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At times when the economy is under stress, it can be useful to turn to lessons from the past to search for solutions to current problems. Although the most recent downturn often has been called “unprecedented” analogs to our present dilemma clearly have been documented in earlier eras. Here the author revisits the challenges faced by other civilizations and notes both similarities to today’s turmoil, as well as choices, for better or worse, that our ancestors made when they faced adversity.

Speculative economics: Uncertainty, Roman civilization and a view of the future

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“The hope of the 20th century rests on its recognition that war and depression are manmade and needless.”

— *Tragedy & Hope*, Carroll Quigley, Georgetown University, 1966

- I. **The art and science of certainty.** In October of 2008, I read an article by Krassimir Petrov, professor of economics at Prince Sultan University in Saudi Arabia, which stated that the current economic turmoil had no real historical precedent. I sent a comment to him suggesting that may be true, except for 476 A.D., where we find the last vestiges of Roman civilization. He replied: “Yes, it’s the end of empire.”

Professor Carroll Quigley portrays the natural cycle of civilizations in his work, “Tragedy and Hope:”

“From these studies it would seem that civilizations pass through a process of evolution which can be analyzed briefly as follows: each civilization is born in some inexplicable fashion, and after a slow start, enters a period of vigorous expansion, increasing its size and power, both internally and at the expense of its neighbors, until gradually a crisis of organization appears. When this crisis has passed and the civilization has been reorganized, it seems somewhat different. Its vigor and morale have weakened. It becomes stabilized and eventually stagnant. After a Golden Age of peace and prosperity, internal crises again rise. At this point there appears, for the first time, a moral and physical weakness which raises, also for the first time, questions about the civilization’s ability to defend itself against external enemies. Racked by internal struggles of a social and constitutional character, weakened by loss of faith in its older ideologies and by the challenge of new ideas incompatible with its past nature, the civilization grows steadily weaker until it is submerged by outside enemies, and eventually disappears.”

Are these the elements we face today? The thoughts are quite sobering. However, they do establish a fact: that the stakes we are playing for are nothing short of pivotal.

So much new terminology has crept into our current lexicon; words such as “unsustainability” or “accountability” or “responsibility” — all of which have become hackneyed and are randomly tossed about by too many public speakers. The foremost throw-away tagline, which has proliferated like a virus, seems to be “... the worst crisis, or turmoil, or anomaly since the Great Depression.” But, is that really the correct benchmark for comparison? Of which “great depression” are we speaking?

Rapid understanding and problem-solving effected earlier in 2008 could have set up an economic environment with regimes capable of giving the markets adequate space for clearing. Having an economy generally in suspended animation is a slow and painful process.

So the questions posed today universally are: How bad is *this* financial crisis? What are its true parallels in history? How did we come to this dilemma? What are the implications for future levels of survival?

The touchstone of the existing economic challenge is that uncertainty is pervasive. The structure of this turmoil is unparalleled in its scope. If it were rendered as a set of architectural plans, it would indeed look like the creation of a perfect financial and societal crisis — confusing and not easily confronted. However, it need not be. A full statement of its construction would tend to open up the door to resolution.

One interesting element of the uncertainty has been the various names and symbols attached to the turmoil — question marks and Xs, e.g., "...the 2007-20xx Crisis" or "... The Financial Turmoil of 2007-?" So let's give it a definite name: The Financial Crisis of 1987 to 2012.

This set of circumstances might have passed muster if it weren't for the fact that these crises have been occurring for thousands of years. Is, "It was worse than we thought," really an acceptable response?

II. Speculative economics and the stewards of the economy. The field of Western economics, in its basic form, is a science. It has observable laws and axioms that can be applied. Some of the basic and fundamental principles are described, for example, in Adam Smith's 18th century treatise "The Wealth of Nations." However, this abbreviated version of the title omits an important element of the concept. The full title is: "An Inquiry into the Nature and Causes of the Wealth of Nations."

Brilliant minds have carried on the tradition of the subject — although much of the field has been laced with random and theoretical studies of behavior and esoteric complications. Its essence is a study in production, efficiency, employment and the creation of wealth. All fields evolve, transmute, and change, but there are basic laws and principles that remain constant. Mr. Smith's book is a blueprint that deals with the fundamental subject of wealth creation.

A few quotes relevant to today, published circa 1776, are used here to illustrate the point:

a. Any increase in the quantity of commodities annually circulated within the country, while that of the money which circulated them remained the same, would, on the contrary, produce many other important effects, besides that of raising the value of the money. The capital of the country, though it might nominally be the same, would really be augmented. It might continue to be expressed by the same quantity of money, but it would command a greater quantity of labor. The quantity of productive labor which it could maintain and employ would be increased, and consequently the demand for that labor.

b. In countries where interest is permitted, the law in order to prevent the extortion of usury, generally fixes the highest rate which can be taken without incurring a penalty. This rate ought always to be somewhat above the lowest market price, or the price which is commonly paid for the use of money by those who can give the most undoubted security ... In a country such as Great Britain, where money is lent to government at 3% and to private people, upon good security, at 4(%) and 4½(%), the percent legal rate, 5%, is, perhaps, as proper as any.

c. The tax which each individual is bound to pay, ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.

