Politics et Cetera

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In this Issue

THEY SAID IT

There is some danger that our impatience for quick results may lead us to choose instruments which, though perhaps more efficient for achieving the particular ends, are not compatible with the preservation of a free society. The increasing tendency to rely on administrative coercion and discrimination where a modification of the general rules of law might, perhaps more slowly, achieve the same object . . . is still a powerful legacy of the socialist period which is likely to influence policy for a long time to come.

The process through which certain kinds of measures can destroy the bases of an economy based on the market and gradually smother the creative powers of a free civilization seems now of the greatest importance. Only if we understand why and how certain kinds of economic controls tend to paralyze the driving forces of a free society, and which kinds of measures are particularly dangerous in this respect, can we hope that social experimentation will not lead us into situations none of us want.

F.A. Hayek, from the forward to the 1956 American paperback edition of *The Road to Serfdom*, 1944.

BE AFRAID. BE VERY AFRAID.

All over the nation, former big shots at banks and financial service companies are warily watching as new management teams enter their sacred sanctuaries on the top floor. Briefcases in hand, assistants and secretaries in tow, these new bosses are appropriating the best offices, handing out pink slips to some, asking others to explain in detail "what you do," and calling "emergency" Saturday morning meetings to discuss the new order of things.

Believe it or not, it is happening in Washington too. The process is subtler, but make no mistake, a new and powerful management team is setting up shop in the nation's Capitol. Whether it is a hostile or a friendly takeover depends on your point of view, of course. But either way, an epic transfer of power and authority is occurring. As Bob Dylan put it years ago, the times they are a changin'.

The U.S. House and Senate are the two big losers in this bloodless coup. Members of these two august bodies cannot be fired, of course, so they will retain all of their public duties, perquisites, and pay. But the bulk of any business they do from now on that significantly impacts the economy will henceforth be conducted in much the same manner as last week's "bailout" bill was, i.e., shoved down their throats by "reality," as outlined, articulated, and sold to the American public by a new team of "experts on the arcane workings of the global financial markets" who, when banded together with a single purpose, are capable of manufacturing self-fulfilling prophesies of doom.

You see, as 9/11 did in the case of terrorism, the "financial crisis" that the nation is experiencing at the moment has, intentionally or not, created a credible threat of the possibility of massive economic destruction on a scale not seen since the Great Depression. As such, just as the gigantic and now authoritatively sacrosanct Department of Homeland Security rose from the ashes of 9/11, we see, emerging in Washington today, a new and powerful group of "experts" whose opinions on the subject of financial meltdowns cannot be challenged by anyone, especially within the U.S. Congress, without the risk of being ridiculed as ignorant, irresponsible, and dangerous to the well being of the country and its citizens.

This group of "experts" has not, of course, taken the form of the Department of Homeland Security, which is a formal, legally sanctioned arm of the Executive Branch of government. It is instead establishing itself as an informal collection of like-minded, "public spirited" individuals with assorted ties to the Fed, to the U.S. Treasury, to the world of finance, and, most importantly, to each other through prior employment and mutual interests. They will formally exercise power in the future, as they are doing now, by assuring that one of their own is always firmly ensconced in a very high level position within whatever administration happens to occupy the White House, most probably, but not necessarily, as Secretary of the Treasury.

There is nothing to be gained by regretting the appearance of this new force in American politics. Neither the on-going heated debate over the circumstances that led to this assent to power nor the charges of "socialism" that greeted the passage of the bailout bill will change anything. In fact, those who are putting forth these protestations are so far behind the curve that they may as well be writing about the disappearance of the great herds of buffalo or the steam locomotive.

As we have said numerous times in these pages, this nation is, at present, in the midst of a long transitional period, not to socialism, but to statism, which we recently defined in these pages, citing the poor man's most popular intellectual reference source, Wikapedia, as "a form of government or economic system that involves significant state intervention in personal, social, or economic matters."

Presumably, the first order of business for this new power center will be to firmly establish in the minds of Americans the existence of a permanent and imminent threat of a massive financial meltdown that will cost them their jobs, their families, their savings, and their health unless the government adheres closely to the counsel of a gaggle of "experts," such as they, who claim extensive knowledge and experience in such matters.

