The Political Forum

A review of social and political trends and events
impacting the world's financial markets

Mark L. Melcher
President
melcher@shentel.net

Friday, September 6, 2002

A REPRINT FROM A PIECE PUBLISHED SEPTEMBER 27, 2000

MEANWHILE IN PRAGUE

Mark L. Melcher
Stephen R. Soukup

While American investors and market watchers were busy last week trying to determine the cause and possible duration of the sell off in the U.S. equity market, some of the world's dumbest economists and financial bureaucrats were getting together in Prague with some of the world's slickest economists and financial bureaucrats, cooking up a stew of "policies" that, if implemented, could eventually, I believe, set off a worldwide bear market that would make the past few weeks look like a picnic.

Like a gaggle of mad scientists busily trying to burn down their own laboratory, these "masters of the financial universe" as one reporter called them, are, among other things, seeking international bureaucratic "solutions" to such thorny issues as rising oil prices, skyrocketing third world debt, a sickly Euro, and, as one reporter put it, "the downside of globalization."

Now, I am no "master of the financial universe," but I sincerely believe that the best way to turn each of these problems into a worldwide catastrophe is to turn them over to a group of dumb economists and smart crooks who have enough collective power to assure, each group for different reasons, that true market solutions are never even tried.

Frankly, I don't understand why these people even need to meet to determine the best approach to each of these problems. Why not, I can't help wondering, simply look in any ordinary 1950s era freshman economics text book from any major U.S. university? There, they would, I believe, find enough basic economic knowledge to lead them to some variation of the following conclusions.

o That the "solution" to rising oil prices is to pay these prices. This would promote increased production, the development of alternative energy sources, and more economical fuel use.

o That the "solution" to skyrocketing world debt is to let lenders eat that portion of the debt that can't be paid. This would put what is known as "moral hazard" back into the financial marketplace, and force debtor nations to shape up, if they wish to continue to borrow.

o That the "solution" to the falling Euro is to cashier the "planners" in Brussels. Socialism doesn't work, and shouldn't be indulged.

o That the solution to the "downside of globalization" is for lenders and investors to be extremely careful with their own and other peoples' money in this "new world order;" that lenders should establish reasonable risk profiles in their loan portfolios, based on their own ability to withstand losses, in recognition of the fact that the post-cold-war international marketplace is awash with crooks and charlatans, many of whom are at the highest levels of the governments of some of the worlds most powerful as well as some the worlds weakest nations.

o That "solutions" that deviate too far from these, or to put it another way, that ignore fundamental laws of economics and human behavior, are absolutely certain to make matters absolutely worse in the long run, most especially for the world's poorest citizens, who have little protection from the combined actions of politically empowered ignorant utopians and malevolent crooks.

Space does not permit an extensive defense of these opinions. So let me briefly elaborate on them, in the context of an article about the Prague conference in the Sunday *Washington Post*. The piece was written by *Post* reporter Steven Pearlstein and entitled, "Debating How to Repair Global Financial System." For starters, Pearlstein noted the following.

> In recent weeks, officials at the U.S. Treasury, The World Bank and the International Monetary Fund have taken great pains to trumpet moves they've already taken to redesign the global financial architecture since the crises in Mexico, Asia and Russia. These include discouraging countries from pegging their currency to the U.S. dollar while shaming them into improving their bank regulation and publishing timely reports on their national balance sheets. Last week, the IMF board of directors also voted to cut back slightly its long-term and repeat lending to countries so it could refocus its resources and attention on its role as lender of last resort when the next global cash crisis hits.

Now, not to be condescending here, but just in case you missed it, gentle reader, the key word in this passage is "when" as in "when the next global cash crisis hits." Why, one might ask, given that the attendees of this conference are "masters of the financial universe," couldn't it have at least read, "if," as in "if the next global cash crisis hits"? I mean, am I being silly to question why, if these guys are "masters of the financial universe" they are preparing for the next financial crises rather than trying to prevent it?

Not surprisingly, the answer to this question can be found in the same passage that raised it. The answer is that the "masters of financial universe" who are trying to "redesign the global financial architecture" in Prague are the very same geniuses that designed the global financial architecture that they are redesigning, the one that led to "crises in Mexico, Asia and Russia" and which, as the article states, is so bad that it assures that there will be another "global cash crisis," even if they actually succeed in "redesigning" it.