It is worthy of note that the concept of the "invisible hand" being the only governor of irrationality makes little sense and doesn't take into account Mr. Smith's earlier work (again abbreviated title), "The Theory of Moral Sentiments, or, an Essay Towards an Analysis of the Principles by Which Men

Naturally Judge Concerning the Conduct and Character, First of Their Neighbours, and Afterward of Themselves." The two books in tandem were recently (and only) discussed by Wen Jiabao, ironically, the premier of the State Council of the People's Republic of China.

The stewards of the world's economies were appointed to what is tantamount to a sacred trust. The execution and precision of their work is important to every member of society. The turmoil is not necessarily complicated, but it is complex — based on its multifaceted component parts.

In the United States alone there is a plethora of departments and agencies: the Federal Reserve Board; the Treasury Department; both houses of Congress; the Federal Deposit Insurance Corp.; the Office of the Comptroller of the Currency; the Office of Thrift Supervision; the Commodity Futures Trading Commission; the Securities and Exchange Commission; the Bureau of Labor Statistics; etc. Internationally, we have the Bank for International Settlements, the International Monetary Fund, the World Bank, the G-20 and the Financial Stability Board, to name just a few.

The Congressional Budget Office, when speaking recently of fiscal and structural deficits and their possible future remedies, was asked if a gross domestic product attribution analysis (what areas created the most growth potential) had been done; it had not. The OCC was asked if there were data delineating a breakdown of over-the-counter derivatives by type of securitized products or asset classes. The reply was that the data were not that granular.

Central banks and sovereign treasuries, to be able to know and analyze macro consequences, must have access to accurate information, and even then the analyses are only as good as the data collected along with the concomitant ability to analyze, understand and predict distributive results and outcomes.

What has been needed is holistic coordination in gathering information and supervisory execution as well as really looking at the effects created and their consequences — both intended and unintended. This coordination needs to be well thought out and pursued with precision.

All systems need essential policy guidance — rules causing behavior to function optimally. The inclination toward deregulation in the mid-1980s began various processes that, although lofty, were never intended to supplant any "built-in stabilizers" or, importantly, prudential regulation (supervision) and monitoring. Without regulatory schemes and mechanisms put into place for risk management, anomaly and turmoil are subject to a high probability of occurrence, often with severe consequences.

Perhaps J.M. Keynes' most notable quote was: "Markets can remain irrational longer than you can remain solvent." That basically encapsulates what's happening today.

Mr. Keynes' work on the dynamics of money and employment during economic turmoil have been used and discussed for decades. Today the view is perceived to encompass interventions by the state, in an effort to cause increases of employment and production. However, as economic crises have been with humanity for many millennia, and economic stimulus has a long history, it would be relevant to mention a couple of instances during Roman civilizations.

Quoting from esteemed historian Will Durant's "Heroes of History":

Gracchus c. 130 B.C.: "His proposals to it aimed to win diverse classes to his support: the peasantry by renewing his brother's program for redistribution of state lands; the middle classes by establishing new colonies ... and developing these as thriving centers of trade; and the urban masses by his *lex frumentaria*, or corn law, which committed the government to distribute grain at half the market price to all who asked for it. It was a measure shocking to old Roman ideas of self-reliance and was destined to play a vital role in Roman history. It enriched contractors and reduced unemployment by a program of road-building in every part of Italy. It was one of the most radical measures offered to Rome before Caesar."

Caesar c. 50 B.C.: "Within a decade after Sulla's (predecessor) death his policy (Sulla) for restoring economic and political order had come to ruin. He had dealt with the phenomena, not the causes, of Rome's decay."

"Continuing the work of Gracchus, he (Caesar) distributed lands to his veterans and the poor. He relieved the pressure of a growing population by sending 80,000 citizens to colonize Carthage, Corinth and other centers thinned by war. To provide work for the unemployed, he allotted substantial sums to building programs in many cities in Italy, Spain, Gaul and Greece. To reduce the leakage of funds in administering welfare to the poor, he required a means test for eligibility to the state dole of grain; soon the number of applicants fell from 320,000 to 150,000. He scaled down debts, enacted several laws against excessive rates of interest, and relieved extreme cases of insolvency by establishing the laws of bankruptcy — essentially as they stand today."

It is noteworthy that the "scaling down of debt" at that time, included those related to a severe housing bubble — recategorizing interest paid to principal reduction bringing loan-to-value ratios back into equilibrium.

The significance of any of these periods only has importance to illustrate that much data and history exist to draw from their causes and effects and formulate conclusions rather than deal in speculation.

III. Analysis program concerning the turmoil. There is inherent value in being a student of history applying heuristic (practical) and analytic methods to the research of core phenomena in pursuit of solutions that have the highest probability of success. Below is a program that, importantly, contemplates reviewing a hierarchy of causes of the current financial turmoil to determine which were most contributive. This would be inclusive of recommendations developed from an understanding of the historical events of the past 25 years coupled with a pragmatic understanding of what occurs in the daily world of this strata of various financial transactions.