The second order of business will be to gain as much control as possible over the trillion dollars that they just managed to have printed "for the good of the nation." And the third will be to assure that their friends and associates control the "oversight" responsibility on this pile of money. And finally, they will cement an alliance with the new President, whomever he is, that will assure them control over financial and economic decision making within the new administration.

Now we are not claiming here that the United States is not facing an economic or a financial crisis of epic proportions. Such a determination is above our pay grade. We do know, however, that crises are to government what Miracle-Gro is to houseplants. And we know that those who favor big government know this too. Moreover, we know the following:

■ That investors should get used to the fact that the threat of a great economic meltdown of historic proportion is, for many years to come, going to be a constant factor in all discussions of financial matters in all venues, from the pinnacles of power in Washington to the barber shops on Main Street, as will be the nagging uncertainty that is a natural companion to such warnings. Henry Paulson rose to a position of significant power on the back of the on-going "financial crisis," which he helped to create, and this is not something that either he or his successors will forget.

■ That a majority of the members of Congress from both parties will find that because they are incapable of regaining the influence they once had over the nation's financial affairs, their best option will be get at least a piece of the action by joining the chorus of fear mongers, as they did last week.

■ That this new financial order will be orchestrated by folks who have a natural penchant for big government, that being the vehicle by which most of them gained the influence they already have and the obvious vehicle for retaining it.

■ That new financial crises, accompanied by new demands for the printing and distribution of more federal funds, are likely to arise with some frequency in the future, since each new event will increase the fear of the public and thus enhance the power of the "experts." More importantly, it will provide them and their friends with another occasion to participate in the distribution and management of the newly printed "emergency" funds.

■ That this concentration of power over financial matters in the hands of those who favor extensive government interference in the private sector is highly conducive to corruption, which is not only economically inefficient, but creates an important new and difficult-to- measure variable into the investment process.

■ That one cannot automatically assume that these particular "experts" in Washington will always opt for what a reasonably person would assume to be the best solution to any given problem, if a less satisfactory approach would yield greater dividends in power and money to them or to their partners, colleagues, and friends in the world in which they live, where the affairs of government and finance swirl together in the ether of power.

■ And finally, that there isn't a damn thing anyone can do about this except to understand it and invest accordingly.

As we said last week, statism is the government of the future. Get used to it.

A CRISIS OF GLOBAL PROPORTIONS.

For the past several weeks, the eyes of the world have been focused on the United States and on its political and financial systems. Not only is the country in the midst of an extremely important and extremely unusual presidential campaign, but it is also in the middle of a purportedly, monumental fiscal crisis that required the intervention of the political class and, despite that intrusion, may not yet be anywhere near over.

More to the point, the problems in the financial sector appear finally to have leaked over into the broader economy. Last week, California Governor Arnold Schwarzenegger had to beg the U.S. Treasury for help, as his state was unable to meet its short-term obligations. In September, the economy shed nearly 160,000 jobs, far more than was expected and quite possibly a sign of more serious trouble to come. The auto industry has been particularly hard hit, with manufacturing and sales jobs drying up at an alarming rate. AutoNation Inc., the nation's largest auto dealership group reported that the credit crunch has stripped it of roughly 20% of its business. California alone has seen over 600 dealerships close already this year.

In other words, times are tough here in the good ol' U.S. of A. And they are likely to get tougher. So it's no wonder then that the entire world would be focused on this country and on its problems. It's only practical. But is it wise?

Don't get us wrong. We have no desire to minimize the potential implications of the current financial and political situations. We believe the United States has some very serious problems, which could have some even more serious repercussions. But the thing about the United States is that it is a stable, generally calm, democratic republic with nearly 150 years of relative social peace. As such, we feel quite comfortable that whatever happens, the United States will remain much as it is today, at least politically. But we're not so sure about the rest of the world.

We self-absorbed Americans have spent the past few weeks arguing over who is to "blame" for the current mess. The left has decided that the culprits here are folks like former Senator Phil Gramm, his friend John McCain, and, of course, President Bush, while the right has, more credibly we believe, turned its sites on the friends (and lovers) of Fannie Mae and Freddie Mac, enablers like Congressman Barney Frank, Senator Chris Dodd, and the various Democratic officials who have gotten rich putting in their time as employees of the two mortgage giants.

