Crisis in a Global Economy. Re-planning the Journey
Pontifical Academy of Social Sciences, Acta 16, 2011
www.pass.va/content/dam/scienzesociali/pdf/acta16/acta16-novak.pdf

WHAT TO DO NEXT? A RESPONSE TO KEVIN RYAN

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Kevin Ryan brings out significant empirical evidence that the worldwide economic crisis is harming families by bringing distress, discouragement, and even despair to millions of households. Rather than elaborate on these central points of his paper, which are well made, I would like to develop two hints that lie within it. Then I will turn to what courses of action a sound philosophy of economics would recommend, in order to remove these sufferings as quickly as possible.

1. The First Hint: The Cultural Contradictions of Capitalism

To his credit, Professor Ryan does not emphasize only the damage done to families and individuals by this economic crisis, but also some undeniable good effects. Among these are a sharp reduction in personal debt, especially credit card debt (in the U.S. at least); a fresh awareness of the fact that marriage is more than an emotional bond, but also 'an economic partnership and social safety net'; a modest reduction (or at least postponement) of divorce; and less discretionary money for expensive vacations and diversions that take parents away from their children. Among the newly rediscovered economic advantages of family living are the paying job of a wife; a couple's commitment to pay down debt; and the willingness of in-laws to help out with rent-free living space and childcare. These ameliorations may be less visible or pressing than the damages done by the severe economic contraction. But they do raise anew questions posed by Daniel Bell's great book of 1976, *The Cultural Contradictions of Capitalism*.

Bell's thesis is that the very success of capitalism in producing wealth in broad and expanding circles throughout society injures the moral system that makes capitalism possible. In effect, Bell sees that contemporary capitalist systems are composed of three closely interrelated, but distinct, social systems. These three may be designated as the political system, the economic system, and the moral/cultural system. These three systems each operate by different rules, and tend to attract different sorts of elites into the service of each different sorts of elites, each primarily committed to and shaped by that system's values. That the values of each are mutually complementary makes the unity of the three systems possible. That they are distinct and each different from the other makes the social balance among the three changeable. Sometimes one system becomes too strong for the other two, sometimes another.

One might hypothesize that during the sudden growth of American industry on a national scale – stimulated by the great Civil War of 1861-1865 and especially after the railroads spanned the eastern half of the country – the business system became more unified and stronger than the political system and moral/cultural system. Then at the time of the Social Gospel and the Progressive Movements of the years 1900-1950, and on account of the stresses of the two great World Wars, so many new powers were added to the Government that the political system became too powerful for the other two systems. Finally, with the enormous growth in new technologies of communication (radio, cinema, quick-drying ink that made the publishing of glossy news magazines possible, television, cell phones, computers, the Internet, Twitter, etc.), the elites of ideas, symbols, and public articulation laid hold of powers superior to those of governments and businesses. The moral/cultural elites even gained the power to ridicule old and stable values in the name of new moralities, fashions, and enthusiasms (indeed, the same cultural elites who were fascinated by 'The Coming Ice Age' in the 1980s waxed even more apocalyptic in the 1990s, this time about the destruction of Planet Earth through 'Global Warming').

The point is that the three distinct systems are necessary as checks and balances upon each other. However, shifts in the internal dynamism of each over time tend to alter the power relations among them.

Bell argues that the peculiar contradiction at the heart of *capitalist* systems that are *capitalist* in their economic system is that they depend on *moral habits* that the sudden, smashing successes of capitalism in the economic sphere tend to undermine. Capitalism is a system based upon *mind* (as the term 'capital' itself suggests) – that is, upon invention, discovery, cooperative organization, and the propensity to deny oneself present pleasures in order to save and to invest (at significant risk) in futures significantly different from the past. Yet its remarkably rapid social transformations encourage later generations simply to live off the profits of the past, to be significantly less self-denying, to live rather more for the present, and to display significant dissipation of their resources and their energies. Thus does the economic system of capitalism tend to undermine the moral/cultural system to which gave it birth.

The evidence reported by Ryan suggests that, conversely, the crisis of capitalism obliges citizens to return in significant ways to the cultural practices and moral commitments that gave rise to the capitalist system in the first place. There may be some truth in that suggestion, and his insight should give rise to further empirical investigation.

2. The Second Hint: The Origin of the Housing Bubble

The second hint buried in Ryan's text may easily be highlighted in his opening sentence:

> This global financial collapse, *which began with the U.S. housing bubble*, has rippled through central banks, stock markets across the globe, and crossed the loss of an estimated fifteen trillion dollars of consumer wealth.

