

# Financial collapse: Lessons from the Social Gospel

by [Gary Dorrien](#) in the [December 30, 2008](#) issue

Now that the nation is deep into a financial collapse, at the beginning of a bad recession, and on the edge of what might become a second Great Depression, it is instructive to recall the first depression and the response of ecumenical American Christianity to it.

In the usual rendering of the story of modern theology, the Social Gospel liberals are nearly always treated as naive idealists—because many of them were pacifists—while Reinhold Niebuhr is treated as a hero and realist. But Niebuhr was wrong about the New Deal, and the social gospellers that dominated the Federal Council of Churches were right.

The social gospellers supported the Emergency Banking Act of 1933, which allowed the new Reconstruction Finance Corporation to buy bank equity. (Suddenly that sounds familiar.) Over the next year, the RFC bought over \$1 billion of bank stock—about one-third of the capital invested in U.S. banks.

The social gospellers advocated mixed forms of worker and community ownership, selective public ownership, social security and public infrastructure projects. In 1932 the Federal Council issued a new version of the Social Creed (first issued in 1908) that called for “subordination of speculation and the profit motive to the creative and cooperative spirit”; “social planning and control of the credit and monetary systems for the common good”; the right to organize for collective bargaining and social justice; equal rights for all people, specifically including all races; “repudiation of war”; “drastic reduction of armaments”; and the “building of a cooperative world order.”

The social gospellers told a story about the necessity of gradually democratizing society; Niebuhr told a more dramatic story, arguing that history would either move forward to state socialism or backward to barbarism—and that there was no third way. In his telling, the social democratic reforms of the Social Gospel were Band-Aids

and the New Deal was a form of quackery.

Not until the 1940s did Niebuhr change his mind about the New Deal; in 1945 he gave up on socialism and adopted a welfare state realism that put him in the mainstream of liberal Democratic politics. Niebuhrian realism became a strategy of countervailing power relations between capital, labor and an assertive national government. Internationally it was a theory of countervailing power relations among sovereign states. In both cases, it emphasized the power of states and the relative balance of power, and it was tremendously influential in the late 1940s and the 1950s.

Today we are witnessing a second historic wave of capitalist globalization. Karl Marx, foreseeing the first wave, famously predicted in *The Communist Manifesto* that “everything that is solid melts into air.” Suddenly that has an existential ring. But Marx wasn’t warning merely that the stock market might vaporize your pension, mortgage or job. His point cut deeper: global capitalism commodifies everything it touches, including labor and nature, putting everything up for sale.

Nothing is exempt from the pressure of competition. Social contracts and places of rest have vanished under threats of obsolescence and ruin, while the global market exploits resources, displaces communities and sets off wealth explosions in wild cycles of boom and bust. Thomas Friedman, a celebrant of the second wave, calls it “turbo-capitalism.” Economic globalization—the integration of national economies into the global economy through trade, direct foreign investment, short-term capital flows, and flows of labor and technology—has “flattened” the world, Friedman says. In a flat world you either compete successfully or get run over.

Today we are recycling first-wave debates about the possibility or limits of taming capitalism, but this time it has truly globalized. In the U.S., manufacturing jobs have disappeared and downsized workers compete for minimum wage jobs in the service sector, while the global economy is an amazing boon for economic winners. U.S.-based corporations roughly doubled their wealth between 1994 and 2004, paying ample rewards to employees and stockholders and huge rewards to top performers in lucrative industries, while the global economy stoked a culture of celebrity.

Friedman argues that global capitalism reduces national politics to minor tweaks. There is no third way in political economy anymore; there isn’t even a second way. Any nation that wants a growing economy has to wear a one-size-fits-all “golden

straitjacket” that unleashes the private sector, keeps inflation low, minimizes government bureaucracy, sustains a balanced budget, eliminates tariffs on imported goods and restrictions on foreign investment, abolishes quotas and domestic monopolies, privatizes state-owned industries and utilities, deregulates capital markets and allows direct foreign ownership and investment. Once a nation takes this path, Friedman says, “its political choices get reduced to Pepsi or Coke—to slight nuances of taste, slight nuances of policy, slight alterations in design to account for local traditions, some loosening here or there, but never any major deviation from the core golden rules.” Friedman wants the U.S. to spend more on green technology and science education, but he also advises us to give up on nostalgic dreams of social justice and equality.

This perspective is so widely shared that in much of the literature on globalization it is treated as obvious common sense. And it is true that globalization shrinks our politics; at least it did until recent weeks. But Friedman exaggerated the futility of political attempts to channel economic forces, and now, suddenly, the ground is shaking beneath us. The counsel to simply accept turbo-capitalism overlooks the fact that some societies do better than others in regulating the financial sector and in dealing with the maldistributive logic of the market.

Governments still play a key role in managing globalization and shaping socioeconomic outcomes. Thus we have contentious battles over free trade agreements, labor rights, ecological standards, immigration, control of labor flows, and now the nationalization of the financial sector. Government policies on technology and direct foreign investment have immense impacts on the kind of economy that a nation develops. If short-term capital flows aren’t regulated by somebody, turbo-capitalism is vulnerable to the kind of meltdown that occurred in East Asia in 1997—the kind that threatens us today.