All of that is well and good, but it tends to obscure the bigger picture, namely that THE WORLD IS COMING TO AN END! OK, so maybe things aren't that bad, but they aren't all that good either. This morning, markets "tumbled" all over the world, spooked by the growing credit crisis in Europe and by the realization that the EU too will suffer a rather pronounced economic downturn over the next several months. The *Wall Street Journal* describes the scene as follows:

> "We now believe national recessions in the U.S. and the U.K. will be deeper and longer than previously forecast," said Larry Hatheway, an economist at UBS in London. "For the first time, we also anticipate recession in the euro zone."
>
> Signs of a deepening European financial crisis continued to emerge. European leaders over the weekend vowed to restore confidence in the markets and to back the bloc's banks, but failed to come up with an EU-wide response to the financial turmoil.
>
> "The troubles in the European banking sector are arguably beginning to overtake those of the US," said Philip Shaw, economist at Investec Securities in London.
>
> Monday, the banking sector came out of its second straight weekend of crisis talks involving company executives and politicians aimed at shoring up liquidity and confidence in a number of its leading players.
>
> French bank BNP Paribas took control of Fortis's Belgian and Luxembourg operations, and Germany's Hypo Real Estate Holding secured a new bailout after an earlier deal unraveled. Italy's UniCredit launched a capital increase, Iceland sought new capital for its banks and Germany issued a blanket guarantee of all its consumer bank deposits.

Under normal circumstances, we'd say that sounds ugly. But "ugly" seems a little too mild. At least if you happen to have read the piece in this morning's London *Telegraph* by our old friend Ambrose Evans-Pritchard, who makes the above-cited economists look downright cheerful. To wit:

> Germany is now in the hot seat. The collapse of a rescue deal for Hypo Real Estate on Saturday threatens a €400bn (£311bn) bankruptcy that nearly matches the Lehman Brothers debacle for sheer scale.
>
> Chancellor Angela Merkel has been forced to pull her head out of the sand, guaranteeing all German savings, a day after she rebuked Ireland for doing much the same thing. Reality intrudes.
>
> During the past week, we have tipped over the edge, into the middle of the abyss. Systemic collapse is in full train. The Netherlands has just rushed through a second, more sweeping nationalisation of Fortis. Ireland and Greece have had to rescue all their banks. Iceland is facing an Argentine denouement.
>
> The US commercial paper market is closed. It shrank $95bn last week, and has lost $208bn in three weeks. The interbank lending market has seized up.

> There are almost no bids. It is a ghost market. Healthy companies cannot roll over debt. Some will have to sack staff today to stave off default.
>
> As the unflappable Warren Buffett puts it, the credit freeze is "sucking blood" out of the economy. "In my adult lifetime, I don't think I've ever seen people as fearful," he said.
>
> We are fast approaching the point of no return. The only way out of this calamitous descent is "shock and awe" on a global scale, and even that may not be enough.

Ambrose, though a very talented and well connected journalist, also tends to be something of an hysteric, at least on economic matters – though a brief perusal of his previously derided forecasts might well demonstrate more prescience than hysteria. In any event, the euro zone and Great Britain are in serious economic turmoil. Erstwhile EU economic wunderkind Ireland is already in recession, and from the looks of things, the Emerald Isle will soon have company.

Compounding Europe's problems is the euro itself, which will make decisive action by EU central bankers either impossible or extremely controversial. Managing the common currency and common fiscal policy has been a breeze up until now. But things are always easier in good times. We've long believed that the euro would eventually destroy the post-World War II order in Europe. (As in the opening paragraph of a piece of our dated May 20, 1998 in which we said: "We think it is probable that the adoption of the Euro will be to 21st century Europe, what the killing of the Archduke Ferdinand was to 20th century Europe; i.e., that point in time when history will record that the unraveling began in earnest.) And if nothing else, this theory may well be tested.

