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The Rocky Economic Road Ahead: Government Policy and Economic Prosperity

Economists and business analysts are increasingly pessimistic about the national economy. A recession, possibly a deep one, seems to be bearing down on us. The immediate culprit is the ongoing collapse in home values and new home construction. Nationally, the housing bubble has burst in dramatic fashion as the high-risk loans and speculative investments that inflated the bubble have collapsed. Those losses have made lenders and investors much more cautious, creating a credit crunch that could choke off a lot of economic activity.

This is not just a problem for high-flying investors and distant corporations. One of the things that has propped up the economy during a period of relatively stagnant real wages has been consumer spending. Rising home values allowed families to take out home equity loans and spend that windfall wealth supporting higher consumption levels. Financial markets' new found enthusiasm for high risk investments also led to non-stop promotion of increased credit card debt. So we not only have been spending the increased equity in our homes but have also been borrowing money at outrageous, but usually hidden, interest rates to maintain or expand our consumption far beyond what our paychecks could support. Obviously consumption based on borrowing is not sustainable and cannot be counted on to help the national economy resist an impending economic recession.

In our enthusiasm for "deregulation" and "shrinking government" we may have created a double whammy here: We have freed financial speculators to wheel and deal

to their hearts' desires, creating one financial Ponzi scam after another: junk-bond financed corporate raids and takeovers, rigged financial reports to inflate apparent corporate earnings, crooked side-deals draining away stockholder wealth, and most recently the time-bomb of sub-prime mortgages hidden in mortgage-based bonds.

At the same time we have allowed our leading financial institutions to gamble with our future in any way they see fit, we have also allowed ourselves to be "liberated" from institutions and government programs that might have reduced some of the risk we face when our individual economic status deteriorates or the entire economy heads south. We and our families are increasingly "on our own." Our employers have no obligations or loyalty to us, no matter how long we have worked for them. Most of us never had a union that negotiated retirement, health, or employment benefits for us. The social safety net painstakingly created over a good part of a century has been slowly snipped away.

This is not just potentially bad for us individually. It also destabilizes the overall economy, allowing negative feedback processes to systematically shrink the economy and financially squeeze our households and businesses. The current concern in world financial markets and central banks with the growing credit crunch is one example of this. As lenders become more and more concerned about the ability of borrowers to pay back their loans, they become more and more hesitant to lend. Interest rates rise rapidly and/or credit is simply denied to even sound businesses and homebuyers. That makes it difficult for some businesses to expand or, even, continue in operation. Households find it difficult to borrow to finance big ticket items like homes, automobiles, and expensive household appliances. Consumer spending drops. Businesses reduce

production or fail. Workers are laid off and consumer spending declines even more. And away we go, spiraling downward together.

That is certainly not a prediction. We should be skeptical of all economic crystal ball gazers. My point is quite different. During the 19th and early 20th centuries, our economy repeatedly lurched from speculative boom into financial panic or economic depression in an unpredictable but seemingly inevitable way. That was a destructive and wasteful pattern. During the first half of the 20th century we worked on developing public institutions and policies to reduce that instability and the human suffering associated with it. The second half of the 20th century has been largely free of such nationwide depressions. The economic downturns we have faced have been quite modest and of relatively short duration.

We have come to take that economic stability for granted. In that complacency, the siren songs of the free market ideologues have convinced us to remove systematically the regulations and institutions that created and protected that economic stability and security. In order to allow still more high-risk wheeler-dealers to squeeze another half-percentage point return out of a new financial scheme, we put national and international financial markets and our future at risk. At the same time we have allowed these intoxicated gamblers to threaten our future, we have accepted their ideological babble urging us to help shed the nanny-like protection of social institutions and public policy and stand on our own, reveling in the instability and economic destruction their high-risk games create. The fact that the speculators call the shots but we pay the cost is carefully obscured behind slogans about freedom and independence. Yet we appear

to be committed to following these Pied Pipers back to the wonders of the 19th century, robber barons, crony capitalists, corruption, financial panics, and all.