A month ago I went around the country saying that because our banks don’t know what their assets are worth, and because it’s impossible to sort out the toxic debt, we might as well half-socialize the banks to unfreeze credit lines. Then Prime Minister Gordon Brown did just that in England, and France and Germany followed suit. Paul Krugman said we should do it too—and shortly thereafter won the Nobel Prize; whereupon Treasury Secretary Henry Paulson agreed, and on October 13 the Bush administration invested \$250 billion in senior preferred bank stock in nine major banks, take it or take it—no choice. We’re bailing like it’s 1933. The financial meltdown is so enormous that it will severely impede whatever plan President-elect

Obama had for his presidency. The next several years will be devoted to cleaning up the financial mess and coping with a major recession.

But this crisis also puts into play questions of national purpose and vision that have been off the table politically for decades. Instead of the usual Pepsi-or-Coke options and the usual fixation with trivia, there is now an opening for larger concerns. What would a good society look like? What kind of country should we want to be?

In the 1980s Sweden and Japan had national discussions of the sort that revolved around the tolerable limits of inequality. Swedish conservatives and liberals debated whether the wage differential between corporate executives and laborers permitted by the nation's solidarity wage policy should be increased to eight-to-one or maintained at four-to-one. In Japan, where worker shareholder plans are commonplace, a similar debate occurred over the tolerability of allowing more than the existing ratio of 16-to-one.

In the United States the ratio climbed to 145-to-1, and no debate ensued. The right to attain wealth was exalted over other values. In the 1980s the U.S. cut the top marginal tax rate for individuals from 70 percent to 28 percent and cut the top rate on capital gains from 49 percent to 20 percent. These measures had very large effects on the kind of society the U.S. became, fueling a huge surge in inequality. By the end of the decade, the top fifth of the population earned more than half of the nation's income and held more than three-quarters of its wealth, while the bottom fifth received barely 4 percent of U.S. income.

Today these numbers look rather moderate, because we have just had 20 years of unleashed greed in the financial sector and eight years of a tax policy of redistribution for the very wealthy. First, Wall Street fell in love with derivatives—financial instruments that allow investors to speculate on the future price of something without having to buy it. Next the Clinton administration tore down the regulatory walls between banking and investment firms. Then the Bush administration refused to enforce protections within the law, cut the capital gains rate to 15 percent and gave enormous tax windfalls to the top 5 percent of earners. In the past eight years virtually all of America's economic growth has gone to the top 5 percent, while the middle class has been saved from drowning only by taking on greater debt. But now the debt resort has reached its outer limit, and people are losing their homes, jobs and pensions.

From the perspective of Economics 101 the current meltdown is just a bigger version of the dot-com bust of the 1990s, with the usual lessons about financial bubbles. But this crisis is harder to swallow, because it starts with people who were just trying to buy a house of their own, who usually had no concept of predatory lending, and who had no understanding of the derivatives scheme on which subprime lending was based. It seemed a blessing to get a low-rate mortgage that saved you from drowning. It was a mystery how the banks did it, but this was their business; you trusted that they knew what they were doing. Your bank resold the mortgage to an aggregator who bunched it up with thousands of other subprime mortgages, chopped the package into small pieces, and sold them as corporate bonds to parties looking for extra yield. Your mortgage payments paid for the interest on the bonds.

This scheme was fantastically lucrative for a while, but it ensured unaccountability. If nobody knew what was in the packages, nobody could be blamed for what happened to them. When the housing bubble finally burst, the bonds lost value after people couldn't pay their mortgage or sell their house, Lehman Brothers went down, and the entire system cratered because the banks don't know what their assets are worth. Eleven years ago there was no market for credit default swaps—private contracts in a completely unregulated market that allow investors to bet on whether a borrower will default. In the past decade that market has soared to \$55 trillion, and it is at the heart of the current crisis.

The speculators gamed the system, and the regulators looked the other way. Also, people everywhere get anxious if they're not making as much as others around them. We must not shy away from acknowledging that what has happened is a consequence of greed running amuck. This is a story about greed being stoked and celebrated to the point of self-destruction. The banks got leveraged up to 40-to-one and still couldn't resist the lure of higher yield, never mind where that was leading.

We are witnessing the end of an era in which the winning strategy was to denigrate government and assume that wealth from the top would eventually trickle down. The current trade and budget deficits are staggering; the entire cost of invading and occupying Iraq was, in effect, put on a credit card. There are limits to economic growth. And we face colossal environmental problems. Global warming is melting the Arctic ice cap at a shocking pace, as well as large areas of permafrost in Alaska, Canada and Siberia, and destroying wetlands and forests around the world. Actually dealing with these problems throws us way beyond the Pepsi-or-Coke options.

*This article is excerpted from Dorrien's speech "Social Ethics for Social Justice: Renewing an Ecumenical Tradition," delivered to the National Council of Churches' general assembly in November.*