



Calum MacKenzie's View From The Shore:

Beware the Ides of October, Mr. Obama

It would be first order conspiracy theory to suggest that the republicans have deliberately engineered the sub-prime financial chaos as a ploy to take a dive in the tenth round, and throw the election to Mr. Obama. The inane ravings of the McCain-Palin ticket holders are so bereft of substance that one can but assume that a smoke screen is being launched to hide the more evil machinations in the financial sector. By mounting a campaign of character assassination both directly and through surrogates¹, and by avoiding pertinent issues, the McCain-Palin folks are going out of their way to alienate the electorate in obtuse and puzzling ways.

One step further down this track takes us to wondering why one would consider taking a dive, after 20 months of effort aimed at winning the White house and the presumed most powerful post on the planet. Could it be that things financial are in such dire straits, that nothing short of capitulation in the presidential race would bring peace of mind and individual survival to a septuagenarian POW? The corollary would suggest that by winning the White House, with the insurmountable problems on the horizon, the democratic candidate will actually inherit such onerous burdens as to be the ultimate loser.

I have heard no national media interviewer or pundit ask either candidate what part that derivatives play in the sub-prime financial stew. I have heard no candidate address the connection between insurance and those same derivatives or how those instruments could bring the world wide financial system to its knees. Articles appearing in *The Chronicle Review*², *Safe Haven*³, and *Come*⁴, have spelled out the dangerous undercurrents in those murky waters. It may well be that our friendly media are trying their best to protect us from the inevitable. Yet by doing so, they underestimate our intelligence by hiding details, and deny our strength by shielding us from the truth.

That inevitable scene builds on the implosion of previous highly esteemed banks and finance houses. Mergers and acquisitions of ranking names in corporate finance are coupled with bankruptcies, break-ups, divestings, write-offs and all of that activity is given front page treatment and rightly so. But what was it about those giants of finance that brought them to their knees and eventual collapse? How is it that the mighty have fallen? What are we not being told?

So let's back up a little and suggest that the sub-prime loan and mortgage situation is what really started the erosion. Predatory, unregulated lending to those who didn't understand what they were getting into, a culture of rampant greed, the political dream of an ownership society, and a supervisory regime which didn't monitor, police or check on the activities of the finance houses, are all happy contributors to the nightmare to come. When the no-deposit, sub-prime teaser loans were later ramped up to market rates or above, individuals were dispossessed and millions were foreclosed. That explanation is certainly plausible.

If we back up a little more we hear Reagan's gift to economics. "Debt does not matter!"⁵ with no sourcing or evidence to back up his edict. VP Cheney also took up that cry when questioned about increasing layers of national debt. Bush didn't understand the question and talked about terrorism, forgetting the terror that he himself and his perverse ideology generates. Those attitudes along with the rushed deregulation of financial markets in 1999 -- just as the congress was going to end of the year recess -- allowed competition and risk to explode beyond what had previously been deemed prudent. Those attitudes certainly added to the erosion of confidence in the system.

Backing up just a little further, it is noted that the gold standard underpinning the currency was abandoned. The only thing which now underpins currency world wide is the prudence and reputation of governments and their central banks. Those qualities are somewhat lacking as we see governments handing over the reigns of power to the corporatists, the weak and ignorant being manipulated into leadership positions, the ordinary working man and woman being ignored, and their plight neglected. Calls to make government answerable to the people are trashed, and derided as pinko, commie rubbish or worse. Fuel has been added to the fire over the last seven years with no one on duty to douse the flames.

If we go back further to the late 1930s and early 1940s, when J.M. Keynes⁶ was laying out a framework for the stabilization of financial markets globally, the US Treasury Dept. took the attitude that the US would not be dictated to by a "Limey". Fifty to sixty years of erosion from Keynes' prudent positions, which advocated a win-win situation for all the participants -- including the poor and the weak -- have taken us to edge of the precipice we now peer over. Some are already heading down the slippery slope. Where Keynes advocated balance and fairness in international trade, the US had to have competition and winners and astronomical profits to be increased each year.

