

The Circle of Manipulation

June 2010

“Where did all those banks put that TARP money?” Hey wait, there’s still TARP talk?

I was on a long drive back and forth to Laredo, TX with one of my brothers. We were doing the twelve hour round trip to see, for maybe the last time, an uncle in poor health. This brother is an attorney, fairly well informed on the way of business. He has good common sense and the intellect to understand most anything. But he couldn’t understand where that TARP money went. “Did the banks just lend it out to their friends? They certainly didn’t lend it to regular folks.”

TARP is so 2008 and 2009 I had almost forgotten about it. Many of those banks have already “paid” that money back. Given TARP’s exorcism from my conscious memory shows how easily we forget and/or how many other BIG issues continue to pop up...health care reform, financial regulation, oil spills, sovereign debt crisis, Korea crisis and even launch of the iPad. But the current circumstances in Europe made my brother’s question once again relevant.

“The banks took that TARP money and bought Treasuries with it.” “So wait”, my brother asked, “You mean the Federal government borrowed money to give the banks money that the banks used to buy debt issued by the Federal government?” “Yup”, I replied, “That’s about how it worked”. “So the government borrowed money at say 3% and they lent it to the banks at 1% who then bought government debt that yielded 3%? How does that work?” You can see why I am a proud sibling of my five brothers and sisters.

For a few weeks a while back I was calling this “the great circle of manipulation”. Taxpayers were saving the financial institutions so they could make more money off... the taxpayer. It almost seemed as ridiculous as when George Bush suggested, “We need to intervene in the free market to save it”. “Huh...what was that you said? Intervene to save the free market?”

Europe is now about to start the shell game. In a slight of hand sort of way the ECB is going to buy the crummy PIIGS debt currently held by European financial institutions. The ECB is going to “TARP out” these financial institutions...at the expense of European taxpayers.

Bad financial institution decisions are leaving their balance sheets and moving on to the taxpayers’ balance sheet. No debt has been eliminated. Actually the amount of debt owed continues to grow only now the responsibility for that debt is being transferred from those who made poor investment decisions to the now growing poorer by the day taxpayers. And the investor class wonders why so many on Main Street are ready to tear down Wall Street and Washington as well?

It’s truly a “great circle of manipulation” between governments and financial institutions to “save the free market”. More than anything it seems to be government’s attempt to not be blamed for their poor oversight and regulation. Why admit your mistakes if you can hide them?

Armchair Economic Perspective
The Circle of Manipulation
June 2010

If you asked anyone in Washington, and anyone whose livelihood is dependent on Wall Street, what the heck is going on they would surely suggest, “This is just the lesser of two evils.” “If we didn’t save the free market from itself then the social calamity would be horrendous.”

What seems to escape them is how shifting debt from investors to taxpayers while simultaneously increasing the amount of debt isn’t likely to lead to something even more horrendous. Debt is debt. It has to be paid back one way or another...or it doesn’t. There seem only three ways to get out of debt.

You can earn your way out. This is what the honorable person does. They accept their liabilities and work hard and diligently to repay that which they owe.

You can default. This must happen when it is obvious the debtor can never totally repay. It is executed via bankruptcy or renegotiation with creditors on how much debt will/can be repaid.

You can steal your way out. This results in a life of crime for the individual. But for the sovereign nation, this may be best described as inflating your way out of debt. By destroying your currency you end up paying creditors back less than they thought you owed them.

That’s it. There is no other way to get out of debt. And earning your way out is the only honorable, principled, of societal value way to do it. The other two are for those of loose morals, who are “trying to save the free market from itself”...or better said are just trying to save their own personal skin...their own personal balance sheet...their own personal position of power. So today we have the U.S. and Europe kicking the can down the road in “hope” that some very positive “change” will save everyone from the financial obligations we have acquired and can no longer really afford.

As previously published in Armchair, organized societies seem to have a natural socioeconomic cycle. They go from insecurity to desire to accomplishment to confidence to complacency to disaster and then back to insecurity. Certainly the “hope” that some very positive “change” will one day relieve us of our liabilities is testament to our current stage within this grand socioeconomic cycle...complacency.

We expect the good ole days will soon return so for now we are just going to “mend, extend and pretend” until they do...or until they don’t. But it appears more and more likely the good ole days won’t really return until after we have lived through a crisis of such magnitude that society once again values honor over wealth. Is it honor that begets wealth, or wealth that begets honor? If not the former, then why play the game of free enterprise with any compassion at all?



Douglas A. Leyendecker
713-862-3030
doug@armchaireco.com