Do All Booms End in Tears (Part 2 … to 2008)

"Have the Harvard Graduates Succeeded where the Communists & Terrorists Failed?"

(Based on a 20th Nov. 2008 after dinner speech to the Harvard Club of Australia, Perth, Western Australia)

It's a fortunate man who can surround himself with people who know more than he does. So, it's my pleasure to be surrounded by all of you tonight.

One of the gifts you receive, after enjoying life's adventures over so many years, is that you get a fairly good idea of how the world works and how people respond to incentives, political and otherwise. The "response to incentives" could be one of our themes tonight.

I remember watching a movie called *Maid in Manhattan* where the hotel Floor Manager, gives these words of encouragement to the adventurous floor maid (Jennifer Lopez), "What we do, does not define who we are. What defines who we are, is how we rise again, after we have fallen." (The theme of my poem on page ….)

We are all simply products of our own experiences and I'm currently assembling my fourth book(1) in an effort to make some sense of where I've been and, more importantly, where I'm going.

The book is called *Heroic Misadventures*(2) (it's a "how **not** to do it" book) and I'm encouraged by the hotel floor manager's words about "how well we rise again." Compiling this book is causing me to have frequent mental flashbacks. I find that most of them, unrelated at the time, do lead to a central theme of "rewards for behaviour".

Let me mention **four flashbacks,** a couple of which came to me at about 3.00 o'clock this morning.

Our family business, started by my grandfather (one of the first mining engineers to come to Western Australia, from Ballarat, in 1895), has, over its 114 years, been involved in all sorts of mining consultancy, machinery importation, design of various mining plants and agencies—all in an effort to get us through various booms and busts.

This means that I'm no stranger to the cyclical events we currently see unfolding.

The first flashback takes me back to the early 1960s when one of our challenges in Kalgoorlie was as regional distributor for Kriesler radios. (The 1960s was a time when Australia used to actually design and manufacture things such as radios and electrical appliances.)

I established a great Kalgoorlie dealership network: (Southern Cross, Leonora, Laverton, Norseman, Esperance and Ravensthorpe) and I must have done a reasonable job because Kriesler flew me over to Sydney to attend a big celebratory dinner, held at a fancy hotel. It was held in the evening after we'd spent all day inspecting their very modern and very high-tech factory, design centre and production line.

We were seated at that excellent dinner much as we are tonight.

The three senior Kriesler Executives (Rae Weingott, Tip Walcott and Lex Ainsworth) were seated at the top table. Immediately after all the celebratory speeches, the maitre d' rushed up to their table and broke the news that “the Kriesler radio factory was on fire”, and “that the fire was so advanced there was nothing that could be done about it.”

What a difference that made to the celebratory spirit of the evening!

The three executives quickly conferred and decided that we would commandeer the hotel’s bus and at least go out to see if anything was salvageable.

The bus was later to return us to the hotel where people could then disperse and go back to their various homes.

Those with no immediate plans to go home were free to join them as they worked their way through a few “what next” scenarios.

As I had no further plans for the evening, I returned with them after witnessing the devastation of a raging fire where absolutely nothing could be salvaged.

That evening developed into one of those rare on-the-job training experiences that are so useful to a young 24-year-old enthusiast.

The strategy planning session went something like this:

1. We have no production facilities, no factory and no office.

2. What do we have? A good set of plans and good people and a building site.

   Their “risk management” was impeccable, even long before the term “risk management” was invented. They had spare sets of drawings of all the components and the various models with their Patent Attorney so that they would be able to start again—but when and how?

That’s when the phone calls started coming into the hotel.

The news of this fire had been broadcast over Sydney radio stations and many other industry executives had heard the news.

They were aware of Kriesler’s big celebration and knew where to contact them.

The general public out there imagines capitalism to be a vicious beast (or as Australia’s current Prime Minister, Kevin Rudd, calls it a “brutopia”).

The general public would imagine Kriesler’s competitors rejoicing that there would be one less major competitor in the field.

However, this is what actually happened.

There were lengthy conversations with various corporate chiefs. One after the other, the calls came in with offers to set up special production lines to produce various items such as the plastic cabinets, or the componentary chassis.

One offer was for the leather wrap-arounds for one of the portable radios.

Another offer was to take on the task of producing Kriesler's range of car radios.

