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"The Hundred Year Bubble"

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> "The men who control Harvard to-day are business men, running a large department store.... Devising new means of expansion, new cash registers and credit systems — systems for increasing their capital and the volume of trade.... The wonderful ability of the American business man for organization is now at work consolidating the Harvard graduates into a corps which seems to have the same sort of enthusiasm about itself as a base-ball team...."

John Jay Chapman, October 1909

> Jack Meyer, former CEO of Harvard Management Company, "repeatedly warned [Larry] Summers [then president of Harvard University and voting member of Harvard Corporation's then US$30 billion-or-so endowment fund] ... that the school was being too aggressive with billions of dollars in cash.... Meyer's successor, Mohamed El-Erian, would later sound the same warnings to Summers.... But the warnings fell on deaf ears, under Summers' regime and beyond. And when the market crashed in the fall of 2008, Harvard would pay dearly, as $1.8 billion in cash simply vanished. Indeed, it is still paying, in the form of tighter budgets, deferred expansion plans, and big interest payments on bonds issued to cover the losses."

Boston Globe, November 2009

Charles William Eliot, president of Harvard College from 1869 to 1909, both embodied and propagated much of what lawyer and writer John Jay Chapman abhorred in American life. Eliot's "New Education" thesis sought a "universal utility" in American education. Chapman, Harvard class of 1885, sought to oust Eliot from the presidency. "My dear James," Chapman wrote to his friend, Harvard professor William James, "those circulars about Eliot's seventieth birthday and the three million [dollar] fund, and all that bombast and vulgarity.... I cannot bear to be called 'a loyal son of Harvard.' This chest-thumping, back-slapping, vociferous and cheap emotionalism, done to get money...."

Chapman recounted the recent dedication of Harvard's New Medical School: "Eliot goes about in a cab with [J.] Pierpont [Morgan], hangs laurel wreathes on his nose and gives him his papal kiss." It was not only the degradation of learning that upset Chapman: "[W]hat has Eliot got to say to the young man entering business or politics who is about to be corrupted by Morgan and his class? How eloquently can Eliot present the case for honesty?" Students saw President Eliot pandering to Pierpont's laurelled nose: a lesson in America's hierarchy to an impressionable undergraduate. The students need "light, not fog". Eliot "and the crew of howlers have wasted and destroyed more by their buildings and their gates — they are submerged in their improvements."

The country was about to enter a period of nationalisation in which the inflated tendencies of modern life would be accentuated. Former Princeton University president Woodrow Wilson was elected president of the United States in 1912. He, too, was a champion of social uplift and reform. Formerly president of Princeton University, he was a proponent of "the science of administration". In his most famous essay on the topic, Wilson wrote of the government bureaucracy: "Its motives, its objects, its policies, its standards, must be bureaucratic." It seems a bit circular, and to a modern audience intimidating, but his professorial audience applauded it.

In the year he was elected president of the US, Wilson published *The New Freedom*, which called for an overhaul of the banking system. The *Wall Street Journal* caught the reform bug. On September 13, 1913, it reported: "Some attention is devoted in the pending currency bill to the question of improving the examination of national banks. It is by no means a minor detail in the general perfection of our banking system."

Eliot, Wilson, and the *Wall Street Journal* were early instigators of the inflationary century. Theirs was an inflation of words and ideals, of an imaginary world. Their ideals were progressive, a belief that the masses could be lifted by education, better (and more) government management, and better hygiene. Inflation of money and credit to the masses went hand-in-hand.

The Federal Reserve Act was passed in 1913. The United States entered the Great War in 1917. The Federal Reserve System — and it was advertised as a system of regional banks that would serve local needs — was to be a lender of last resort. It had a few other mandates, all minor, and none that could possibly justify today's price-fixing scheme by which the Fed sets the world's short-term interest rate. Nor was the Fed designed to destroy the value of the dollar.

The Federal Reserve Annual Report of 1918 noted the institution's "duty to cooperate unreservedly with the government [i.e. the Treasury] to provide funds needed for the war". The Federal Reserve Act was amended to reduce reserve requirements of banks. This liberalisation spurred the economy into a war-goods production machine. This expansion was never rescinded. The Fed has continued to reduce or eliminate reserve requirements to the present day. Banks have lent to a much greater extent than would otherwise have been possible, from the expansion of consumer credit in the 1920s to 125%, negative-amortising home mortgages today.

The war stirred other schemes to aggrandisement. General Electric president Gerald Swope, recruited to align production to the war effort, endorsed a planned economy. Financier Bernard Baruch, head of the government's War Industries Board (WIB), was given dictatorial powers over production and regulation. The WIB and affiliated bodies took over the country's entire railroad system, telephone companies, warehouses, terminals, commandeered an arms plant, and limited travelling salesmen to two trunks. President Wilson's bureaucracy was, if nothing else, bureaucratic.

