



KMI report – May 2012

*There are only 4 ways to
deal with an enormous build-up of debt:*

1) Inflation

This is the current U.S. strategy, based on the theory that increasing money supply ultimately creates inflation. This theory has never succeeded (other than possibly one questionable instance in Chile) and has demonstrably failed.

The main monetarist theory apologist, Milton Friedman, (whose devotees is Ben Bernanke) has excused the failures of monetarist policy by saying that all previous adherents failed because they didn't do it enough. In other words, if something isn't working then you need to do it more. America is getting close to ever-kill now – every injection of stimulus having a smaller and shorter-lived effect than its predecessor with some estimates now indicating that each \$1 of stimulatory input results in only 12 cents of additional output. That doesn't mean that the current monetarist ideologues are ready to abandon their strategy (it's the only one they have). The term "double-dip" is coined to describe the situation where recession/depression recurs because of the inability of central banks to maintain the effects of stimulatory output because of the law of diminishing returns.

Mr. Bernanke's complacent claims to be able to easily create inflation by harnessing the twin technologies of printing presses could well become his epitaph.

2) Austerity

This is the current German/ECB/euro zone core prescription for Greece and its fellow "GIPSIs" (Greece, Ireland, Portugal, Spain and Italy) as well as being the UK coalition's self-prescribed foul-tasting medicine. However, like the monetarist inflationary theories, the tail-chasing dog on an ever-downward spiral of trying to reduce debt while GDP is being destroyed has rarely, if ever, proven successful in major debt episodes. Inevitably it isn't able to be pursued to its logical conclusion as people prove unwilling or unable to put up with it to that point.

As the FT pointed out last year, we should never forget that while hyper-inflation destroyed Germany's last shreds of self-esteem, it was the austerity imposed by Germany's creditors through the mechanisms of the Bank of International Settlements that led to the election of Hitler and the Nazi Party. Social tensions are building globally – from jasmine riots to Arab Springs and from Tottenham Court Road (UK) to the recent euro zone election results. The results provide the glimmers of hope that some pressures can be released before austerity inevitably results again in self-appointed extreme dictatorships or military regimes.

3) War Event/Subsequent Peace Dividend

Ultimately, WW II did lead to the resolution of the 1929-1949 debt crisis. In that sense austerity did lead to the solution of the problem.

Globally, tensions between nations are on the rise again, as witnessed by the navies of China and the Philippines standing off over a tiny Pacific outcrop, Iran has raised stakes in the Straits of Hormuz over nuclear aspirations, Vladimir Putin's rhetoric and actions tend to be inflammatory, roguish nations continue to develop nuclear programs and the US has increased military presence in Asia Pacific.

Global nuclear conflagration ought to be totally unthinkable, but sadly it isn't.

4) Default

Nations default when they can't pay. This happened in the 1930s and has started happening again today.



Heaped rubbish remained uncollected in Athens, Greece, during strikes against austerity.

Default, whether outright (through debt repudiation) or de facto (currency/debt debasement) is rarely orderly (although Greece managed to live in default for over 50 percent of the last two centuries). It tends to happen when all other choices have been exhausted. Whatever form it takes, if the conditions which led to the situation that caused it are changed, then it can be a base from which to achieve sustainable growth, cure dysfunctional banking and liquidate malinvestment, restoring social order at the same

time.

This is what happened in South East Asia following the crises of 1997 and in Iceland after 2007. What can we learn from our parents and grandparents? Answer given below in famous quotations:

“Those not learning the lessons of history are destined to repeat them”

“Definition of madness is doing the same thing over and over again and expecting different results”

If we don't learn lessons from 1930s parallels, there's a very good chance that the outcomes of this decade might be even worse than those suffered then.

Lee R.J. Green

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Much of this item borrowed from *Paul Gambles, managing partner and group chief investment Officer, MBMG International, USA. With thanks.*