All of these offers were to use Kriesler's plans and designs. And one of them actually offered to assemble all of the various components into a finished product.

By the time the sun's rays started shining through the windows in that hotel dining room, every single aspect of assembly and production had been taken care of to the point that the executives could confidently predict that production would recommence in three months and the factory would be rebuilt in exactly six months. This was achieved.

As a young man, I saw for the first time the true value of the ESTEEM that this group had built up within their very competitive industry.

That night was a measurement of the value of ESTEEM and true goodwill.

Over the next few weeks I heard many interesting stories about how the Kriesler radio group had established an impeccable record in their dealings with their peers, who then regarded it as a privilege to return the favours.

Their "moral compass" was forever present to guide their actions in 1960.

Now, half a century later, we are wondering if Wall Street and those responsible for the Global Financial Crisis (GFC) of 2008 simply lost their way, by losing their moral compass.

The second flashback took me back to the early 1970s when, through a strange set of circumstances as importers of underground diesel trucks from Sweden, we became distributors for Volvo trucks and cars and this also led us to being distributors for Subaru cars.

I must have done a good job of that, too, because I won a dealership award and Subaru sent me up to Japan to tour the factory.

Subaru was a relatively new brand to Australia at that time and, to my astonishment, I found that there was no such thing as a Subaru factory.

The cars were simply manufactured in a corner of a huge manufacturing enterprise called Fuji Heavy Industries.

They were producing a remarkably well-engineered car and being of some engineering background myself, I took particular notice of several features and asked some questions of one of the senior people as to how a company making diesel locomotives, light aircraft and helicopters decided to get into the car business.

He explained to me that the boss (owner) of Fuji Heavy Industries had sent a team around the world to study various countries' auto industries, so that they could decide how to add a car manufacturing facility to the enterprise.

The team had travelled extensively and found themselves somewhere in Germany where they had located a closed-down car factory that, until recently, had produced a well-engineered front-wheel drive car called the Borgward Hansa.

They described to the boss the style of car and the quality of the manufacturing facilities.

Fuji's boss made a quick decision to buy the factory for that particular model, "lock, stock and barrel". They transported it back to Japan where it was successfully installed and produced a car with a newly designed body built over what bore a striking resemblance to the Borgward Hansa engine and undercarriage.

Like everything the Japanese do, it was remarkably improved over the ensuing years.

I was also aware the next day that the executive who spoke to me was admonished for his candid comments, as apparently it did not match up entirely with the official "Subaru story".

However, the take-away message that remained with me is that if you can develop a team in whose abilities you have total trust, then that enables you to make quick decisions (without endless committee meetings) and through the diligence of that same team, you can see your dreams come true.

I've usually been lucky in having people like that working alongside me.

The reward for being the boss, is that you get to choose who works alongside you.

Subaru, as you know, has gone on to be an excellent car, such a desirable unit that General Motors of USA several years ago purchased a 20% stake in Subaru.

Because of their own financial situation, General Motors has since been forced to dispose of that asset and we are now seeing General Motors go cap in hand to the U.S. Government seeking a handout of many billions of dollars to enable them to stagger forward into the future.

How a great company such as General Motors can get to this stage has been the subject of much corporate examination.

Such potential corporate collapses are a disturbing trend.

This is only my personal opinion, but I'm concerned that one of the weakest links in capitalism at the moment is with corporate governance, that is, the relationships between shareholders, directors and managers.

Here we see insider trading, self-dealing, golden parachutes and the latest fad: "fail fees" where they, the executives, get a big prize for failing. We also see the same sort of behaviour in federal and state governments, and even among State Governors (specifically Tasmania).

As Saint Matthew pointed out a long time ago (chapter 6, verse 24):

> "No man can serve two masters or else he will hold to one and despise the other."

The "two masters" in today's corporate world are the shareholders' interests versus the executives' interests, where those interests are not aligned.

Disturbing events that we are often confronted with in our careers, and also as investors, now demands action, by individual investors, rather than waiting for things to get to the stage reminiscent of General Motors, many years ago where they basically transferred the enterprise value to the employees instead of the shareholders.

In that big unionized company, General Motors' executives tried to get one more year without a calamity by giving the union damn near everything, and then they felt they had to give everyone else (the non-unionists) even more because they were valued employees and not in the union.