Some, but not all, of the economy was denationalised after the war. Most important was the change in how Americans thought. Historian William Leuchtenberg wrote that the military draft demonstrated "the quiet efficiency with which a powerful twentieth-century state goes about its business of turning lives to public ends". "Quiet efficiency" is a nice touch. The Fed's open-market operations and reduced reserve requirements during the 1920s were leading causes of the Great Depression. This has not entered the interpretation of Federal Reserve chairman Ben Bernanke, the "great expert of the Great Depression". The industry of academic economists has not uttered a word in defiance. Nor would it dare.

In 1910, John Jay Chapman wrote of a "special prohibitory code, which prevents the college professor from … enlightening the community of our educational abuses". Speaking for professors who would not speak out, Chapman wrote: "[H]e is poor, he has offspring, and hopes for advancement." To disagree would cost the professor his place. "Such personal sacrifice seems to be the price paid in this world for doing good of any kind."

It is such spineless behaviour that leaves the masses in the dark today. Over the past century, over-creditisation has swamped every field of enterprise and recreation. The constant cry for greater growth, expansion, avenues of credit and market share have created distortions now integrated into all crevices of life. The pressure to keep up, prosper, and exude pep, hustle and zip has invaded soccer leagues, diets, summer camps, vacations, philanthropy, medicine, sports, entertainment, vocabulary, education, and the arts. (On selling from the permanent collection of Los Angeles County Museum of Art in 2005: "We have to sacrifice … in order to reinvest the collection.") As dismembered from the Fortune 500 as these fields may appear, they are (or were) "growth" industries, fuelled by reckless Federal Reserve money expansion and credit creation many multiples of that required for healthy business expansion.

Charles William Eliot's fundraising looks innocent in comparison to the onslaught today. Collecting and spending engulfs the field of education. In 2003, the Cincinnati City School District launched a US$480 million bond issue to "renovate or replace every school in the district". Boston University's US$100 million five-level recreational centre was an eye opener to Bloomberg reporter Liz Willen in 2005: "About 18 students soaked in a heated whirlpool, while others jog against the current in the 'lazy river,' a churning channel of water. Professors in their 70s swim laps in the 16-lane pool. A line of rock climbers forms near the 35-foot-tall artificial mountain." Willen seemed a bit mystified: "The BU gym is among the hundreds of luxurious new amenities rising on U.S. college campuses — and few of these projects are directly related to education."

It is axiomatic that greater quantity reduces quality. Over the last century, as more money poured into education, American student achievement declined objectively and in comparison to peers. In 2009, SUNY (the State University of New York) found that only one-third of its freshman class could convert fractions into decimals. A 2005 Indiana University survey discovered that 22% of first-year college students in the country needed remedial tutoring in math; 55% of the 90,000 American high school students surveyed spent no more than three hours a week on homework; 65% received all As and Bs. In 2005, a Chinese university won the 29th Annual Computing Machinery International Collegiate Programming Contest. The best an American university could do was 17th place. This 2005 finish followed a long trend. "The U.S. used to dominate these kinds of programming Olympics," said David Patterson, a computing professor at the University of Berkeley.

Studies plastering the front covers of weekly magazines calculate the vast income discrepancies between college and non-college graduates. Parents struggling to live a middle-class life do not dare think their children should do other than attend university. The financial burden is fantastic. Consultants are well paid to instruct parents how to structure their three-year-old sons' and daughters' lives for acceptance into the best schools. Tuition at the eight Ivy League colleges exceeded US$40,000 and is closing on US$50,000 a year. Stanley Eleff, Harvard class of 1969, put his finger on the downward plight of the American household: "It puts an enormous burden on people who a generation ago would have been considered wealthy but aren't necessarily considered wealthy now."

The anxiety is as great in the academy. Beaver College in Pennsylvania re-named itself Arcadia University. Applications doubled as a result. "All I hear in higher education is 'brand, brand, brand,'" observed Tim Westerbeck, a branding specialist. Westerbeck went on: "There has been a sea change over the past ten years. Marketing used to be almost a dirty word in higher education." (John Jay Chapman in 1909: "The name of Harvard is an asset worth thousands of dollars…. Eliot and Harvard have become trade-marks. We shall very likely live to see their names on collar-boxes.")

This period in American history is at an end. Credit is now retreating. The first consumer credit explosion was in the 1920s. The finale was probably between 1990 and 2005, when 15% of the American population acquired access to credit for the first time. This inflated the belief that everyone was middle class. (This also inflated the holy gross national product.) Symbols of status were within reach of the most recent immigrant. Access to consumer credit is attenuating and probably has already been lost by most of the 15% mentioned above. To an increasing degree, the American people, trained to believe a college degree is a necessity, will find their frantic efforts to reach this goal are in vain.