So far as I can see, not being an economist, there seems to be virtually universal agreement that the current economic crisis did indeed begin in the U.S. housing bubble. But what caused the housing bubble? Much hinges on the answer to that question.

It so happens that my economist colleagues at the American Enterprise Institute were predicting this collapse nearly a decade before it was to happen, and strongly recommending corrective action before it became too late. AEI is a private research center which specializes in anticipating the unintended effects of policies, private and public. In this case, my colleagues had correctly identified one immensely destructive policy of the United States Congress – promoting mortgage lending to people of very low income through off-budget guarantees and lax lending standards (rather than explicit, on-budget subsidies) which disguised the substantial risks to the financial system as a whole.[1]

[1] See Peter J, Wallison and Bert Ely, *Nationalizing Mortgage Risk: The Growth of Fannie Mae and Freddie Mac* (AEI Press 2000); Peter J. Wallison (ed.) *Serving Two Masters Yet Out of Control: Fannie Mae and Freddie Mac* (AEI Press 2001); and many other publications and conferences posted at www.aei.org/basicPages/20040927152122935. Cf. Peter J. Wallison, 'Cause and Effect: Government Policies and the Financial Crisis', *AEI Financial Services Outlook*, November 2008, posted at www.aei.org/outlook/29015.

The two giant 'GSEs' (government sponsored enterprises), Fannie Mae and Freddie Mac, supplied hundreds of billions of dollars of government-guaranteed loans for 'subprime' mortgages, while the bank regulators pressured banks to relax traditional lending standards dramatically and to increase their mortgage lending. Much public praise (including, alas, from me) was lavished on 'Fannie and Freddie' for making millions of poor families owners of their own homes. What was overlooked was that the homes were really owned by the banks and other lenders – and that the families had been loaded with far more debt than they could afford when and if housing prices fell, as of course they did.

The intentions behind these federal laws were entirely benevolent and moral. Congress wished more and more lower-income people to qualify for mortgages, so that they, too might benefit by the pleasures and responsibilities of owning their own homes. However, the unintended *effects* of these laws were to invite speculators among the middle class, and the wealthy also, to apply for these cheap and guaranteed mortgages (in order to buy second homes). Such persons were more likely to benefit than poor persons heretofore excluded from home ownership.

These second mortgages, moreover, were *guaranteed* by the government in a way no other mortgage lender could match. No wonder that about sixty percent of all mortgages during the period just before the financial crisis were granted by Fannie Mae and Freddie Mac.

In fact, it has been reported that half or more of all the mortgages granted in the state of Florida, a state highly favored by many retired folks, were to persons taking out mortgages on second homes, in a kind of speculative bet that future values would steadily rise. When that hope was not realized, the market price of homes collapsed, and it became cheaper for many to foreclose on their loans, rather than to pay the escalating interest charges to which they had consented.

This huge set of unintended consequences, flowing from an ill-conceived government policy, could not, of course, be contained within the housing market alone. Private banks all around the world purchased the loans made by Fannie Mae and Freddie Mac (who were after all the original grantors of these mortgages, but not their long-term holders). Worse still, these private home mortgages, not subject to the same rigorous green-eyeshade scrutiny as in the past, were not sold individually to secondary banks. They were sold, rather, in anonymous 'bundles'. Then when individual mortgages began to go bad, as it had been clearly foreseen by my colleagues that they would, the new owners of these bundles of mortgages had no way of knowing just how many bad ones might be in the particular bundles they had bought. From being in possession of a reliable stream of income from well-backed mortgages, they faced the shock of financial uncertainty and a significant devaluing of their assets.

I do not wish to make the point that government policy is alone responsible for the current crisis. Rather, only that it played an originating part in the falling of the house built of cards that my colleagues had identified almost a decade earlier. There was enough blame to go around, especially since, when the approaching crisis was swiftly approaching, there was no sustained public outcry against the original federal laws. In the short run, many people were benefiting from this misguided policy.[2]

3. Some Good News From the Last Forty Years

Meanwhile, other colleagues of mine at AEI have closely studied the great decline in the number of poor persons on earth who earn less than $1.00 per day. In 1970, that number had reached 968 million. By 2006, the number was driven down to 350 million. During that time, the earth's population had increased by three billion. Nonetheless, the number of poor persons shrank tremendously, by 64 percent.[3] If intellectual, political and church leaders can keep that process going for another thirty years, the remaining 350 million ought essentially to have been freed from poverty.