General Motors in the U.S. continued to do that for 40 years, running to the point where now the shareholders' equity has virtually been destroyed, and their finished product is less attractive to consumers because each car they produce is burdened by a $2,000 "surcharge" to cover workers' healthcare.

If General Motors fails, the assets will simply find their way into other hands, and a more desirable product will emerge, from a less unionised workforce and the miracle of the market will take the company into the future. Unfortunately, the poor shareholders are punished for the poor management decisions of various generations of executives.

This then being an example of the wrong people being punished.

Flashback #3

In September this year (2008), I was invited to South Korea, along with two German economists, several U.S. academics, and some Austrian, Venezuelan and Chinese economists, to be fully briefed on the challenges facing that nation.

In Australia we don't read or hear a lot about South Korea, one of our major trading partners, but there are some unsettling events taking place.

"Dear Leader" (Kim Jong Il) just over the border is in seriously bad health and the South Koreans are apprehensive that North Korea will simply implode, as did East Germany, and leave them facing much the same sort of mess that West Germany had to clean up after reunification.

The South/North Korea situation is much worse. Indeed, South Korea has been described, by our hosts, as having two Zimbabwes just over its northern border.

Our visit to the Demilitarized Zone (DMZ) gave us some interesting insights to this (see Fig. ……..)

All these “inflection point changes” are of great interest to me, as I’d been involved with teams visiting Germany in 1982 and Russia in 1990, at the time when they were toppling statues, and then our task was to “train” the Russians on how to handle free enterprise because it was arriving the following week!

There are some horrific disasters that can be bottled up any time that governments get in the way of free markets; I saw this in Germany 1982, in Russia 1990 and now the Global Financial Crisis of 2008 is another classic example of this.

Today, we see this “Global Financial Crisis” being blamed on the Free Market, when in all honesty there is no Free Market, there are only "Government Interventions”. Unfortunately, what is often regarded as good politics, usually involves bad economics.

Without an understanding of the damage done by Government Intervention, it will be difficult to seek retribution and choose the best way forward.

Flashback #4

This one, also this year (September 08), where, as a member of the Mont Pelerin Society, a group of economists, academics and business leaders with a classical liberal bent, first set up in 1947 by Prof. F.A. Hayek, Milton Friedman and others. Each General Meeting is held in a different country, this year we were in Japan.

Being a non-economist gives me the opportunity to ask very informal questions and I had the opportunity of asking this question of Prof. Gary Becker, (Nobel Prize-winner in economics, 1992).

“Over many years we observed the Communists trying to bring down the free market and particularly, the economy of the U.S., but they were unsuccessful because of the resilience of the free-market system. However, we’ve seen more recently the Wizards of Wall Street [including the many Harvard Graduates] manage to achieve what the Communists were not able to achieve. Are there some comments that you might like to make on that topic?”

Professor Becker’s answer:

> I don’t think Wall Street brought down the free market.
>
> I think we have a crisis now, but you have to also look at benefits as well as causes.
>
> I think we had financial innovation, derivatives and various other factors that have contributed greatly to world trade and growth in economies over the last 35 years.
>
> But perhaps I don’t know enough about this, I don’t think anyone knows enough about it because I’ve asked my colleague, Richard Posner, one of the real experts on this, and he doesn’t know what the answer is to your question.

However, let's consider the consequences that you can have in a Global Financial Crisis. If you look at the facts of the crisis so far. Tremendous publicity that the United States has been devastated; some banks have been devastated too.

Look at the U.S. economy, which hasn't yet been designated, but may be designated to be in a mild recession. I say, mild, because for every single quarter, but one, the U.S.'s GDP is continuing to grow.

The last quarter grew at 3.3%, some forecasts are that it's going to go pretty well for the 3rd quarter coming out shortly.

Unemployment is up and we'd like to get it lower but it's not at such bad levels, 6%. There are many European countries with 5 – 6%.

So, I think it is a recession. It's certainly been induced in part by the financial sector; there is no doubt about it. However, you have to also count the benefits. It's a little like deciding whether to send your child to university.

If you just look at the single fact that it's very costly, what's the point in sending them away to college?

But of course you do get a lot of benefits from doing so.

