MONETARY & ECONOMIC REVIEW

Volume XXIII, No. 3 Winter 2008/2009

Will Obama's Economic Policies Result in a Second 'Great Depression'?

By Marilyn Brannan

The events of the past three-and-a-half months in the United States—in both politics and economics—are unprecedented in our history.

In the first ten days of September, several of the oldest and largest financial institutions in the world were wiped out, one of them being Lehman Brothers. On September 15, when that failure became public, global economic activity and global credit markets quickly began to freeze, invoking a sense of panic. Political leaders demanded action from the federal government, warning that a complete collapse of the economy was imminent. The government quickly stepped in to "rescue" the largest insurance company in the world (AIG), and then bailed out two huge mortgage brokerage companies—Fannie Mae and Freddie Mac—that had invested in about half of the mortgages in the United States—roughly 40% of which were sub-prime.

The fall of Lehman Brothers (and other investment houses that had been trading in securities that were risky, highly leveraged, and financed with short-term borrowings) cannot be explained apart from the risky practices of Fannie and Freddie. The securities in question were mainly derivatives from mortgages—an industry where the trouble was economic and political at the same time.

Efforts over a period of several years to reform Fannie and Freddie were unsuccessful, largely because of political protection from the left in Congress. Democrat leaders such as Barney Frank and Christopher Dodd sat on powerful committees that controlled legislation pertaining to banking and finance; and bills aimed at reform were never allowed out of committee for an open vote. Meanwhile, kick-backs in the form of political contributions flowed generously to those who were most influential in keeping Fannie and Freddie engaged in their risky but highly lucrative business—buying up risky mortgages that bankers and other lenders were required by government regulations to make to unqualified borrowers. It was all done in the name of "affordable housing," but the objective was political: a guarantee of votes "in perpetuity" to the Democrat Party. It was a cynical scam of surreal proportions, doomed to collapse, and carrying a price tag that the American taxpayers and their progeny will struggle for many decades to pay.

For days after the Lehman collapse, the system of credit transfers that makes commerce possible were virtually frozen. In a very short period of time, the stock market lost more than 40 percent of its value. Data from October and November show shrinkage of 10% to 20% and more in corporate earnings, sales of homes, cars, and commodities in a host of other areas. It all happened over the course of weeks, not years.

Then, amidst the economic chaos that was reaching around the world, the "Big Three" U.S. auto makers applied to Washington for a bailout, arguing that unless the government came to their rescue, our entire economy was in danger of collapsing. American taxpayers began to wonder when the bizarre string of bailouts and rescues—funded with money that we do not have—would finally come to an end. Recession is now upon us, and it is likely to be sharp and possibly prolonged, depending on the economic policies adopted by the incoming administration.

Recovery—when?

In attempting to predict a time frame for recovery, economists are finding that, given the circumstances of today, none of the past growth patterns of the GDP are a useful guide. There is simply no precedent for the way events have unfolded over the past few months. As President Lincoln said of the aftermath of the Civil War, the consequences of the present economic and political changes are both "fundamental and astounding." We would add that it is also frightening, because the changes we have seen—and will continue to see—constitute a giant step down the road, away from the principles and institutions that have made our country a great nation.

In November, National Review Online asked a group of economics experts to assess the Obama economic team. Their comments were published November 25 at National Review Online under the title, "Obama Money Talk: The new administration and the economy." Following are excerpts from some of their assessments.

Bruce Bartlett — *White House economist in the Reagan administration and a Treasury Department economist in the George H. W. Bush administration:*

"[T]hey have their work cut out for them. First, they face the worst economic crisis since 1929. Second, they are going to have their hands full fighting off the liberal special interests who view the crisis as a once-in-a-lifetime opportunity to spend like there's no tomorrow."

(**Editor's Note:** Rahm Emanuel referred to this "once-in-a-lifetime opportunity" when he made the following comment while speaking to Wall Street Journal reporters in November. He said, "You never want a serious crisis to go to waste, and what I mean by that is an opportunity to do things that you didn't think you could do before.")

Bartlett continued: "[Summers, Director of National Economic Council] can be a bull in a china shop at times. But I think this quality is exactly what the person in this job needs. [His] personality, not to mention his extraordinary resume, will ensure that serious economic analysis underlies, or at least will be given fair consideration, in every Obama initiative. I think this is the best conservatives can hope for under the circumstances."

John Berlau — *Director of the Center for Entrepreneurship at the Competitive Enterprise Institute:*

"The Geithner nomination would be 'more of the same' of the worst aspects of the Bush administration — more bailouts, more lack of transparency in the bailouts, and more corporate welfare.

"According to accounts from both conservative columnist Robert Novak and the financial magazine Conde Nast Portfolio, Geithner was the main instigator of the bailout, getting Paulson and Fed Chairman Ben Bernanke to sign on to his handiwork."