Sometimes good fortune is disguised. Products of the "best" colleges, those who make it to the very top, show signs of senility, not intelligence. Larry Summers, economic adviser to President Obama, considered a successor to Ben Bernanke at the Federal Reserve, studied at Harvard, taught at Harvard, and ran Harvard. He displays the modern economist's obsession: growth. In 1995, Alan Greenspan's re-nomination as Fed chairman was in question. Deputy secretary of the Treasury Summers made a speech that left no question he expected Greenspan to loosen monetary policy. Only an accredited economist could think Summers' address made sense: "We cannot and will not accept any 'speed limit' on American growth." No speed limit was applied to either the stock market or to the house mortgage market, the engines for growth over the following decade.

In 1998, it was obvious that derivatives could bring down the banking system. That was a clear possibility when a single hedge fund, Long-Term Capital Management, failed. The deputy treasury secretary told Congress any oversight would cast "a shadow of regulatory uncertainty over an otherwise thriving market".

In 1999, when legislation was passed that eliminated the separation of commercial from investment banking, (now) Treasury Secretary Summers claimed: "With this bill the American financial system takes a major step forward toward the 21st Century — one that will benefit American consumers, business and the national economy."

As president of Harvard College (the Harvard Corporation) from 2001 to 2006, Summers spent as never before. If there is an advantage to an economist managing a university it would seem to be in the field economists traditionally studied: how to make the most out of the least. Summers was building so fast he had to borrow to do so, even though the endowment grew by several billion dollars during his term. He managed Harvard's cash alongside a leveraged endowment, which was apparently adequate preparation for his next job at D.E. Shaw, a $25 billion hedge fund. He was Eliot and J. Pierpont Morgan in succession, hanging laurels on his own nose. Now what, my dear Chapman, does an ambitious student learn from *that*?!

What is the legacy of Larry Summers? Federal Reserve Chairman Greenspan did cut interest rates in 1995 and markets boomed, then burst. Derivatives were not touched. They boomed, then imploded. The combinations of commercial and investment banking functions created too-big-to-fail banks. They boomed until they collapsed. Harvard is attempting to arrest financial hemorrhaging, some due to Summers, some due to shrivelled paper fortunes the college relies upon. (The projected maintenance for Summers' new Stem Cell Institute has been calculated at US$100 million a year.) D.E. Shaw boomed, at least partly from unrestricted derivatives and from dealing with too-big-to-fail banks. Summers received a US$5.2 million pay cheque from the hedge fund in 2008, before joining the Obama administration in 2009. During 2008, Summers "also received significant income from Harvard University" and US$2.77 million in speaking fees from "financial sector firms and other places", including a US$135,000 speaking fee from Goldman, Sachs.

He heads the president's National Economic Council, where his most noteworthy achievement has been to reduce the influence of presidential adviser Paul Volcker. Volcker, Federal Reserve chairman from 1979 to 1987, has proposed that too-big-to-fail banks be broken up. Currently, the banks that collapsed, but were considered too-big-to-fail, are up and running again, in large part from Federal Reserve and Treasury department handouts.

In the 1920s, when the United States was concocting its measurement of economic growth (the gross domestic product), Count Keyserling, a visiting German, met with Henry Ford, John D. Rockefeller, and other business leaders. Keyserling wrote that these field marshals of business and industry "never have a new idea. And what does this type of person talk about? … [A] perpetual rehearsal of slogans which have their roots in the eighteenth century; chewing the cud of higher living standards, better institutions, a sound community life, and so forth and so on. If such talk is not the sign of senility, I have never seen one…. This inherent childishness also explains the fact that one rarely hears of any standard of value but that of quantitative achievement."

"My dear James," wrote Chapman in 1907, "Eliot has boomed and boomed — till we think it's the proper way to go on. He *must*, or lose foothold. [Note: Today, Federal Reserve Chairman Bernanke thinks he *must* continue to expand — he *must* hold rates at zero per cent.] Well, why not a man who does not boom? Is boom the best thing in life? Is it all boom? Is there now and to be nothing ever but boom, boom, boom? Is there not something that operates without money — not anywhere?"

A century later, the boom is at an end. In striving for perfection, the fields of education, government bureaucracy, and bank reform (construction of the central bank) have fallen to unimaginably discredited standards. The masses that were uplifted have now been dumped. John Jay Chapman did not think Charles William Eliot was a bad man; he considered Eliot short-sighted. And so he was. Eliot never dreamt the Harvard Corporation presidency would be so mishandled. Chapmam saw it. He was considered provocative and out-of-date when he wrote. Maybe there is a more receptive audience in the 21st century.

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