I believe that same thing is true of financial innovation. A lot of mistakes have been made. There has been lying and cheating and misinformation on both sides of the market and probably that's all true, but I don't think you want to blame all the new financial tools for risk management, as they have been extremely useful.

They are extremely useful in navigating oneself through the risky world economy."

[Please note that subsequent to that September 2008 discussion, Professor Becker has considerably developed this answer on his blog (www.becker-posner-blog.com) under the sub-heading "Is the Goose that Laid the Golden Eggs Severely Wounded?"]

As you know, the Global Financial Crisis of 2008 is still unfolding, so we are still seeking an understanding of this ongoing process, hence tonight's focus on "rewards for behaviour".

Incidentally, arriving back in Australia in mid-September, at a time when the whole financial world appeared to be imploding at a rapid state, I found it strange to find very little public concern here, as the events hadn't managed to penetrate our complacency.

Here are three first-hand impressions of when I arrived back in Australia:

1. At the airport we were given a "free book" [See Fig. …..] *Bombproof* by Michael Robotham.

Why a free book? Well, you see, inside the front cover it explains that Michael Robotham is the pseudonymous author of ten best-selling non-fiction titles and it also explains that this book "is an Australian Government initiative developed through the Australia Council for the Arts, the Australian Government's Arts Funding and Advisory Body".

I worry about taxpayers' money being chucked around like this.

It appears to be a very ordinary novel and should therefore be left to compete with all the other novels on the booksellers' shelves.

How could this be the legitimate role of Government, to get into the free novel business?

2. The second example was a news item of the day when it was proudly announced that Stephen Smith (Australia's Minister for Foreign Affairs), on behalf of the Prime Minister, Kevin Rudd, had just "donated" $10 million of taxpayers' funds as "food aid to Ethiopia".

   The announcement went on to explain that this $10 million was to help buy Australia a "seat" on the U.N. Security Council.

   "Remarkable", I thought, as there appears to be ample evidence that this type of foreign aid has never helped African countries or countries anywhere else for that matter.

   Foreign aid might be defined as a transfer of money from poor people in rich countries to rich people in poor countries.

   If Australia really wants to help people in less fortunate countries, there are many ways to do this, but they will require thoughtful and meticulous programmes rather than these photo-opportunity media events.

3. Then to cap it off, the first print media news item we saw in the *Courier Mail* was headlined "Government plan to make prostitutes feel better about themselves", followed by the news item itself:

   > "The Bligh (Qld) Government is set to spend $400,000 a year on an advocacy service whose functions will include promoting the positive aspects of prostitution."
   >
   > "The service should contribute to a more balanced and positive view of sex workers in the general community, assisting to overcome the stigma attached to prostitution," the authority says in its latest newsletter.
   >
   > "Queensland Health recently hired a consultant to complete what it describes as a "needs assessment" of the state's sex workers.
   >
   > According to the authority, that exercise found that the Queensland sex industry's various sectors had different needs.

> The results are meant to inform of the establishment of the new state-wide advocacy service with a budget of about $400,000 a year."

Again, I ask the question, "Is it the legitimate role of government to make prostitutes feel better about themselves?"

I would have thought that that the girls' various clients would have had the responsibility of making the girls feel better about themselves; not the government.

Can I ask you simply, "What a strange set of priorities our various governments appear to have as they find ever-new ways of spending our hard earned tax payments?"

Now that brings us right up to the present time and one of the topics for tonight's discussion "Have the Harvard Graduates Succeeded Where the Communists & Terrorists Failed?" (the U.S. economy, having survived repeated attacks from Communists and Terrorists, now appears to have been brought down by the Harvard graduates on Wall Street.)

Now I know this is a very sensitive issue, particularly amongst your group of Harvard graduates, so let's attack the question using the following headings:

1. Where is my evidence that it was the Harvard graduates' fault?

2. How serious is this event in the overall historic world view?

3. Causes of the problem.

4. Will the various governments' bailouts actually work?

5. What could work?

6. The challenge remaining for all of us as we move forward.

My evidence?

I know it would be unreasonable to blame Harvard graduates entirely for this Global Financial Crisis.

It's a bit like blaming Oxford University for Robert Mugabe and the downfall of Zimbabwe. I know that President George W. Bush went to Harvard, but the seeds of this Global Financial Crisis preceded President George W. Bush. It actually goes back to President Roosevelt.

