Right now, those who argue that somehow President Bush has been soft on terrorism are rightfully dismissed as lunatics who have concocted wild conspiracy theories either because of actual mental illness (e.g. Howard Dean) or out of political expediency (e.g. Howard Dean). But should another attack take place, President Bush might well be more susceptible to charges that he didn't do everything possible to stop it from happening, in part because his opponents would be able to use (or misuse) Kean's words against him.

You see, in addition to suggesting that there is someone, or several someones, who could or should be held accountable for missing the signs leading up to September 11, Kean has also

declared, with some incredulity, that these persons have not only escaped accountability, but actually still have their jobs. He said: “There are people that, if I was [sic] doing the job, would certainly not be in the position they were in at that time because they failed. They simply failed.”

And while there is no question that the loyalty and dedication that President Bush has demonstrated to both friends and staff is a refreshing characteristic, it is possible that Bush is, quite literally, loyal to a fault. Last month, after Deputy Defense Secretary Paul Wolfowitz’s Baghdad hotel was attacked, former national security consultant Micheal Ledeen argued, as Kean appears to be set to do as well, that the President’s loyalty, while commendable, has been taken to such an extreme as to constitute a problem. Ledeen put it thusly:

Placing Paul Wolfowitz in such a place at such a time was a criminal blunder, and everyone who okayed the decision should be fired, along with the people on the ground in Baghdad who seem unable to understand that we are really at war, and that our men need proper protection and intelligence, whether they are in helicopters or in convoys or in hummers.

It’s long past time — since September 12, 2001 to be precise — for people to be sacked for failure, and the fact that virtually no one has — except for Larry Lindsay (seemingly for insufficient aerobic exercise) and a couple of others dealing with “the economy” or with faith-based initiatives and volunteerism — is the greatest failure of this administration. The bureaucracy has learned that there is no penalty for failure. The only way to change their mindset is to do to them what Reagan did to the air controllers.

Unfortunately, Dubya has embraced the Loyalty Thing that is one of the Bush family’s most cherished values. He doesn’t turn on his own loyal aides, even (perhaps especially) when they come under attack.

It is more than a little disturbing that President Bush has fired no one since September 11, as if everyone did their job perfectly up to that point and has continued to perform excellently since. And though Kean has yet to name names, one could be forgiven for wondering why, for example, Director of Central Intelligence George Tenet and Transportation Secretary Norman Mineta (both Clinton appointees, by the way), still have jobs, since both agencies have been shown to have performed poorly both prior to 9/11 and since.

One could also be forgiven for wondering how President Bush will react when Kean does, in fact, name names. Will he dismiss those worthy of dismissal? Or will he dismiss Kean’s findings? Whatever he does, if Kean is right and there are still people in power who have performed their jobs less than adequately, then the political aftermath of another attack might well damage the President more than aftermath from the first attack helped him.

And that would serve only to compound one tragedy with another. For while President Bush may not have handled things perfectly or even as well as Monday-morning quarterbacks like Tom Kean, Michael Ledeen and I may have wished, he has done a truly remarkable job and almost certainly has handled things better than President Dean would. So keep your fingers crossed in the days ahead, gentle readers, for more reasons than one.

**A HEARTFELT THANK YOU FROM WES POLK AND ME.** I (Mark) want to take this opportunity to thank all the clients and friends who responded so generously to my request two weeks ago for a contribution to help buy my friend Wes Polk a better prosthesis to replace the somewhat primitive one he was provided following the accident he had three years ago, which severed his hand and forearm. Your kindness and generosity is greatly appreciated, though not unexpected. After all, you're the best.

**HAPPY HOLIDAYS EVERYONE.** We want to thank you all for your support this past year. It was by no means certain when Steve joined The Political Forum last spring, reuniting a partnership that was formed over seven years ago at Prudential, that enough clients would sign up for a second year to keep the endeavor viable. But, while we lost a few clients at re-up time, we retained enough to have a reasonably good year, and we thank you all for that.

That said, we're taking next week off. Steve and his wife Melissa are going to lovely and sunny Nebraska, so their families can enjoy their beautiful little daughter, Emma. Mark will stay in the Shenandoah Valley to spend Christmas with his family and feed some 50 heifers and calves every day. We'll be back on January 5. In the meantime, we join in wishing you all a wonderful holiday season and a Happy New Year.

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**THE POLITICAL FORUM**

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