VOLUME X No. 213 **W E D N E S D A Y** **November 12, 2008**

WHAT THE WORLD REQUIRES, TODAY:
A CATEGORICAL, MORAL IMPERATIVE

Animals and plants die of old age.

Financial crises rarely do.

For the most part, crises of all kinds have more in common with each other than is rarely appreciated.

For financial crises, many people maintain that one learns from the lessons of the past.

It is not so, sadly.

The present financial crises has its roots in the US; and, the *'fungus'* from The Land of The Free and The Home of The Brave has spread throughout the world.

And the leaders of the Western World have weighed the moral hazard and have made a determination.

That determination is very similar to the determination, going back a complete century to The Panic of 1907.

In that financial crisis, there were numerous runs on banks and trust companies in New York City, following a failed attempt by some investors to corner the copper market.

Since, in those days, there was no lender of last resort, it took a group of well-healed and determined bankers to form The Trust Company of America, which acted, first as a brake, and, then, as a buffer: *'The trouble stops here!'*

It was the stern and unfaltering will, strong leadership, stentorian and clear communication – in the case of the 1907 crisis, it was the legendary banker, John Pierpont Morgan (recognise the name?) – that eventually brought about the resolution to the crisis.

But it was not without a cost.

In any financial crisis, there are always, at least 2, diametrically opposed solutions:

(a) Do nothing and permit the crisis to burn itself out; and/or,

(b) Provide a lender of last resort.

In order to make a determination as to which course of action to take, assuming that a combination of (a) and (b) is not the likely solution, the following considerations are paramount:

(a) The size of the potential damage that may be forthcoming due to the knock-on effect in the event that (a) is chosen; and,

(b) The cost of providing a lender of last resort (b).

Central banks, around the world, have come to be the lenders of last resort and, thus far, these central banks have proved to be somewhat effective in smoothing the ruffled feathers of investors who have been burnt by the most-recent financial crisis.

One of the many problems, facing central banks, today, is that they are being seen as potentially nationalising certain banks and financial institutions and at least one, major insurance giant.

Put another way, if, as in the case of the US Federal Reserve, this central bank continues to take material equity stakes in banks, financial institutions and insurance companies, in effect, it is tantamount to causing US taxpayers to fund the mistakes of private enterprise.

A counter argument is that The Fed has little choice in the matter because to permit entities, such as **A**merican **I**nternational **G**roup Incorporated (**AIG**), to fail would result in there being a ripple effect right through the US economy – and elsewhere, too.

Therefore, the only alternative, in the case of AIG, was to make available at least $US80 billion to this ailing insurance provider, which happens to be the biggest in the world, today.

By this action, The Fed ended up as the largest, single shareholder of AIG, owning, beneficially, in excess of 75 percent of the Issued and Fully Paid-Up Shareholding of the company.

The resultant effect of this move is that, today, that political determination has caused The Fed to privatise profits while socialising losses.

Which is not, exactly, in keeping with the philosophy of a free-market economy, laissez faire, or non-interference by government in private enterprise.

With The Fed, The **E**uropean **C**entral **B**ank (**ECB**) and The Bank of England, just to name 3 central banks, having made it known, widely, that they will not permit their respective economies to be held hostage to maladministration and/or nefarious activities of lending institutions, either by accident or design, that knowledge, explicitly or implicitly conveyed, has caused market participants to react rather circumspectly.

If The Fed, the ECB and or The Bank of England had not demonstrated their concomitant willingness to take firm action in tackling the financial crises of their respective economies, market participants may have acted completely differently.

When one knows that one must pay the full penalty for the mistakes that one is likely to make, one is quite likely act in a manner with a view to minimising any potential errors.

Conversely, when a lender of last resort is known to be standing in the wings, so to speak, the managements of weak financial institutions may take it upon themselves to engage in more risks than they, normally, would care to consider.

But, the more times that such institutions go to the financial *'well'* for water, the greater are the chances that these financially weak institutions will, eventually, be turned away: The *'well'* is dry.

Once such a financial institution is permitted to fail due to non-action by a lender of last resort, the attitude of the managements of other financial institutions take note of the situation and act, accordingly, in order not to follow the example of the failed financial institution.

After all, the question could well be raised: Which institution will be next in line to permit it to fail?

The lender of last resort, as in the case of The Fed and AIG, the moral hazard had to be measured and weighed, carefully: The short-term risk weighed on the scales of the reflection of national values.

If AIG had been permitted to go into liquidation, it was estimated that many tens of thousands of US workers would have been hitting the streets, looking for alternate sources of employment.

Shades of The Great Depression of 1929.

This Saturday, November 15, 2008, the political leaders of the 20 largest nations of the world will meet in Washington, D.C., at the behest of President George W. Bush.

Aside from taking pretty, Rose Garden photographs of these 20 political leaders, if no definitive solution to the present financial crisis is found, it could well unleash even more financial panic.

It is a given that outgoing President George W. Bush is quite unable to summon up sufficient perspicuity to resolve the present financial situation, even to carrying out the garbage in his own back door.

But are the other leaders of the free world any better equipped?

What appears to be lacking, today, is a concerted, international directive, one that is agreed by all of the leaders of the free world for the sake of the free world, putting aside national prejudices.

In short, a categorical, moral imperative is required in order to resolve the present financial crisis due to its very depth.

The US dollar is the *'hot'* currency of the day not because the fundamentals of the US economy warrant, swapping other world currencies for the greenback, but because it is difficult to find a safe haven for money in the chaos that is worsening with the passing of each day.

Today's world is such that the present financial crisis cannot be permitted to burn itself out – because the costs dwarf such a determination.

Iceland is, already, a bankrupt nation.

What other nation(s) are willing to admit to their inability to solve their financial problems?

National pride, only too often, inhibits honesty.

-- E N D --

While TARGET makes every attempt to ensure accuracy of all data published, TARGET cannot be held responsible for any errors and/or omissions.

readers' views, but reserves the right so to do subject to the laws of libel.