I know that Warren Buffet was knocked back in 1950 at the age of 19 when he applied for admission to the Harvard Business School.

Buffet would later come to consider his rejection by Harvard as the pivotal episode in his life.

On being knocked back he immediately started investigating other graduate schools and, while leafing through the Columbia catalogue one day, he came across two names that were familiar to him: Benjamin Graham and David Dodd.

They were both big names to him as Buffet had just finished reading Graham's book *The Intelligent Investor*.

Buffet was accepted at Columbia and the rest is history.

Okay, well let's focus on who actually went to Harvard.

There have been some remarkable people, such as Jeff Skilling, the former CEO of Enron.

However, the evidence I'm relying on tonight are copies of Case Study notes that appear to have fallen off a truck and mysteriously come into my hands.

They are obviously Case Study notes for some of the finance courses involved in the design and marketing of toxic derivatives and based on sub-prime mortgages.

I have no way of vouching for the authenticity of these documents, however they sound about as authentic as the financial products that were wildly marketed with high commissions, around the globe.

Here's one.

#1
Once upon a time in a village in India, a man announced to the villagers that he would buy monkeys for $10.

The villagers, seeing that there were many monkeys around, went out to the forest and started catching them.

The man bought thousands at $10, but, as the supply started to diminish, the villagers stopped their efforts. The man further announced that he would now buy at $20. This renewed the efforts of the villagers and they started catching monkeys again.

Soon the supply diminished even further and people started going back to their farms. The offer rate increased to $25 and the supply of monkeys became so little that it was an effort even to see a monkey, let alone catch one!

The man now announced that he would buy monkeys at $50. However, since he had to go to the city on some business, his assistant would now act as the buyer, on his behalf.

In the absence of the man, the assistant told the villagers: "Look at all these monkeys in the big cage that the man has collected. I will sell them to you at $35 and when he returns from the city, you can sell them back to him for $50".

The villagers squeezed together their savings and bought all the monkeys. Then they never saw the man or his assistant again—only monkeys everywhere!"

Welcome to WALL STREET.

#2
Young Chuck moved to Texas and bought a donkey from a farmer for $100. The farmer agreed to deliver the donkey the next day. The next day he drove up and said, “Sorry son, but I have some bad news, the donkey died.” Chuck replied, “Well, then just give me my money back.”

The farmer said, “Can’t do that. I went and spent it already.” Chuck said, “OK, then, just bring me the dead donkey.” The farmer asked, “What ya do with him? Chuck said, “I’m going to raffle him off.” The farmer said, “you can’t raffle off a dead donkey!”

Chuck said, “Sure I can, watch me. I just won’t tell anybody he’s dead.” A month later, the farmer met up with Chuck and asked, “What happened with that dead donkey?”

Chuck said, “I raffled him off. I sold 500 tickets at two dollars a piece and made a profit of $998. The farmer said, “Did anyone complain?”

Chuck said, “Just the guy who won. So I gave him his two dollars back.”

Chuck now works for one of the two remaining US Investment Banks.

How serious is this Global Financial Crisis?

It’s hard to get a handle on this, partly because of all the colourful language and the accent on the words that strike fear into the hearts of innocent bystanders.

Commentators use metaphors rather than speak in precise terms.

Phrases like, “freezing up” are used in the same sentence as “melting down”.

“Credit is the life-blood”, “toxic assets” “a crushing economic contagion”.

In measuring this Crisis, we now use the remarkable word trillion. Just exactly how much is a trillion dollars? If US$1 trillion was piled in $100 notes, the stack would be 12,400 kms high (i.e. the distance from Perth to Athens).

We must be careful in reporting on a Crisis of this dimension as this can create self-fulfilling prophecies, but after sorting through much evidence it does appear that there are up to US$60 trillion worth of these “toxic” derivatives that have been sold and distributed, with commissions paid, around the world.

To see if this is a really significant number let’s relate it to the total value of all the world’s economies, i.e. the value of the world, which is US$72 trillion.

So, the good news is, that the world just falls short of being terminally ill.

William Buckler (www.the-privateer.com) describes what we are seeing (Nov. 2008) as The Great Deflation.