James C. Capretta— *fellow at the Ethics and Public Policy Center and a former associate director at the Office of Management and Budget:*

"What's most worrisome is that Senator Obama himself seems to have strong instincts toward policies which would hinder growth rather than hasten a rapid recovery. He is clearly not an ardent free-trader. He speaks the language of redistribution, not growth. . . .

Richard Ebeling - *visiting professor at Trinity College (Conn.) and senior fellow at the American Institute for Economic Research:*

Editor's Note: The liberal media have given the impression that President-Elect Obama's economic team reflects an underlying "pro-market" orientation, but Richard Ebeling states that team members are actually "advocates of manipulating markets to generate outcomes more to their interventionist and welfare redistributive liking. . . ."

"[This] 'indicative planning' [as the French call it] uses the tax system and the regulatory mechanism to induce the private sector to do what politicians and ideological special interests want. That is not the free market. They will manipulate the markets to bring about the 'green' and pro-labor union outcomes that will have nothing to do with the outcomes we as consumers would have desired in a more competitive environment.

Peter Ferrara—*director of entitlement and budget policy for the Institute for Policy Innovation*

Ferrara characterizes the Obama economic team as "hopeless liberals." He adds, "They are going to try to solve the financial crisis with unprecedented Keynesian overspending and deficits, proven to fail, rather than Reaganite supply side economics, proven to work. They have a blind spot for global warming regulation and central economic planning for energy, which is enough to crush the economy by itself, and produce blackouts and gas rationing. In the long run this crowd will bring back ruinous inflation as well.

Burton Folsom Jr. — *Professor of history at Hillsdale College and author of New Deal or Raw Deal? (Simon* & Schuster, 2008)

"The problem with Obama's economic team, especially Timothy Geithner and Lawrence Summers, is not so much their ties to the Clinton administration, but their stronger ties to failed economic policies of the past. They support bailouts and put much confidence in a large 'stimulus package' that [they say] will create jobs and protect American investments.

"Such actions have never worked before. We can't secure a recovery by taking dollars from one group and giving them to another. What is gained in jobs at one end is lost at the other."

Rea S. Hederman Jr. — *Senior policy analyst and the assistant director of the Center for Data Analysis at the Heritage Foundation*

"Christina Romer [tapped to head the Council of Economic Advisers] recently published a paper arguing that tax increases hurt economic growth and discourage investment, albeit not for pure supply-side reasons. She also has warned about the long-term structural deficit of the U.S. government. This flouts the new, revived 1960's mentality that deficits do not matter, and government spending is again a magical cure-all. . . ."

Raymond J. Keating—*chief economist for the Small Business & Entrepreneurship Council*

"In recent months, the Bush economics team has been leading a government bailout frenzy that seems to change and expand daily . . .

“And despite the fact that government policies [and politicians] got us into this mess, the message from political leaders has been that the market [i.e., capitalism] failed, and government must come to the rescue. Not only is that fundamentally incorrect, but it establishes a very dangerous precedent.

“President-Elect Obama [has] pushed the government-as-economic-savior idea further along, pointing to an economic recovery agenda focused on additional government spending on assorted infrastructure and energy boondoggles . . .

“As long as these types of proposals dominate economic policy, it really does not matter who is on the Obama economics team.”

Dan Mitchell— *Senior fellow, Cato Institute*

“There are two big economic issues facing the country: A government that is too big and too expensive and financial markets whipsawed by bad monetary policy and misguided intervention. Unfortunately, the economic team unveiled by President-Elect Obama offers little reason for optimism. Larry Summers, who will head the National Economic Council (and also be the dominant player) is a reflexive supporter of higher tax rates. . . .

“The only potential bright light is Christina Romer, who has been tapped to head the Council of Economic Advisers. Some of her research has illustrated the negative impact of higher tax rates, so hopefully she will provide the incoming president with some much-needed cautionary words about making government even bigger and more expensive.”

Grover G. Norquist— *President of Americans for Tax Reform and author of Leave Us Alone—Getting the Government’s Hands Off Our Money, Our Guns, Our Lives*

“What does one think of Obama’s economic team? Would you really care about the names or personal attributes of the gentlemen making up your firing squad?

“The questions is not who, but what they intend to do. That was settled when Obama became the candidate of the trial lawyers, the labor union bosses and the big city machines. Obama and his three-headed Cerberus of trial lawyers, labor unions and big city machines have a fixed set of plans. Who implements them is not important.

“Everything Obama’s team says they will do will hurt the economy. Tax increases. Protectionism. Subsidies for the economically challenged and the politically favored. More government employment. More regulations. More lawsuits. Less competition. Who cares who pulls the trigger?”