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Did "de-regulation" really cause this mess? I think not...

You may be surprised to learn that I often listen to Democracy Now! on CIUT on my way into the office in the morning, because a lot of "business types" think DN is "left leaning" and "socialist". The thing I find so lonely out there, is that there is no coherent "grouping" for people who oppose the abomination that passes for "capitalism" outside of "the left".

If you think invading Iraq was a bad idea, you're left leaning.

If you think bailing out all these zombie banks will make things worse, you're a pinko.

In the height of Orwellian irony, it is now "in the interests" of our free market economy to become a socialist state, while the real leftists and socialists out there are gleefully pointing at this economic mess and gloating "See! We told you Capitalism doesn't work!"

As I say tirelessly (and perhaps pointlessly) here time and again:

What passes for "Capitalism", isn't &"Free markets", aren't.

As I hear the chorus growing louder that the financial crisis was caused by rampant deregulation of the financial industry, the rush is on to regulate it. But here's the thing: this mess was caused by government interference in various financial markets and asset classes going back a lot of years. If you wanted to pick a start date, you have many to choose from:

1997: When LTCM imploded and guys like Rob Rubin and Alan Greenspan said "something had to be done" or it was "the end of the financial system as we know it".
2001: The tech wrech, where a recession was simply not permitted to occur and run it's course or else it would be "the end of the financial system as we know it"
1971: Nixon closing the gold window because otherwise the US couldn't continue their deficit spending and it would be "the end of the financial system as we know it"

The list goes on, but the common theme is that the REAL market forces at play were never permitted to bring home the consequences of what short-sighted politicians (who can't see beyond the next re-election cycle) and leverage-crazed bankers were doing, which was inherently risky and based on ponzi structures and ever increasing loads of debt financing.

Listen, next time some politician facing election or re-election stands at a podium, flanked by a couple of bankers who just drove up in a Mazaratti or flew in on a private jet, and they tell you "we have to do the following or it's the end of the financial system as we know it", keep in mind that the financial system, as we know it, is probably something that may be better off ENDING.

This is where the left gets their ammo however, because they look at the smoking ruins of the current economy and say "de-regulation" caused all this.

Let's look at what de-regulation actually is and how it plays a role in all this.

The first crack in the foundation (this time) was the sub-prime mortgage debacle.

This is where people who had no financial means to buy a home were lent money to buy an overpriced house. Many of them had no job, no income, and no assets (NINJA loans) and NO BUSINESS owning a house.

What happened instead? Instead of letting the MARKET find a natural clearing level of home prices balanced against people who were determined enough to own a home to save up 25% of the equity as a down payment balanced against responsible bankers who would only lend money to people they deemed serious about home ownership and paying off mortgages, the government decided that "it was a good thing" to get as many Americans into home ownership as possible.

So they created a few quasi-government agencies like Fannie and Freddie and Sally et al and turned them loose over the decades, gradually ramping up the leverage and allowing more debt to be piled on more debt to be serviced by less verifiable income and at some point a speculative blow-off took over and all this crap somehow got sliced up, repackaged, blessed with a AAA rating from Moody's and next thing we know every pension fund on the planet is holding a bunch of toxic sludge.

Under a completely DE-regulated market, where the market forces of safety of principle combined with an reasonable rate of return, would have NEVER allowed this to happen. It could ONLY occur under a regime of government intervention, government guarantees and nanny state coddling to get as many deadbeats onto the asset side of the banks balance sheets as possible, before the game of hot potato came crashing down around everybody.

Government control of interest rates is not "de-regulation"

Every time I hear some windbag complain about "too much de-regulation" I just ask the guy what he thinks about the interest rate on his bank savings account. Too low? Pitiable? I just opened a bank account the other day with a 1% interest rate. Is that too much de-regulation in action?

The biggest losers in all this are people who have responsibly saved money. The guys who maxed out their credit cards on flat-screen TVs, sitting in their 110% multiple-refinanced homes watching Paris Hilton vids and lining up for their foreclosure bailout made the savers look like idiots.

There is no incentive to consume less than one produces, because the interest rates are being held down by the governments. If there's no point in saving, they hope, the money will flow back into the stock market in search of some halfway decent yield. It won't happen.

Privately, interest rates are soaring. Anybody lucky enough to have some cash right now, won't let it go cheap. But the benchmark rates are and have been visibly suppressed below their normal market clearing rates. A meaningful recovery can only come from unspent capital (like savings) but the game is rigged to screw the savers. This isn't what would happen if market forces, in this case interest rates, were allowed to find their own natural levels (were not being regulated).

The stimulus

This is the flipside of interest rate manipulation. As important as it is to penalize anybody who tries to save some capital, the governments are frantically trying to reignite the debt bubble. So money is being "injected" into the markets to prop up asset prices and try to get the credit markets flowing.

Again, all this does is once again put some distance between the "reality" the markets need to communicate to the world, which is that pretty much everything is overpriced because it's all been bought on borrowed money, and the delusion that everybody can get rich simultaneously by borrowing a heap of money from the person beside them.

It also screws the savers (again) because now the stimulus is expanding the money supply, robbing the savers through inflation.

Is that deregulation run riot again? I would challenge anybody to find a period in history where the same thing happened in absence of a complicit government trying to decide "what's best" for the markets, or even better, where things got this out of hand in a society using a gold-backed currency.

The bailouts

For the nth time, Vincent LoCascio's The Monetary Elite vs. Gold's Honest Discipline describes, in excruciatingly accurate detail several years before the onset of real difficulties, why a government guaranteeing the solvency of any business against it's own stupidity is counter-productive:

"[P]eople fail to consider that federal guarantees make bank failures more likely by artificially encouraging people to choose the highest interest rates available, which in turn causes bankers to seek riskier, higher-yielding loans and investments".

"Failing banks do not face the same fate as other failing businesses. Other failing businesses must contract, face more restrictive credit conditions, tighten their belts, and turn adverse results around as quickly as possible to become more viable. Failing banks, however, can ignore the reality of their situation...They can use federally guaranteed deposits to try to speculate themselves out of trouble

Which is a pretty accurate description of what happened in this latest crisis. Again, the response to all this, governments bailing out the banks, governments bailing out the car companies, governments bailing out American Idol, isn't de-regulation run rampant. It's the opposite.

The response to the financial wreck, worldwide, has pretty much ensured a 5 to 10 year depression. At the end of it, words like "capitalism" and "free markets" will be unusable (how many German's do you know with the surname Hitler? It'll be something like that). But the ultimate irony is none of this had anything to do with either. What a sham.

Posted by Mark Jeftovic in Venture Crapital at 13:43