> "More than $US 32 trillion has been erased so far from the value of global equity markets. That is twice the size of the entire annual US GDP.
>
> That is the carnage in only one area. There are two other global deflations, the one in real estate and the worldwide crash in commodity prices. Add those to stock market losses and the damage exceeds $US 50 trillion."

What's the cause of this problem?

The following is a classic case of over simplification, but easy to remember:

> Americans borrow and spend.
>
> Whereas, the rest of the world –
>
> Produces and saves.

Does this mean that Americans are only good at shopping with borrowed money? Probably one of the best people to answer that question may have been William Shakespeare (1564 - 1616) who, in Hamlet, said,

> "Neither a borrower nor a lender be,
> For loan oft loses both itself and friend,
> And borrowing dulls the edge of husbandry."

One of the best "single-pagers" on the causes of this crisis was sent to me by Yoon Chang-hyun (Professor of Business Administration, University of Seoul, South Korea).

His comparisons with the earlier Latin American and Asian crises also helped.

What has brought on the U.S. financial crisis?

"The U.S. has been staggering from one of its worst financial woes in recent days, ending its decades-long global leadership in the direct financial market with some of its once overbearing investment banks suffering a disgraceful failure or forced sale. Latin American countries fell into a crisis in the 1980s when the loans heavily extended by the commercial banks in the euro-dollar market were defaulted. The Asian financial crisis in the late 1990s was also triggered by banks overstretching their loans beyond the borrowers' payment capability.

The U.S. appears to be in a different situation. The U.S. financial crisis is closely related to the entire financial sector, including commercial banks and investment banks. The usual business for commercial banks is to extend mortgage loans and receive principals and interests. But the U.S. commercial banks created mortgage-backed securities by selling the rights to the principal and interest.

Investment banks came to be involved in the securitization of the loans. They enjoyed huge commissions by making and selling securities backed by mortgage loans. Through the securitization, the commercial banks could receive the money and lend it again. Whenever this cycle repeats, the financial companies can make more money. In short, the commercial banks and investment banks have been overstretched in this business.

When the asset-backed securities were sold, the proceeds were lent again and again, with the loans snowballing and reaching to sub-prime borrowers [many with variable rate mortgages]. An excessive amount of funds were used as mortgage loans. Then the housing prices unexpectedly stopped their years-long booms and began to bust, sending all the mortgage loan-related financial companies into distress.

Commercial banks who lent the mortgage loans, investment banks and hedge funds who raked up asset-backed securities and collateralized debt obligations, and the monoline insurers who wrote protection for the assets held by those banks all fell into a whirlwind. The mortgage insurers Freddie Mac and Fannie Mae were taken over by the government. [Both of which were originally set up by the U.S. Government as a lender of last resort for borrowers who couldn't match prudent lending standards, then vigorously expanded to "keep the ball rolling". (see Fig. …… being the N.Y. Times 1999 full page article). Lehman Brothers filed for bankruptcy and Merrill Lynch was forced to sell its assets. The world's top investment bankers, Goldman Sachs and JP Morgan, decided to turn themselves into commercial banks. With a US$700 billion bailout plan for the financial sector passing through the U.S. Congress, all eyes are now on how to contain and end the Global Financial Crisis.

A European View

To represent one important European point of view, a joint press release by 38 European Economic Think Tanks was dispatched from the European Resource Bank meeting in Tbilisi, Georgia. It reads as follows:

Government Made the Global Financial Crisis; Let Us Not Make It Worse
15th October, 2008

Representatives of economic policy organizations throughout Europe released the following recommendations to deal with the Global Financial Crisis.

The basic cause of the Global Financial Crisis was that the U.S. government, along with other governments, engaged in excessive credit expansion and pressured banks to make loans—particularly home loans—to unqualified buyers.

Therefore:

1. We believe that responding to the credit crunch by adding more liquidity in the market is a short-term fix that will only help banks that were mismanaged, and will fuel inflation.
2. We believe governments should facilitate, and not hinder, the process of the market determining prices that realistically reflect supply and demand.
3. When hard times come, governments should share the burden with businesses and consumers (cut public spending and taxes) and not try to insulate themselves from the harm they have caused.
4. Governments should refrain from rescuing particular businesses or business projects. The cost of saving businesses that failed will fall on the

shoulders of others, through increased taxes, inflation, or capital misallocation.

Free market capitalism has proven to be the only system which leads to sustained economic progress and respect of human liberty.

