

The destruction of our economy by parasitic governments and financial institutions

Present

Most countries' financial centers and governments are currently in the process of expanding the supply of world currencies and cheap credit, in order to boost their own budgets, salaries and political power and to avoid recessions. One of the effects of this policy is the protection of their own personal wealth consisting of paper assets such as bond and stock funds that would otherwise have collapsed.

Past

A similar expansion of the monetary supply has historically led to the de-industrialization of entire regions or countries that followed such policies for a sustainable period of time, typically over several generations. On the surface, the mechanism of such de-industrialization seems to work by inflating the costs of doing business faster than the price inflation of manufactured goods and services produced by affected companies, thus destroying profitability, especially when a vast supply of goods is available from peripheral provinces or from other countries. One such example was the 5th century Roman Empire (see [Fall Of Empire](#) essay), the other one is 16th century Spain under Philip II.

“Nuts and bolts”

Industrial companies that may initially enjoy the cheap credit, use it to expand production facilities or other business assets, which then leads to excess production or excess supply of services and inevitably destroys profitability. Decreasing profitability reduces investment yield, the Return On Investment (ROI) but it also serves to restrain the inflationary pressure fuelled by the financial expansion. The reduced inflationary pressure due to collapsing profitability allows the central banks and governments to maintain the low inter-banking lending interest rate which in turn facilitates the issuance of even more credit, including borrowing by the governments for virtually limitless spending on themselves.

Risk management, CDS and leverage

The issuance of more and more credit to an expanding circle of corporate and other borrowers at a time of falling yields would have normally been stopped at some level by the rising risk premium preventing a further reduction of interest rates. Rising loan risk would have acted as a negative feedback preventing the currently observed unprecedented drop in interest rates and related bond yields. It would have ultimately prevented excessive credit generation. The negative risk-mediated feedback has been sabotaged by the use of a special form of financial credit insurance called “Credit Default Swaps” (CDS). CDS allowed the lending institutions to exceed the lending limits imposed by the normal risk avoidance standards (and by common

sense) , by allowing them to profitably lend, giving very low and falling loan interest rates. In this low interest rate environment, it was necessary to lower the required capital reserve for banks and financial institutions such as hedge funds in order to maintain the expected profitability. Until recently, this required capital reserve was decreed to be 1:11 (capital-to-total loans), which was recently further reduced by the “Basel 3” agreement to 1:30 bringing the world banks to similar “standards” as hedge funds which “enjoyed” the 30:1 leverage even before the 2008 crash (Leverage is the inverse of the capital requirement).

Positive feedback loop of destruction

Apart from destroying industrial profits, the excessive credit also creates bubbles in selected investment sectors such as stock, futures and bonds. Rising bond prices are further depressing the yields and interest rates which further accelerated the lending. This situation is described in science and engineering by the term “positive feedback loop”. This means that even a small input stimulus is amplified by the system and fed back to an input, amplifying itself further until the system reaches some very large deviation from an equilibrium, and saturates or the system breaks down.

Eventually financial companies flee the market where interest rates and Return On Investment (ROI) has been depressed, moving most of their investment capital off-shore to countries where the ROI is still high. The process is repeated until all manufacturing economies end up eventually running unprofitable industries, subsidized at first by the investment capital influx, later by government subsidies to maintain employment and to prevent the paper assets backed by industry from crashing. Subsidized manufacturing in poorer countries floods the world market with underpriced industrial goods allowing prices of industrial goods to remain stagnant (deflation) in spite of the rapid expansion of the financial system and money.

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I saw the future...

The last stage of this economic destruction is the breakdown of the unprofitable manufacturing, resources and agricultural sectors when the subsidies run out or when the employees refuse to work under the austere conditions imposed upon them by the profit squeeze. This process, like the credit growth itself, is also governed by the positive feedback law. Once started, it will accelerate, fuelling itself like a cancer or fire. This will happen specifically, when food prices and the cost of living overtake the wages paid by unprofitable manufacturing companies causing industrial disruption due to strikes and closures, leading to further increases in the cost of living and so on.

The impact of this upon the developed countries that almost totally depend upon the subsidized under-priced production from the developing countries, will be equally severe. A decline of the subsidized imports of industrial and consumer goods will cause the supply chain to break down in the developed economies, leading to explosive inflation of all prices for manufactured goods, commodities, food and services. The ensuing inflation will put an upward pressure on interest

rates which government will no longer be able to obfuscate or manipulate using financial techniques alone.

[Note: 13-Jan-2015 - I was wrong. The above scenario is incorrect, an inflationary trend in the manufacture and resource - dependent economies seems to have been contradicted by 2014, by deflationary pressure due to a decline in the debt-backed paper assets, and due to declining velocity of money caused by the flight of the foreign liquid assets and savings into the US\$. It looks more like a deflationary spiral rather than the inflationary recession I thought might happening. Commodities and resources' deflation is evident when one expresses the prices in the US\$, whereas prices expressed in the local currencies may be increasing or stable. Interestingly, falling resource prices will probably cause a fall in the financial assets later on, in the same way as the fall in property used as collateral caused a banking crash in 2008. Stan (Heretic)]

Aftermath

The inflation-induced jump in interest rates and yields will crash the bond market (bond values are inverse to their yields). Old bonds will drop in value destroying most of the pension funds and probably most of the financial institutions, given that it may trigger an avalanche of CDS claims (another positive feedback) which will accelerate the institutional and systemic collapse. At the same time, the new bonds will become very expensive for borrowers to issue, thereby derailing the "gravy train" enjoyed by governments and large corporations the world over. It may even make the refinancing or rollover of old debt impossible.

The breakdown of the government bond market will cause currency exchange rates to vary wildly and may cause some currencies to crash and disappear, beginning with those countries that will default on their government bonds first and ending with probably all presently known paper currencies disappearing and being replaced by something else.

Science, technology and ideas (including business ideas) are unlimited. Completely new industrial companies, technologies and services will be created, filling in the present business vacuum, using new-old forms of self-financing and capital-raising that are more robust and do not depend on large financial institutions and governments. This will happen in the countries that provide a legal framework effective in protecting private ownership and civil order yet not stifled by any excessive legislation or taxation.

The good news is that that which worked in the past, will work in the future, and what didn't work in the past won't work in the future.

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