Throughout the world, nations are in trouble. The Japanese auto industry is being dragged down by the same forces that are dragging down America's. Exports to the United States and to China have fallen sharply. Japanese Prime Minister Taro Aso pleaded with his fellow elected officials last week to worry less about early elections and more about the country's struggling economy. And according to Reuters, he has good cause to worry:

> Large Japanese manufacturers turned pessimistic in September for the first time in five years and prepared to tighten their budgets for capital spending as the financial crisis cut into their export markets, a survey from the Bank of Japan showed Wednesday.
>
> The Tankan, an index that tracks sentiment among big manufacturers, slipped to -3 in September from 5 in June, compared with economists' expectations for a fall to -2.
>
> The survey turned negative shortly before the Japanese economy entered its previous two recessions, and the September reading suggested that Japan was again on track for a recession . . . .
>
> Japanese exporters are facing the weakest demand in decades. In August, the country posted its first monthly trade deficit since 1982, excluding the traditional slowdown in exports that occurs each January. Exports to the United States recorded their sharpest decline on record.
>
> Exports and capital spending were the main drivers of the longest postwar economic expansion in Japan, which appears to have ended after the economic contraction recorded in the second quarter.
>
> "The data confirmed the widely held view that the Japanese economy is already in recession," said Okuda, of Sumitomo Shoji.

In China, the benchmark stock indices are down by more than 50% this year, and losses continue to mount. The Chinese economy may still be growing, but it is growing more slowly, a condition that will likely be exacerbated by diminishing exports to the United States. Add this to recent consumer disasters, most notably the existence of melamine in Chinese milk and baby formula products and the revelation that Chinese officials were aware of the contamination, and China too appears headed into rough waters.

And that brings us lastly to Russia, the newly revived, brash, and bold bear, thriving under the leadership of Comrade Putin. Or something like that.

Oil prices are down, as is the benchmark RTS index, which has fallen 27% in the last month alone and 42% since the mighty bear invaded Georgia. Trading on the Russian MICEX index was suspended this morning after a 15% crash, and foreign capital has been racing out of the country. And all of this comes just a decade after the last banking crisis and in the midst of ongoing social upheaval. As longtime Russophile and Georgetown professor emeritus Murray Feshbach noted yesterday, Russia "is not just sick, but dying."

> Three times as many Russians die from heart-related illnesses as do Americans or Europeans, per each 100,000 people.
>
> Tuberculosis deaths in Russia are about triple the World Health Organization's definition of an epidemic, which is based on a new-case rate of 50 cases per 100,000 people.
>
> Average alcohol consumption per capita is double the rate the WHO considers dangerous to one's health.
>
> About 1 million people in Russia have been diagnosed with HIV or AIDS, according to WHO estimates.

Using mid-year figures, it's estimated that 25 percent more new HIV/AIDS cases will be recorded this year than were logged in 2007.

And none of this is likely to get better any time soon. Peter Piot, the head of UNAIDS, the U.N. agency created in response to the epidemic, told a press conference this summer that he is "very pessimistic about what is going on in Russia and Eastern Europe . . . where there is the least progress." This should be all the more worrisome because young people are most at risk in Russia. In the United States and Western Europe, 70 percent of those with HIV/AIDS are men over age 30; in Russia, 80 percent of this group are aged 15 to 29. And although injected-drug users represent about 65 percent of Russia's cases, the country has officially rejected methadone as a treatment, even though it would likely reduce the potential for HIV infections that lead to AIDS.

And then there's tuberculosis – remember tuberculosis? In the United States, with a population of 303 million, 650 people died of the disease in 2007. In Russia, which has a total of 142 million people, an astonishing 24,000 of them died of tuberculosis in 2007. Can it possibly be coincidental that, according to Gennady Onishchenko, the country's chief public health physician, only 9 percent of Russian TB hospitals meet current hygienic standards, 21 percent lack either hot or cold running water, 11 percent lack a sewer system, and 20 percent have a shortage of TB drugs? Hardly.

On the other end of the lifeline, the news isn't much better. Russia's birth rate has been declining for more than

> a decade, and even a recent increase in births will be limited by the fact that the number of women age 20 to 29 (those responsible for two-thirds of all babies) will drop markedly in the next four or five years to mirror the 50 percent drop in the birth rate in the late 1980s and the 1990s. And, sadly, the health of Russia's newborns is quite poor, with about 70 percent of them experiencing complications at birth.

What does all of this mean? Hard to say, but we doubt that it's anything good.

