A Crash Felt Round the World

On *Understanding the Crash*, edited by Gerald Frost.

This well-assembled group of brief essays on the 2008 economic crisis and the resulting Great Recession provides a pithy and rigorous summary of those very complicated and universally influential events. The Danube Institute in Budapest is not an especially well-known source of opinion in the English-speaking world on such matters, but this ambitious undertaking gives close to a 360-degree view of the issues raised by the debacle of 2008 in less than 100 pages. The well-known and well-traveled John O'Sullivan, the former editor of *National Review* and comment editor to the *London Times* and *London Daily Telegraph*, the *New York Post*, and the *National Post of Canada*, and head of the Voice of America in Europe, contributed a rather learned but still very comprehensible introduction on the creation and growth of the U.S. housing bubble, the sudden bursting of which almost brought down the world's banking system. Mr. O'Sullivan well records how the American political community, from left to right, immediately came to the consensus that the private sector was the cause of the problem and more regulation was needed.

Though John O'Sullivan does not labor these points, the political class was uniform in its views of the cause, after the incumbent President George W. Bush's ungalvanizing tocsin: "The sucker could go down," referring, rather complacently, to the economy, and as if he bore no responsibility for this condition. The financial community, much less monochromatic and fast on their feet than the politicians, fumbled and blundered, and no one except a few early commentators pointed out that the problem arose when the politicians of both parties promoted a political free lunch by forcing non-commercial mortgages for people of modest income on the mortgage sector (dominated by quasi-state guaranteed companies Fannie Mae and Freddie Mac and the lending banks, who were under executive and statutory order, respectively, to waste their equity-holders’ interest and depositors’ money on such loans). The rating agency cartel (S&P, Moody’s, Fitch) went along with the gag that the consolidated debt packages made up of many streams of mortgage and like income, combined with convenient back-to-back insurance for them, were investment grade. With the U.S. government inflating the inner tube, the bubble grew to proportions that surpassed the equity bubble that exploded in 1929 (which was at least altogether the work of the private sector, except for the failure of governments and stock exchanges to regulate borrowing prudently).

Norman Lamont, John Major’s first Chancellor of the Exchequer, gives a lively account in this volume from the official side and sidled up to fully stating his reservations about quantitative easing, which is really just an increase in the money supply. Peter Wallison of the American Enterprise Institute writes a learned but again very readable summary of the development of this bubble. The Federal Housing Administration was set up by the New Deal, when great numbers of American workers and farmers faced the danger of foreclosure and eviction, and initially required a 30 percent equity payment for a mortgage. This was sharply reduced in the Eisenhower years, and in the Bill Clinton–George W. Bush years was reduced to zero. The most uninhibited speculation naturally ensued when people with nothing to lose except ownership of residential units for which they had not paid anything took bunches of them, and the land developers and building trades unions flourished and tangibly remembered their political benefactors. The regulation of the banking industry in the 1970s actually made matters worse. Money was available for non-commercial mortgages because the U.S. government required it, not because of the incompetence of the lenders, though that factor is never altogether absent. By late 2008, 56 percent of the gigantic American mortgage industry was in sub-prime mortgages and the whole financial system of the Western world was cantilevered out over a precipice. Americans had their elected leaders to thank for this defiance of the forces of gravity and arithmetic. Another alarming fact, which this book does not deal with, is that almost no one—central bankers, lending bankers, investment bankers, treasury officials, academic economists, or financial journalists—recognized the impending dangers.

Jack Hollihan forcefully details the evolution of the role and nature of banks and their contribution to the debacle. Traditional and relatively prudent lending banks had merged with investment banks, which are essentially made up of traders and seekers of capital gains, and as these personnel bring in most of the money to banks in good times, these people and their ethos took over the entire top end of American banking. The triumph of the trader's mentality was not just a methodological change, but something of an ethical deterioration also. This change was aggravated by immensely faster and more powerful computer capabilities, by the greedy complicity of the rating agencies, and, when the crisis came, by the disastrous decision of the Treasury Secretary, Henry Paulson, to let Lehman Brothers go bankrupt, when, like Bear Sterns, it could have been salvaged and the losses confined to its equity-holders. Paulson, a former competitor of Lehman when he had been at Goldman Sachs, claimed that he believed it would be a sobering and even reassuring lesson to everyone to learn that some of these companies could fail, responding to the goads and taunts of the left. There may have been other motives as well, but it was a bad mistake and severely rattled the markets.