Signed ………….

The rest of this is reported @ www.rbeurope.org

Whilst in that part of Europe it's interesting to learn from the words of the head of the Georgian State Chancellery (Kakha Bendukidze). Richard W. Rahan in the *Washington Times*, Oct. 15 2008, reported;

> "Commenting on the Global Financial Crisis, he [Bendukidze] correctly observed that as long as governments continue to rely on central banks and extensive regulation of the financial industry rather than free banking, "periodic financial crises will continue to plague mankind." He argues that it is unrealistic, as Hayek and Friedman also did, to assume central bankers know more and can outguess the market, and that financial regulators can somehow prevent the next crisis, since they are unlikely to see where it is coming from.
>
> Georgia does have problems, including the large number of refugees resulting from the war. But unlike Washington and the European governments, the Georgian leaders did not deal with their crisis by creating the new "program of the day." Instead, they told the people the government would continue to stay out of their way and the people would have to find ways to solve the new problems. Most of them have done that quite well and the government remains highly popular."

Was this crisis predicted? Yes, by so many people.

Ranging from writer philosopher, Ayn Rand in 1959—"Watch money. Money is the barometer of a society's virtue. When you see that trading is done, not by consent, but by compulsion—when you see that in order to produce, you need to obtain permission from men who produce nothing—when you see that money is flowing to those who deal, not in goods, but in favors—when you see that men get richer by graft and by pull than by work, and your laws don't protect you against them, but protect them against you—when you see corruption being rewarded and honesty becoming a self-sacrifice—you may know that your society is doomed."(3)

Through to economist Nouriel Roubini (known as New York University's Dr Doom).

Through to Peter Schiff's prediction of the 2008 Crash (http://www.europac.net/) and http://www.garynorth.com/public/4251.cfm

To Australia's William Buckler (www.the-privateer.com), who has also been predicting the nature of the collapse and its expected severity for years. Buckler's recent (June 15, 2008) comment is, "What people are witnessing, though comparatively few of them yet realise it, is the end effect of the debasement of money. They are watching the purchasing power of the monetary unit decline with increasing rapidity everywhere."

However, it’s interesting to observe that neither the Australian Treasury nor any current politicians had ever suggested that this event might happen.

That’s interesting when they are so precise about predicting what average global temperatures are likely to be in 2020, 2050 and even 2090.

For a very comprehensive overview of the history and causes, let me direct you to Niall Ferguson’s *Vanity Fair*, Dec. 2008 article, “Wall Street Lays Another Egg.”

http://www.vanityfair.com/politics/features/2008/12/banks200812?

Will the Various Bailouts Work?

How can they?

Wasn’t the relaxation of prudent loan requirements a key factor that got us into the mess in the first place?

It seems a little odd that the solution to the problem is to encourage more imprudent consumer borrowing.

Isn’t it strange that in all this discussion of how to fight the Crisis that so far, there has been little mention of introducing some prudent lending requirements such as requiring a deposit, and checking on the client’s ability to service a loan? It should be in the lending institution’s best interests to do so, rather than it being a government legislated requirement.

You might gather that I’m somewhat sceptical about government programmes.

Larry Winget at www.larrywinget.net/blog puts it well when he says:

“When the government says that something will cost a dollar, it will cost three. One for the program. One for government waste to implement the program. One for someone to make money off the program. Also, any government program takes twice as long to implement as promised and does half as much good as promised.”

One of the reasons against the US$700 billion Bailout working, is that it appears to be rewarding the wrong people.

The message Bailout clearly sends is that “unless you are Big Business” we don’t want to hear from you. You need to be in the “too big to be allowed to fail” category to get a seat at the table.

This is entirely ignoring America’s core business identity: Small Business.

Over the last six months (to Oct. 2008) U.S. Big Business had lost more than 170,000 jobs, while Small Business created 200,000 jobs (www.fastcompany.com).

What about all the calls for more controls and more regulations?

We already have too many rules and regulations, but the question should be asked, what have these regulators been doing?

For example, Fannie Mae and Freddie Mac had 200 regulators working within these organizations. Doing what?

It was these regulators who enforced the government legislation that home loans be granted to people without any hope of repayment.

What could work?

Again, it comes down to aligning the rewards and punishments to go to the right people.