Almost all this progress had been made in China and India, which were not long ago the countries with the highest number of poor persons. Since about 1980, however, China and India together have moved considerably more than half a billion persons out of poverty and up to one rung or other of the middle class. This was one of the greatest anti-poverty successes in history, rivaling the great material progress of Europe between 1800 and 1900. During that century, the income of a British worker had risen by sixteen hundred percent.[4] Foods, beverages, and textiles never before available even to better-off persons entered the workers' daily lives.

[2] For more on the causes of the housing crisis, see Thomas Sowell, *The Housing Boom and Bust* (Basic Books, 2009).

[3] See Maxim Pinkovskiy and Xavier Sala-Martin, 'Parametric Estimations of the World Distribution of Income' (2005, NBER Working Paper 15433).

[4] See Paul Johnson, 'Has Capitalism a Future?' in Ernest W. Lefever, ed., *Will Capitalism Survive?* (Washington, D.C., Ethics and Public Policy Center, 1979), p. 4. Also see Ludwig von Mises, ed., *The Anti-Capitalist Mentality* (Princeton: D. Van Nostrand Company, Inc., 1956); and Friedrich von Hayek, *Capitalism and the Historians* (Chicago: University of Chicago Press, 1954).

In the case of both China and India during the last forty years, these results were the fruit of moving from a socialist command economy to one based on private property, open markets, private profit, and personal enterprise. That is the very method that raised standards of living so notably in Europe during the 1900s. In 1859, Abraham Lincoln himself described the range of new international products that were already showing up in the American West:

> Look around at Young America. Look at his apparel, and you shall see cotton fabrics from Manchester and Lowell; flax-linen from Ireland; wood-cloth from Spain; silk from France; furs from the Arctic regions, with a buffalo robe from the Rocky Mountains.

And on 'Young America's' table, one can find:

> besides plain bread and meat made at home...sugar from Louisiana; coffee and fruits from the tropics; salt from Turk's Island; fish from New-foundland; tea from China, and spices from the Indies. The whale of the Pacific furnishes his candle-light; he has a diamond-ring from Brazil; a gold-watch from California, and a Spanish cigar from Havanna.[5]

In other words, the sudden prosperity of the United States so soon after its founding is now being replicated in Asia.

I wrote some years ago that during the first thirty years of the new millennium the main moral task would be to reduce drastically the numbers of the world's poorest persons. There seemed to me no reason written in the stars why this Earth should have so many poor people. The cause of poverty seems directly linked to poorly designed human systems for creating new wealth, and an abysmal failure to teach all peoples how to shape their habits and daily practices, in order to become creators of new wealth. Sound economic habits and skills of enterprise and invention are quite natural to the human species, and only need to be taught and encouraged in order to blossom.

At that time, I did not anticipate the relatively sudden structural shift of two of the most populous and also very poorest countries, China and India, into capitalist economies. Once, Asia was the world's continent with the highest numbers of the poor. Nowadays, the focus of neediness shifts to Africa,

[5] See Abraham Lincoln, 'Lecture on Discoveries and Inventions', Jacksonville, Illinois, February 11, 1859, in *Speeches and Writings: 1859-1865* (Washington D.C.: Library of America, 1989), p. 4.

and to the remoter regions of Latin America. Many (but not all) remote regions stand 'outside the circle of development', which spreads outwards from free economic systems. The road ahead is still long. But it is only wise to take encouragement in this difficult work from successes recently won.

Another stunning example of the progress of the poor during the past forty years can be found in the recent study by the United States Census Bureau on the *Living Conditions of the United States 2005,* with detailed reports on the *Percent of Households Reporting Consumer Durables.*[6] This study compares the results from 2005 to those in 1971 by a number of selected characteristics, amongst them households below the poverty line.

My colleague Mark J. Perry summarizes the survey thus:

> Certain appliances such as air conditioning, clothes dryers, color TVs, and dishwashers that used to be luxury items owned by a minority of American households in 1971 became so affordable that by 2005 a large majority of households owned all of those appliances. And some household items such as microwave ovens, VCRs, computers and cell phones that were virtually nonexistent in 1971 became so affordable that more than two out of every three American households owned these items.

Household Appliance Ownership: 1971 (All) vs. 2005 (Poor) vs. 2005 (All)

Household Appliance Ownership (%)	1971: All Households	2005: Poor Households	2005: All Households
Washing Machine	71.3%	68.7%	84.2%
Clothes Dryer	44.5	61.2	81.2
Dishwasher	18.8	36.7	64.0
Refrigerator	83.3	98.5	99.3
Freezer	32.2	25.1	36.6
Stove	87.0	97.0	98.8
Microwave Oven	1.0	91.2	96.4
Color TV	43.3	97.4	98.9
VCR	0.0	83.6	92.2
Personal Computer	0.0	42.4	67.1
Telephone	93.0	79.8	90.6
Air Conditioner	31.8	78.8	85.7
Cellular Phone	0.0	48.3	71.3

Source: U.S. Census Bureau

[6] U.S. Census Bureau, Survey of Income and Program Participation, 2004 Panel, Wave 5. Internet Release date: November, 2009.

