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Macro Views

I have on many previous occasions expressed my opinion that government should step away and allow the free market to solve the current financial crisis. It wasn't my beloved free market that caused these problems through lack of regulation as a swathe of market commentators would now like us to believe, I am sure as a justification for a new period of over-regulation which we are inevitably heading towards.

One of my favourite market commentators, Dr John Hussman, a former academic but more to the point a brilliant fund manager www.hussmanfunds.com (see article 30 March) makes the following observation as part of a detailed critique of the US Treasuries latest attempt to solve the financial crisis:

"The Treasury's proposal to address insolvency is to finance the purchase of impaired assets from the banks, primarily using taxpayer funds. But note that if the questionable assets are taken off of the bank's books at their actual value, there is absolutely no change on the liability side of the balance sheet. The bank's capital position does not improve. The "toxic asset sale" simply replaces the bad assets with cash. While this might improve the "quality" of the bank's balance sheet, it does not make the institution solvent.

Indeed, the only way for the toxic asset sale to increase shareholder equity is if the buyer overpays for the asset. To accomplish this, the Geithner plan creates a speculative incentive for private investors, by effectively offering them a "put option," whereby taxpayers would absorb all losses in excess of 3-7% of the purchase amount. This is essentially a recipe for the insolvency of the Federal Deposit Insurance Corporation itself, which would provide the bulk of the "6-to-1 leverage." To the extent that it is not acceptable for the FDIC to fail, the Geithner plan implies an end-run around Congress, and would ultimately force the provision of funds to cover probable losses."

To my simple understanding of this plan the proposal is just another way for the fat cats to walk away with the spoils whilst Mr. Public is left to pick up the tab for many years and maybe decades to come.

Today everyone is a Keynesian. According to the majority of commentators and government spokespeople the only way for an economy to maintain aggregate demand in the face of a massive reduction in spending is for government to step in a fill that gap. We have decades of failed Keynesian policy practice to refer to, yet the political need to do something instead of the right thing (nothing) once again sends us back on the path of failed governmental policy. I end with a quote from Henry Morgenthau, US treasury secretary under president Franklin Roosevelt between 1934 and 1945.

"We have tried spending money. We are spending more money than we have ever spent before, and it does not work. I want to see the country prosperous. I want to see people get a job. I want to see people get enough to eat. We have never made good on our promises. I say after 8 years of this administration, we have just as much unemployment as when we started and an enormous debt to boot".

Michael Berman, Ph.D.