We have seen the villains walk away with the prizes and the innocent bystanders incinerated, so there should be a test to see if a remedy for this Global Financial Crisis fits the fairness criteria.

Perhaps the marketers of sophisticated financial "products" should be paid in the currency of these "products".

In discussing this problem last month, with a friend, Sir Arvi Parbo AC, he felt that we had a lot to learn from the Roman Empire, and his comment was, "The Romans tested the integrity of their engineers by requiring them to stand under the bridges they built while the scaffolding was being removed. Today's financial engineers not only will do their utmost not to be identified as having built the bridge but will be as far as possible from it when it is opened to traffic."

Whose advice could we follow?

In looking at the earlier theme of rewards for behaviour, both good and bad, it's important to identify the moral hazard caused by the U.S. Congress and the Federal Reserve in rewarding reckless lending and borrowing.

Further rewards for past bad behaviour will only create a bigger crisis next time.

This may not be a problem for the politicians (as they may have moved on by then). However, for the rest of us in the real world, it remains a problem. Particularly for our children and grandchildren, as they will inherit our debt!

If we personally have any financial stresses and strains, a good remedy is a dose of deleveraging, which is simply the reduction of debt and leverage.

Big business and banks know this and that's why they are deleveraging with a vengeance.

Then how is it that governments continue to encourage their "subjects" with offers of more cheap credit, to do just the opposite and continue spending and consuming?

The smart money is doing one thing, but encouraging consumers to do the opposite.

If survival is important to us, just ignore such advice and do the opposite.

Peace of mind can easily be bought by reducing debt and living off our cash flow.

Let me conclude with …..

The challenge remaining for all of us as we move forward

I'm looking forward to the new post 2008 financial environment even though many of us will have to contend with some "strong head winds". Similar to previous downturns when the commodities we produce, or the countries we represent, or the philosophies and belief systems we promote are somewhat "on the nose".

To me it's somewhat reminiscent of the 1990s era of W.A. Incorporated when we had two Premiers and a Deputy Premier spending time in jail.

We just had to put our heads down and work a little harder in order to restore the moral fabric of our State.

In many ways a similar challenge is now faced by Americans as they work even harder at restoring the "made in USA" brand. However, always remember; the sun always shines through—it always does!

Of great concern to me is how our liberties and our freedoms and our general level of civility have all been severely damaged. First, by these few years of terrorist actions and threats and now the financial ponzi scheme collapse.

If we do nothing, we are likely to see a ratchet effect and we'll continue to lose freedoms but never regain any. Alternatively, we can be proactive and work toward restoring trust, freedoms and civility.

My favourite economist, Friedrich Hayek, once analysed our free society and offered a sobering speculation:

> "It may be that a free society as we have known it, carried in itself the forces of its own destruction, and that once freedom is achieved it is taken for granted and ceases to be valued" ... and then he went on to ask, "Does this mean that freedom is valued only when it is lost, that the world must everywhere go through a dark phase of socialist totalitarianism before the forces of freedom can gather strength anew?"
>
> He answers, "It may be so, but I hope it need not be."
>
> Hayek then offered his remedy to this threat. He argued that, " … if we are to avoid such a development, we must be able to offer a new liberal program which appeals to the imagination. We must make the building of a free society once more an intellectual adventure, a deed of courage."[(4)]
>
> (*The Intellectuals and Socialism*, F.A. Hayek).

Another colleague, the Rev. Robert Sirico,[(5)] (Acton Institute—Michigan) adds another dimension to Hayek's advice. "We must make the building of a free society once more a *moral adventure*—for its construction was morally inspired in the first place. It emerged from a vision of man as a creature with an inherent and transcendent destiny. This vision, this anthropology, inspired the institutions of Western Civilization: Universal human rights; the right to contract and private property; international institutions of charity; the university. All these formed because of the high view of human dignity we inherited from our Judaeo-Christian tradition."

Friends, from your privileged position as business and community leaders; please join me in the challenging process of rebuilding this free society.

(1) http://www.mannkal.org

(2) http://www.mannkal.org/bookshop.php?isbn=0859051757

(3) Atlas Shrugged by Ayn Rand

(4) The Intellectuals and Socialism, F.A. Hayek

(5) Acton Institute—Michigan – http://www.acton.org/