Perry also cites economist Steve Horwitz for a yet more startling overview of the relevant statistical tables:

> Life for the average American is better today than 35 years ago, life for poor Americans is better than it was 35 years ago, and poor Americans today largely live better than the average American did 35 years ago.

Explains Perry:

> By almost every measure of appliance measurement, poor American households in 2005 had much better living conditions than the average American household in 1971, since poor households in 2005 had much higher ownership rates for basic appliances like clothes dryers, dishwashers, color TVs, and air conditioners than all households did in 1971.[7]

Again, it takes many fewer hours of work in 2009 than in 1973 to purchase these household appliances. In other words, there is more than one way to make the poor better off.

Time Cost of Common Household Appliances (Hours Worked), 1973 vs. 2009

Household Appliances	Retail Price 1973	Hours of Work @ $4.12/hr.	Retail Price 2009	Hours of Work @ $18.72/hr.	% Change 1973 to 2009
Washing Machine	$285	69.2	$400	21.4	-69.1%
Clothes Dryer	$185	44.9	$400	21.4	-52.4%
Dishwasher	$310	75.2	$570	30.4	-59.5%
Refrigerator	$370	89.8	$425	22.7	-74.7%
Freezer	$240	58.3	$265	14.2	-75.7%
Stove	$290	70.4	$650	34.7	-50.7%
Color TV	$400	97.1	$300	16.0	-83.5%
Coffee Pot	$37	9.0	$30	1.6	-82.2%
Blender	$40	9.7	$32	1.7	-82.4%
Toaster	$25	6.1	$30	1.6	-73.6%
Vacuum Cleaner	$90	21.8	$100	5.3	-75.5%
	$2,272	551.5 hrs	$3,202	171 hrs.	-69.0%

It is right and just for measures of what counts as poverty to go up decade by decade, even though after forty years the poor live better than the average household did four decades earlier.

[7] See Mark J. Perry, 'The Rich Are Getting Richer and The Poor Are Getting Richer', [Weblog Entry] *The Enterprise Blog*, American Enterprise Institute, 1 Dec. 2009 (blog.american.com/?p=7694). Accessed 23 March 2010.

It discourages further progress, however, not to notice strong progress in the immediate past.

4. What to Do Next?

'If you had your way, what programs would you propose in order to end poverty such as we recently saw in Bolivia and Brazil (or some similar location)?' Pope John Paul II (or more likely, Archbishop Dziwicz) asked me more than once at the dinner table in his Apartments.

Reminding them of the obvious, that I am not an economist, I always made three simple yet basic recommendations:

1. Since the most dynamic form of capital is human capital, give priority to social spending to expand and improve education. Along with that, put new emphasis on economic creativity, enterprise, wit and invention (which in *Centesimus Annus* the Holy Father identifies as the chief cause of the wealth of nations today).[8]
2. In order to supply the millions of new jobs desperately needed among the unemployed (and underemployed) in many poor countries, make it easier for poor persons to form economic associations such as small businesses, under the protection of limited liability, so that they do not put at risk the whole well-being of their families in their new ventures. Hernando de Soto has studied the exorbitant costs in fees and bribes paid, in many Latin American countries.[9] By contrast, the legal process of incorporation in Hong Kong is low (about thirty U.S. dollars), quick (less than a month), and executed by mail on a simple form. Human beings have a natural right to association (first vindicated by St. Thomas Aquinas in *Contra Impugnantes Religionem*), and any nation wishing to escape poverty must help unleash the economic creativity of the poor. It is virtually criminal to exclude the poor from the right to form business associations, and to do so quickly and cheaply.

[8] See *CA* 32: 'In our time, in particular, there exists another form of ownership which is becoming no less important than land: *the possession of know-how, technology and skill*. The wealth of the industrialized nations is based much more on this kind of ownership than on natural resources'.

[9] See Hernando de Soto, *The Other Path: the Invisible Revolution in the Third World* (New York: HarperCollins, 1989), 11, 12, 13.

Most new jobs are created by small businesses employing between three and twenty-five persons. So it is good (even indispensable) policy to help these to be founded easily, quickly, and cheaply. It is also wise for caring leaders to keep their eyes on the rate of small-business formations in their nation or district, as the best indicator of progress against unemployment and underemployment. Without rapidly increasing employment in the private sector, a nation is unlikely to grow out of poverty.