The positions then held by individuals were also held by corporations, companies and small business. Loans to replace equipment, meet payroll, upgrade processes, or buy new raw materials and stock, were available for the asking. A previous record of meeting payments and a history of honoring credit was sufficient collateral to keep the funds flowing. Suddenly loans dried up and credit worthiness was not honored. Businesses large and small found it increasingly difficult to acquire funding through loans of any kind.

The banks, long held to be storehouses of ready cash wouldn't even lend to each other. If banks don't trust banks, what are we ordinary mortals to think? Central banks then stepped in, releasing unheard of massive sums to improve the liquidity in the monetary system.

Some European countries have stepped beyond socialism and actually nationalized some of their banks. Others have shied away from that dirty 'N' word by taking an ownership position in their banks like the US has. Who would have thought that the fallen angels of socialism would actually rescue the hides of those responsible for the debacle in the first place? Did the obvious failure of the contemporary model change anything on Wall Street? (Answer: *No!*) CEOs still net multi-million dollar salaries, and receive decadent bonuses for running their companies into the poorhouse. In many ways its business as usual; Alice in Wonderland at the Mad Hatter's tea party.

Some have compared the current dilemma to the stock market crash of 1929⁷ when the stock market went belly up and folks lost their life savings. Company directors jumped from

buildings rather than take the severely punishing embarrassment of facing stock-holders. No one is jumping this time around. They don't have to with a pseudo-socialist government in the White House.

Others think the comparison is more apt to the depression of 1873⁸ -- where a parallel set of circumstances which mirror the present -- created a dire situation that took 4 years to turn around in the US and 6 years in Europe. The 85 billion dollar bailout of AIG is but the thin end of the wedge. AIG went through the 85 billion like a hot knife through butter and came back to the well for another 37 or so billion. Who is minding the store? Where is the accountability? Even in the most lax of socialist heydays, such largesse to a private enterprise was unheard of. The US government doesn't have that kind of money to throw around. Why are companies allowed to get 'too big to fail?' Why is responsibility in park and accountability checked at the door?

Just as the housing bubble caused distress for millions, the previous high tech bubble had a similar outcome. Elsewhere on the planet there have been bubbles in commodities such as wheat and spices. The South Sea Bubble been particularly notable⁹. In every case the losers are those on the bottom rungs of the stock market hierarchy, while those who control the scams of capitalism get a free ride, pass go and don't go to jail. Deregulated markets have but un-enforced rules. The vast majority, the world's poor are left out of the loop and left to fend for themselves in a collapsing world not of their choosing and in which they had no say.

If you were under the delusion that AIG was just an insurance company then you may well be excused for assuming that the bailouts would have fixed the problem. But AIG was also in the derivative trading business under its subsidiary AIG-FP. Their financial products service makes it a huge player in the credit-default swaps. These are derivative securities that allow banks, hedge funds and others to insure against loans gone toxic. They were a prominent and highly competitive player at home and abroad accepting more risk from borderline clients or worse.

AIG-FP was not the only player although it did service an international slew of clients. At the heart of credit derivatives is an assessment of risk in order to minimize loss in the event one of the toxic loans going bad. If the risk is assessed too high, then higher premiums have to be charged just as with teenage drivers with several prangs on their records have to cough up very high premiums.

Competition enters into the mix so that one company which has assessed risk competently may be undercut by several competitors all of whom offer reduced premiums. The assessor's competence is now drawn into question by his colleagues who rue the loss of a client. Additionally they lose the fees and their inflated bonuses. Competition in this way forces ever more risk into the equation because it's unregulated while seeking reduced premiums for an expanding client base.

