

Our Economy

The future is a wonderful place. Because you can borrow from it.

Nobody really owns a house, not normal people anyway. They only rent it. They either rent it from a landlord or they rent it from a bank, through something called a mortgage. Some landlords actually rent their real estate from the bank and then sublet it to some hapless tenant. Renting from a landlord is less risky. Renting from a bank means that you are likely to either make a colossal amount of money if property prices rise, as they have in places like Hong Kong or Singapore, or you might lose more than everything including your pet cat, if property prices slump, as in places like Florida or Nevada.

But you don't really have a choice. Cheap housing doesn't really exist in cities where the jobs are. Jobs are only available where expensive real estate is on hand to relieve you of your hard earned wages. Cheap real estate is only available where jobs are cruelly scarce.

So it makes sense to be a landlord or homeowner, but only if property prices are rising or if you don't have to rent your real estate from a bank.

A long time ago you would buy a house with a mortgage and would have had a good chance of paying off this mortgage before having to move into a pine box carried by six of your best friends. There was a point in time when the bank would hand you back the keys and the deeds to the property. These days you're more likely to refinance and rollover your mortgage and home equity debt until a point in time when you handed the keys to the house over to the bank or the bailiffs. It is a sad state of affairs, and it is not exclusively American or Western.

Debt is not bad. It enables and it facilitates. Problems arise when we start taking it for granted and lose sight of the obligations to repay it. So ingrained is debt and how it is regarded that it has become a cultural phenomenon.

Whereas debt used to be a good thing that allowed you to enjoy something today which you envisaged being able and willing to pay for in the future, today debt is just something that allows you to enjoy something today, period. The obligation and the ability to repay has been relegated to a mere irritation.

Soon households began to repay credit card debt with other credit cards, cycling their debit balances whenever they came due. This practice while initially frowned upon has become standard practice for even high grade corporate issuers and indeed has been turned into an art form by sovereign issuers. It seems today that even sovereign bonds are PIKs (Payment In Kind bonds, kinda like junk, usually worse.)

So ingrained in our society has this practice been that it is the de facto financing mechanism for buying cars in the UK from a Toyota to a Porsche. White Bentleys with mirrored glass tend to be paid for in used hundred dollar bills with non sequential serial numbers in patent croc carryalls borne by big men in dark suits...

Installment plans can be found for everything from luxury watches to designer clothes. Store credit cards continue to be dealt out by croupiers in the basement of Harrods or the fifth floor of Harvey Nichols. And everyone seems happy to rent their clothes, cars, mobile phones and iPads.

All we need is time. It will be better tomorrow. This time next year we'll be rich.

Pensions. A defined benefit pension defies the concept of responsibility and quite frankly is naïve. A defined contribution pension is fairer and more practical. Even that,

however, can be gamed. If the trustee of a defined contribution scheme exposes the scheme to credit risk in a conflicted or cavalier fashion, what recourse is there? What preventive or preemptive action can be taken? Some of the arguments and proposed solutions to pension underfunding have an unmistakable kleptocratic logic to them. 'Raise the pension age' really means don't pay the old codgers so soon and let's see if we get lucky and some of them die. 'There's no problem, they have home equity' really means, let them eat cake, they seem to have money anyway, how dare they take back what they've paid into over the last 40 years. Countenancing an arithmetic that involves an arbitrary and mandatory cash transfer between generations is institutionalized theft. Besides, pensions discourage discretionary saving, and a misplaced belief in the promises of companies and states. Ultimately, we are on our own and if you don't believe that then trust your pension, your bank, your banker, your accountant, your member of parliament, prime minister, president, generalissimo et al.

I would honestly like to know what happens when a corporate or a state is no longer able to meet its pension liabilities. An employee provides their services on 30 day credit to their employer and on 30 year credit to their employee pension fund. What happens when companies just cannot hire anymore? What does that say for the structure of business organization? Already the British public sector workers have woken up to the fact that their easy ride has run away.

The human race is great at depleting things. Just as we deplete all the stuff in the ground that powers our planes, trains and automobiles, and holds up our glass and steel towers, we deplete our future leaving a massive burden of debt.

This is a consequence of living beyond our means and getting ahead of ourselves. Yes it makes sense to borrow to buy today what we can pay for tomorrow. But it is not alright to borrow

to consume today and expect future generations to pay for it. There are limits to profligacy and we have stepped well over the limit. We laugh at the thrift and inefficiency of some of the more backward nations, nations from whom the Europeans now hope to obtain a loan, and then have discovered to their surprise and dismay that these nations actually have some sophisticated underwriting standards. They actually expect to be repaid in money that's worth something in cold hard stuff.

Chapter 11 is good in that it allows companies to get back on track to profitability. Personal bankruptcy gives people a second chance to rebuild what has been lost, or spent. But safety nets have two sides, one that saves and another that encourages irresponsible behaviour.

Another broad phenomenon has been the fall of communism and the lack of a counterbalancing force to capitalism. Without a dual, capitalism has evolved in a perverted way. Where once the system would reward and punish decisions in equal measure, the type of capitalism practiced today rewards but does not punish. At least it tries at each turn to bail out investors, to entrench management, to enrich the powerful. How can the price signal work if its distribution is deliberately skewed to the upside? The system attempts to blunt the punishment to inefficient resource allocation and poor decisions. The spectre of moral hazard hangs above every market and economy, holding policy and governments hostage to the concept of 'too big to fail.' Without an alternative regime, a competing model, there is no incentive to refine, improve or keep the capitalist model honest. Even the communists have adopted capitalism, albeit without democracy. This unbridled form may be even more cutthroat than the original model where minority rights actually meant something, instead of being swept away in a torrent of economic growth.

The perversions of capitalism have led to excessive debt without the recognition of responsibility and hence an absence of a credible long term solution, also moral hazard writ large

which have policymakers doing what the market wants, and price distortions the result of asymmetrical efforts to support special interests. These make the current trajectory of economic development unsustainable and unstable.

Already the degree of intervention in markets and the economy has reached unprecedented levels. Central banks have bloated their balance sheets monetizing debt issued to finance Keynesian fiscal policies. Fictional bank stress tests are applied to signal strength where there is weakness. Regulators require more conservative practices from banks while governments require credit profligacy. Central banks extend credit to one another in a kaleidoscope of capital they hope no one can trace or fathom. And accounting standards have developed, or degenerated, depending on your point of view, to the point that they can no longer be considered generally accepted.

Something has to give and suddenly the future is not so wonderful a place. Because we've borrowed the living daylights out of it.