Now this sounds a little complicated, I admit. But it can be easily understood if one remembers something I said earlier. That is that these "masters of the financial universe" can be divided into two groups.

The members of the first group are what I would call ignorant innocents. They are innocent of any real knowledge of economics, sociology, or political science. And they are innocent enough to believe that meetings such as the one in Prague truly are about "redesigning the global financial architecture" with the goal of making the world a better place. Moreover, they are people who truly believe that people like them could actually do such a thing if they were only given a chance. In short, they are socialists.

The second, smaller but more powerful group, the crooked charlatans, I'll call them, are not stupid. These people know that the whole idea of a bunch of economists and bureaucrats sitting around a room in Prague "redesigning the global financial architecture" in such a way that everyone will be happy and rich is dumb.

These are people who are there because this is the not just the biggest financial game in town, but the biggest financial game in the world. These are representatives of the sharpsters who have learned that there is a lot of money, billions and billions of dollars in fact, to be made in the international bad loan business, so long as the "global financial architecture" is designed in such a way as to protect both lender and borrower when the loans go bad. These people can be divided into two camps, those whose friends make money on the lending side, and those whose friends steal the money after it is loaned.

If this sounds cynical, let me refer readers back to the paragraph from Pearlstein's article, in which he notes that the IMF is saving up money in preparation for the "next global cash crisis" so it can "refocus its resources and attention on its role as lender of last resort."

Hello? Is this an invitation to corruption, or what? Can someone tell me again why the IMF, which is funded by American taxpayers, should be saving up money to be the "lender of last resort" when a group of international investment bankers make a bunch of bad loans to a country run by a bunch of economic ignoramuses and crooks?

Pearlstein notes that I am not the only one asking such questions. In fact, he says that several of the arguments in Prague over what should be done to prepare for the "next global cash crisis" arise "from criticism of the rich nations' handling of some past financial crises--notably those in Mexico and some Asian countries--because the emergency loans were used largely to pay off foreign investors and lenders, while the general populace was left to suffer the effects of economic austerity and, in some cases, deep recession."

Pearlstein doesn't say it, but the "rich nations" to which he refers are (despite the plural) the United States. And, once again, while he doesn't say it, the "foreign investors and lenders" to which he refers are those giant U.S. investment banking firms with friends who helped “design the global financial architecture” that arranged the “emergency loans” to bail them out.

Pearlstein notes that Canada and Britain will “push for clearer guidelines” on how it will “bail in” private investors in the future, when the next collapse occurs. But he also notes that the Clinton administration, represented by Robert Rubins’ successor at Treasury, Larry Summers, “prefers the current system.”

Well, of course, says I. Wouldn’t want the American bankers, especially those who contribute large amounts to Democratic campaigns, to foot the bill for their bad loans, now would we? Why, they might stop lending to people who don’t have a prayer of paying them back, and that could cause a “global cash crisis.” Right?

Once again, let me point out that I am apparently not the only one who wonders about such things. Pearlstein doesn’t give us the names of any other such cynics, but he quotes a guy named Morris Goldstein, a former IMF official and now senior fellow at the Institute for International Economics in Washington as follows.

> There’s a tendency to assume that when the Treasury or the Fed opposes what looks like a good idea, it’s out of some cynical impulse to protect the interest of the big banks or Wall Street.

Goldstein assures us, this is not true, that cynics such I and others who have “a tendency to assume” that when something walks like a duck, it usually is a duck, are wrong. There is, he says, a much simpler, and more reassuring, explanation. That is that the people at the Fed and the Treasury are basically stupid. Or, as he put it, “In fact, most of the time, they just don’t feel they know how to do it.”

In the meantime, the “masters of the financial universe” are busy in Prague working out plans to respond when the “next global cash crisis hits.” And America’s bankers are busy preparing a long list of new offerings in foreign debt, including billions and billions of dollars of loans to a morally bankrupt, socialist nation called China that has one very important thing going for it, namely that it is “too big to fail.”