Casino Capitalism and Financial Recklessness: Obama Has Missed His Moment

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Barack Obama has squandered his presidency. He had a fleeting moment to challenge the casino capitalism and financial recklessness of our economic and political elite. He could have orchestrated a state socialism that would have provided a safety net for tens of millions of Americans faced with dislocation and misery. The sums he has doled out to Wall Street could have been used to force companies to keep workers on the job or create new banks to open up credit. But he lacked the foresight and the courage to challenge entrenched power. And now we are headed down one of two frightening roads—massive deflation or hyperinflation. Neither will be pleasant.

Hyman Minsky—an economist largely ignored during his lifetime and now held up as something of a prophet—argued that speculative bubbles, and the financial collapses that follow them, are an inevitable consequence of unregulated capitalism. Minsky, an economics professor at Washington University in St. Louis who died in 1996, warned: "The normal functioning of our economy leads to financial trauma and crises, inflation, currency depreciations, unemployment and poverty in the middle of what could be virtually universal affluence—in short … financially complex capitalism is inherently flawed." He called for socialized banking and stimulus packages to protect workers.

Our Minsky moment, however, has passed. Obama did not introduce radical measures to change our financial structures. And the outlook, even from Obama's chief financial advisers, is very gloomy. The U.S. economy will continue to contract "for some time to come," said Lawrence Summers, director of the White House National Economic Council. "I expect the economy will continue to decline," with "sharp declines in employment for quite some time this year," Summers said Sunday on "Fox News Sunday."

The International Monetary Fund has forecast that the U.S. economy will shrink 2.8 percent this year and have no growth in 2010, with unemployment rising to 10.1 percent.

Deflation, for the moment, remains our most immediate threat. The Labor Department reported that in March the consumer price index fell 0.4 percent over the last year, the first decline in over 50 years. Home values have fallen in the last year by 18 percent. Our current deflation is not the massive deflation endured during the Great Depression, but if it continues, and it becomes sustained, it will wreck our economy. I suspect that the few trillion dollars thrown at an economy that may have lost as much as $40 trillion in wealth means deflation will win out.

A sustained deflation, such as the one that has afflicted Japan, would make it much harder for borrowers, who would have less cash, to pay off debt. It would fuel more defaults, see more bankruptcies and dry up credit. It would lead to a fall in wages. Those attempting to sell houses, or any other products, would watch helplessly as the value of what they own evaporated.

Classical economic theory states that when you pump huge sums of money into the economy you produce inflation. And Fed Chairman Ben Bernanke would like to trigger inflation to relieve the heavy debts weighing on many banks and investment houses. Inflation, because it reduces the value of the dollar, effectively devalues debts and reduces what many owe. This push toward inflation is why we have low interest rates. This is why we are printing and borrowing hundreds of billions of dollars. And this is why projected deficits are almost beyond comprehension.

The Congressional Budget Office recently released its analysis of the Obama administration's 10-year budget proposal. The projected deficit for fiscal year 2009 is $1.8 trillion. And the CBO projects deficits over the next 10 years that annually are between about $650 billion and $1 trillion. The CBO also projects that the outstanding federal debt held by the public will increase from 40.8 percent of GDP in 2008 to 82.4 percent in 2019. This is a doubling of the national debt over the next 10 years. These deficits are being produced to jump-start the economy, to prevent deflation and to produce inflation.

Inflation, which may look good if you are a Wall Street firm overloaded with bad debt, is as risky as deflation, however. It can easily morph into hyperinflation and bring, like deflation, political and economic instability. It can lead to runs on banks. It can make your currency worthless. It discourages investment and thrift. And when you borrow at the level we are borrowing at you frequently debauch your currency. This could lead to the dollar being abandoned as a global currency. Why would the Chinese, or anyone else, want to keep buying our debt while we work overtime to devalue our currency? It means, in essence, that they can never make a profit and what they own is being reduced daily in value.

Hyperinflation is never controlled domestically. It is created by outside forces. If China and other buyers of our debt view the endlessly increasing American deficit spending as a threat to the viability of the U.S. dollar they will abandon the dollar and reduce their purchases of treasury bills. Chinese leaders have already questioned the wisdom of keeping foreign reserves predominantly in the form of U.S. dollar-denominated treasury bills and bonds. And if they walk away from the dollar our currency will become junk and hyperinflation will race through the society like a plague.

Deflation or hyperinflation will be our nemesis. These are the only two options left. The speculators on Wall Street and in the White House are again rolling the dice. But be assured that no matter what combination comes up, we are going to be fleeced.

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