As a general rule, when the nations of the world face massive economic disruptions, people tend to die. In massive numbers.

Many American analysts have been warning of a severe recession or even a depression and have been conjuring up images of bread lines and soup kitchens. Such things are possible, we suppose, but the more relevant images, in our opinion are those of Nazis goose-stepping through the streets of Berlin, concentration camp survivors greeting their liberators, and mushroom clouds over Nagasaki and Hiroshima. The last time there was a global depression, in other words, the United States suffered high unemployment and tough times. Europe suffered fascists in Italy, National Socialists in Germany, and mass slaughter everywhere else. Japan suffered a loss of civilian control, the ascension of the Imperial Council, a decade of war, massive destruction, and, eventually, occupation (which continues to this day). China suffered the ravages of invasion, the rise of Mao, extended civil war, and the slaughter of tens of millions. And the list goes on.

None of that is possible again today, you say? We hope not. But we have our doubts. It is worth noting, we think, that World War II began within the lifetime of one half of staff at The Political Forum. As recently as 19 years ago, the Butchers of Beijing were slaughtering their own people in Tiananmen Square. And even more recently than that, civil war, mass social disruption, and even organized "ethnic cleansing" took place in the heart of Europe, requiring, once again, American intervention.

The fact of the matter is that wars, conflicts of one sort or another, and death on a monumental scale generally take place during periods of economic turmoil and particularly when the United States is distracted from global affairs with its own domestic worries. As the historian and classicist Victor Davis Hanson reminded us last week:

> During the stagflation and economic malaise of the Jimmy Carter years, the Russians invaded Afghanistan, the Iranians stormed our embassy in Tehran, the communists sought to spread influence in Central America and a holocaust raged unchecked in Cambodia.

One of the oldest and most consistent predictors of martial activity is domestic and economic turmoil. Leaders have, for millennia, used war, invasion, and general bluster to distract increasingly agitated domestic mobs and to focus their anger and frustration on external, rather than internal foes. And anyone who doubts that such considerations still affect global leaders need only look to small – and partially occupied – Georgia, into which Comrade Putin dropped his thugs in a weak and thus far only marginally successful attempt to divert attention from Mother Russia's domestic woes. Who's next? Hard to say. But we don't think we'd plan any trips to Taiwan in the next couple of years.

As longtime readers know, we have often cited the work and the theories of political scientist Ted Robert Gurr, who introduced the concept of "perceived relative deprivation" to explain when and why societies devolve into civil unrest and revolution. As people's expectation grow increasingly removed from reality and from the reasonable forecasts, domestic volatility and the threat of violence increases. Ultimately, regime change can result.

Now, in stable democracies, regime change takes the form of an electoral victory for the out-of-power party. But there are relatively few long-term stable democracies in the world. Even France is on its fifth constitution and its Fifth Republic in just over two hundred years. And that doesn't count the various directories, consulates, empires, restorations, revolutions, and communes that have intervened. One can probably count the world's truly "stable" long-term democracies on hand – and they'd all likely speak English.

As if all of this weren't troubling enough, American voters appear more and more inclined every day to drop into this mess a young, inexperienced, radically leftist, peacenik, political neophyte. After our experiences in the 1990s, we've taken a break from trying to predict which presidents the American people will like and dislike. And we don't want to prejudge anyone's reactions to stress and actual events. George W. Bush surprised us – and most of the world – in the aftermath of 9/11. And who are we to say that lightening couldn't strike again?

Nevertheless, it's hard to see how a President Obama wouldn't be overwhelmed by all of this. Indeed, we worry that John McCain would be overwhelmed. And we suspect that President Bush himself would be, were it not for the calming hand of Vice President Cheney.

Still, we've seen this movie before, and it ended badly. And truth be told, Jimmy Carter had a wealth of experience – including executive experience – in comparison to young Mr. Obama. We're not saying that there is no chance that Obama couldn't handle himself. Just that we have seen nothing in this, the longest presidential campaign on record, to reassure us. He gives a good speech. But beyond that, what's he got?

We don't particularly like to be pessimistic. But sometimes it's hard not to be. We should, we guess, take some comfort in the fact that the dollar's recent rise suggests that in times of great stress, the world still looks to the United States for leadership. Would that we were assured that any would be forthcoming.