Peter Akos Bod, the former governor of the Hungarian National Bank, fills in the additional vulnerabilities of Central European countries whose commercial banks are, in large part, foreign-owned. Being in the European Union, their hands are largely tied, and the whiplash from overseas is made more severe as the local, foreign-owned banks have to respond to the parent banks failing their regulatory ratios in their home operations. The same theme is elaborated by Piotr Naimsky, a Polish opposition MP and former Solidarity official, and, and by Jiri Weigl, a close associate of the Czech reformer Václav Klaus. The American-originated crisis quickly put intolerable strains on the European Union, where, as they point out, the single currency is more a political than an economic statement. The more vulnerable countries, stuck with a hard currency for the first time in their histories, were unable to alleviate conditions by their normal method of simply inflating through increased money supply, spreading the devaluing money around among the hard-hit, and resurrecting export competitiveness. Naimsky and Weigl might have mentioned that all of these countries had piled into Europe by selling the Germans a false prospectus about the real fiscal strength of their countries, a chicken that came home to roost in this crisis. Naimsky notes that the power structure of Europe makes Germany the master of the continent with the collaboration of France and the stronger states in the Eurozone (Netherlands, Austria, etc.); the U.K. has an almost autonomous position, as do the Scandinavians not in the Eurozone, and the weaker parts of the Eurozone are under German-led suzerainty. The Eastern European countries are the last consulted with the least influence. Naimsky calls them a “post-colonial region” and gave Hungary’s Viktor Orban credit for resisting the dictates of Berlin and Brussels. Weigl asserts that Europe is dictating to semi-protectorates, a process that is reviving old antagonisms, and that either the Euro will be abandoned to the countries with weaker currencies, while Germany and its entourage (with or without France) set up a new arrangement while retaining a common market, or several of the weaker countries will just drop out of the Euro. France has become economically enfeebled, so its status is in question, but Naimsky cannot entertain the thought of managing Europe politically without France.

Kishore Jayabolam comments on the Vatican’s view and laments that its initial reaction was only to condemn the acts of greed, though it addressed politicians as well. The Roman Catholic Church’s concerns are mainly with economic distractions from and minimalization of spiritual values, and with economic inequalities, and it tends to regard globalization as a viral carrier of the shortcomings of Western capitalism. Pope Francis’s *Evangelii Gaudium* clearly expressed the concerns of an Argentinian, but Argentina (a country which had the same standard of living as Canada in 1945) has only itself to blame for its poor economic and political record. Jayobolam well makes the point that the Catholic leadership supported all social spending and benefit programs that created the debt bomb, and then decried the existence of the debt (the sub-prime mortgages were for the benefit of the lower-income population, though a good many outright sharpers took advantage of them). He warns that the Church should not forget the moral responsibility of borrowers, who were often as greedy as the lenders, and quotes Benedict XVI’s observation that “Morality without a knowledge of economics is mere moralism; science without an ethos misunderstands man and is unscientific.” The Vatican must be careful to remember, in the political-economic equation, which side its bread is buttered on, and must not wander back into the wilderness of a “third way” like Pius XII’s half-baked corporatism, or G. K. Chesterton and Hilaire Belloc’s distributism.

Hannes Gissurarson gives a fascinating picture of the economic rise and fall and resurrection of Iceland, and shows that its own mistakes were aggravated by the Federal Reserve’s suddenly ceasing to allow currency exchanges into dollars, and by the British government’s invoking completely misapplied anti-terrorist rules against Icelandic banks operating in the U.K. There is no doubt that the reckless antics of these two great powers, normally friendly to Iceland, caused a terrible escalation in the country’s problems, but after a brief flirtation with the regulatory left, it has bounced back very well. He concludes with Thucydides that “the strong do what they can and the weak suffer what they must.” Karlyn Brennan, an American pollster, records that, despite the terrible black eye the economic system suffered, in the United States by 2012, 80 percent of people still believed in free enterprise and 61 percent considered capitalism a good thing.

This is a good, brief, and thorough digest of the Great Recession’s causes and effects. It reminds us that capitalism is the best system, as it is the only one aligned with the human desire for more, but that it requires the prudent manager, as well as the bold plunger, to conserve the benefits of economic growth while minimizing the risk of violent correction.

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