3. Since poor people lack the personal capital to buy materials or to pay collaborators *before* they begin operations, government must help by establishing legal, helpful small credit bureaus in every locality, which offer practical advice as well as advance funding – and at the lowest possible rates. Such credit bureaus offer practical advice because they want their lenders to succeed, and thus to pay back in a regular stream the moneys they have borrowed. In this way, these mini-loans can be recycled to still other entrepreneurs. Archbishop Mark McGrath, of some fame at Vatican Council II, developed such a scheme of recycling small loans in Panama, to considerable good effect.

In other words, governments should focus on educating and supporting many women and men of enterprise, especially among the poor, who will create new jobs, new products, new services and, in the end, new national wealth. Such progress at the bottom is the best method for bringing the fruits of new wealth to the grassroots of society, where in a relatively short time (as we learn from all the 'Asia tigers') persons of considerable economic genius will begin to emerge. For the Lord has spread economic talents abroad like the sower sowing his seed.

5. Concluding Remarks

For more than 180 years, ever since Karl Marx popularized the term and gave it a derogatory meaning, important intellectual forces in the world have denigrated 'capitalism'. Usually, this is because they wish to boost by mere words a rival form of economy. If any of us could collect a nickel for every derogatory use of the word 'capitalism', we would earn considerable wealth.

During the era in which capitalism began to flourish in human history – in the 17th and 18th centuries – the usual motivation for denigrating it has been to collect more power in the hands of the State. The usual rationalization for this collectivization is to 'regulate', 'correct', and 'direct' the market.

Up to a point, a certain degree of regulation is advantageous to the economy itself, and thus to businesses, just as it is necessary in team sports to set down in advance clear rules. In fact, businesses themselves often ask for regulation, in order to protect patents or other advantages of their own. Thus, the drive toward regulation is commendable. But carried too far, it is self-injuring. That is how congressional actions to force the U.S. housing market into narrow channels built a house of cards, whose collapse led to a chain of collapses in other financial markets.[10]

The lust of political elites for more and more control over economic activity is always a danger against which wise societies take strong precautions. Today, new myths such as 'global freezing' in the 1980s, and 'global warming' since the 1990s, have stimulated new lusts for government control over economic activism and economic creativity. The motives are said to be good, sweet, and pure.

There seem never to be lacking those who would suffocate economic activists and creators of new wealth in the name of 'helping' them. But experience shows us wise ways to regulate and unwise ways – destructive ways and creative ways. We must always ask, quite realistically, and close to experience, what actually liberates the poor from poverty and unemployment? In the long run, it cannot be the State. Historically, nothing so broadly liberates the poor as creative economic activism.

Today, more than ever, elites who form and transmit ideas have gained disproportionate power over the politically wise and the economically creative. Thus it is more important than in earlier times to keep our eyes on practical and realistic ways of breaking the chains of poverty among the very poorest people. These are quite often not only unknown to but strongly resisted by the head-shaking classes.

In the real world (the world of actual experience), certain systems, methods, learned habits, virtues, and practices have worked wonders in liberating (quite recently) an immense proportion of the world's population. They have done so even while the world's population has doubled three times since the year 1800 (from one billion to two, from two to four, and

[10] See Kevin Hassett, 'How the Democrats Created the Financial Crisis', *www.bloomberg.com,* September 22, 2008, posted at www.bloomberg.com/apps/news?pid=newsarchive&sid=aSKSoiNbnQY0.

now from four to steadily heading toward eight billion). Both population growth and liberation from poverty have come together in tandem, due to marvels in the advances of medical knowledge and medical technology. These advances, in turn, have been made possible by wealth newly created through astonishing inventions in countries sometimes denigrated as 'capitalist'. These denigrations would be less dishonorable if they displayed a proper understanding of what that system really is, and how it really works. It is a system with many serious faults. It is a poor system, until compared to all the others. It has no peer in lifting the world's poor out of poverty.

It was only about two hundred years ago that the Christian West moved (against Malthus) to lift the cruel burden of poverty from the whole human race. The persisting aim was to help today's poor to live at standards of living unattainable by even the wealthiest persons in 1776. At that time, the dream of 'universal affluence' was first voiced by Adam Smith in tiny and then not very wealthy Scotland. Thus was born the liberating idea of economic development.

Fortunately, in the profound study laid out in *Centesimus Annus*, Pope John Paul II gave the free economy its due (especially in sections 31-42), under proper, fruitful safeguards. Economists and philosophers of economics do well carefully to measure his achievement. He did much in that place to be a 'witness to hope' for the world's poorest.