Competition forced mortgage companies to take risks and government encouraged those who could not afford it to enter the home ownership market. Such is the case with the sub prime mortgage fiasco (AIG). Should one risky policy go bad, a large company can recoup the loss by spreading it across a large client base. However, when a series of toxic loans fail and the insurers has to pay up over and over again, the insurers very rapidly

finds themselves with their backs against the wall, overwhelmed and with no way out. Teaser rates and small print baited the ignorant and the unschooled, while banks and finance houses -- who should have known better and seen disaster looming -- allowed the system to gear up and then grind to a halt when the true mortgage rates kicked in.

As US-led corporate trade initiatives allowed more and more US manufacturing to go off-shore (with the Bush administration's blessing and encouragement) loyal American workers suffered. US providers were left out in the cold as more and more US corporations fed their addiction to greed by importing foreign made goods and services and out-sourcing work to cheaper labour markets. US high flyers avoided paying for the homeland services that they used as foreign tax havens were allowed to be used.

Similar tactics were employed in Europe, Canada, and Australia, so much so that local workers were laid off by the millions. Without the jobs to support the local economy, the other sectors of the economy were soon hurting. Unfortunately, some see the situation worsening before it recovers. The sub-prime mortgage derivatives amount to some 3 trillion dollars while credit derivatives which include the sub-prime derivatives and all other exposures amount to some 63 trillion!

And just to give some perspective to the magnitude of the problem, that figure surpasses the total global economy. Every organization that lives on credit, including local households, will feel the pinch as credit dries up. With a complete meltdown, how can the man in the street come to grips with a financial over-extension to 63 trillion? It would be disingenuous of the financial advisers of each campaign to keep this information under wraps. Yet they will have to face up to it sooner or later and put rules in place to ameliorate an untenable situation.

The more prudent high flyers, those who sought to put aside something for a rainy day, will be able to survive nicely. Just as Carnegie and Rockefeller put their nest eggs to work to buy up good companies at fire sale prices in the 1870s, there will be winners who see profit in other's misery. Just as Yeltzin's henchmen and insiders made out like bandits as the USSR collapsed and left its citizens in poverty, there is a strong possibility that ordinary folk will need more than a belt tightening to survive what's ahead.

But belt tightening is definitely part of the solution. The Hollywood and cowboy lifestyle is now passé. In everything we do, we must think of more efficacious ways to reduce our dependencies; on money, on oil, on electricity, on eating out, on entertainment, etc., etc. We need to find ways of sharing and being our brother's keeper collectively and communally as we rescue the planet and our lifestyle. Instruments of credit have not always been our friends and we should take immediate steps to abrogate their influence by moving to being a budget conscious, cash society.

As the election campaigns of each candidate seem to merge and differences become blurred, the old republican and democrat ideologies will have to take a back seat to a new reality. Neither party has acted as an independent broker as they nursed the present situation into being. The Dennis Kuciniches¹⁰ and Ralph Naders¹¹ have been trashed as dingbats for so long, that some will now have to eat crow, and start paying attention to the real world that Dennis and Ralph have defined. Prophets in their own country, they have suffered enough brickbats, and deserve serious attention for their contributions.

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Notes

- 1 - <http://www.hungrypeasant.com/articles/jdc/rvm-c4-anecdotesoflearning.pdf#page=19>
- 2 - *The Chronicle Review*, <http://chronicle.com/>
Does the Financial Crisis Affect How Economic Theory Should be Taught?
<http://chronicle.com/weekly/v55/i07/07b09901.htm>
- 3 - *Safe Haven*, <http://www.safehaven.com/>
How Central Banks Destabilized the World's Economies, <http://www.safehaven.com/article-11550.htm>
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<http://www.safehaven.com/article-11556.htm>
Is the Stock Market Crash Over?, <http://www.safehaven.com/article-11559.htm>
- 4 - COMER is The Committee For Monetary and Economic Reform, <http://comer.org/>
- 5 - <http://www.youtube.com/watch?v=2wRMNhqKnBg&feature=related#>
<http://answers.yahoo.com/question/index?qid=20080723102019AAAnAm7K>
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- 6 - <http://en.wikipedia.org/wiki/Keynes>
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- 10 - http://en.wikipedia.org/wiki/Dennis_Kucinich
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