The financial upheaval that is with us today — and will continue for an indeterminate amount of time — needs to truly be understood. However, retracing specific events leading up to a complex series of problems is especially important to fully grasping the situation before devising a strategy. Restoring confidence would mean embracing very determined and decisive action. Moving to the beginning of these evolutionary processes one might consider, "What policy actions could have been instituted that might have created systemic regulatory and prudential (supervisory) framework control?" These regulatory frameworks are still capable of acting positively today. The categories contained in the frameworks could be carefully defined and enumerated.

Embracing these concepts, the program would contain the following attributes and components:

- A concise historical timeline of causal events that led up to this severe economic crisis inclusive of the dismantling of earlier safeguards that had been put into place.
- An analysis of capitalism by breaking it down to its component parts viz., a) free-market theory and b) "financial capitalism" (banking and financial services). These two concepts, although complementary in the main, have some mutual exclusivity and need not necessarily be synthesized as one theory. Too often, "capitalism" and "free enterprise" are used interchangeably although they refer to different concepts. One element to be reviewed could be the growth of the financial services sector from 15% to 35% of GDP and its effect on employment.
- Regulatory anomalies that have occurred over the past 25 years or so which portray a confusing system of financial regulatory frameworks and legislation that have generated an array of unintended consequences through poor coordination. Included would be legislation of the late 1990s.
- A review of derivatives, especially the unregulated swaps or OTC markets, and how their existence and use has acted to magnify the bursting of an otherwise severe but manageable series of "asset bubbles" into a complexity at a higher "order of magnitude" than has been contemplated in modern times — which has virtually frozen or stalled the capital markets. As a note, these instruments are termed by some as "welfare enhancing" credit risk transfer instruments — which create diversification and liquidity. However, the speculative nature and sheer volume of these unregulated instruments have been daunting to the international financial system and hard on real economies.
- The adverse effects of unplanned international support systems in terms of credit, interest rate and foreign currency derivatives and the roles played by various dealers and other participants.
- A view of the inherent flaws of the credit-rating agency system.

- The concept of “super anti-efficient” or shadow markets and the evolution of special purpose entities as they relate to the current dilemma’s off-balance-sheet transactions and their effects.
- Overview of the existing inventory and potential default severity of credit instruments (by asset class) still held by financial institutions (especially housing) along with relevant Financial Accounting Standards Board accounting procedures.
- Recommendations for applied remedial actions in an effort to address the current turmoil at its core, and to restore a sense of normalcy to the United States economy and to the global markets.

Obviously, other elements would need to be analyzed and solved, such as residential and commercial real estate valuation and their financings. But the key to any program would be to have one overarching purpose: to allow the markets to clear, reset and move forward. Reinstatement or the creation of new frameworks would provide boundaries to keep the economy on a smooth road.

IV. Prognosis: The full faith and credit. The United States is such an interesting place, with its Constitution, its freedoms, its magnitude and its capacity for that most holy of attributes: its production. It houses approximately 4.5% of the world’s population and yet is responsible for 25% of the world’s production.

To add some perspective, let’s take a look at some of the International Monetary Fund’s listing of global GDP and population for 2009:

- United States — \$14.25 trillion; 313 million
- Japan — \$5.1 trillion; 127 million
- PR China — \$4.9 trillion; 1.4 billion
- Germany — \$3.3 trillion; 81 million
- France — \$2.7 trillion; 65 million
- UK — \$2.2 trillion; 62 million
- Italy — \$2.1 trillion; 60 million
- Brazil — \$1.6 trillion; 193 million
- Spain — \$1.5 trillion; 47 million
- Canada — \$1.3 trillion; 34 million
- India — \$1.2 trillion; 1.2 billion
- Russia — \$1.2 trillion; 142 million
- Saudi Arabia — \$360 billion; 26 million
- Iran — \$330 billion; 79 million

These numbers indicate that the United States and its citizenry have a very high capacity to monetize resources, both as hard assets and as human innovation, production, and technology. So the question becomes, what is the prognosis?

The balance sheet of the United States is not in the news very often. However, in a fiat monetary system, which we have, wouldn’t this be the central part of the “full faith and credit” that backs our currency?

The value of our public and private assets is truly a staggering amount. The public assets alone have an estimated value of some \$500 trillion, including land holdings, mineral rights, real estate, equipment assets, etc. So from one perspective, what we have as a country is a cash flow problem. Assets could be monetized. The Treasury and the Fed could get creative with the interplay between assets and the national debt. The structural deficits need rethinking accompanied by good planning. GDP and employment need attribution analyses to provide for immediate growth. Regulation needs to be pursued in a logical manner.

It would certainly be auspicious for the stewards of the economy to create a point of control to analyze and coordinate actual solutions. If this can be done in a timely manner, with creativity and certainty, the prognosis can still be good — and the civilization will be described as one that will endure.

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