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Stop the Presses

Whatever the backlog of subjects I had in mind for this issue, they have been blown away by events that have overwhelmed even what is shaping up as a watershed presidential campaign. In fact, aside from their respective economic policy strategies if elected, the two presidential nominees are pretty irrelevant to the urgency of the crisis, and both of them illustrated why this is so in their second debate.

We are certainly living through the most significant financial crisis of the past twenty years, and it will no doubt ultimately rank among the most significant in U. S. history, for several reasons: (1) since the beginning of the worldwide securitization of financial assets and the derivative segmentation of risk made possible by the warp speed development of computing technology over the past 25 years, this is the first true stress test of the management of this revolutionary risk segmentation and diffusion; (2) it comes at a time when the globalization of trade and employment and the challenges to the long-held principle of comparative advantage have given rise to worldwide anxiety about employment security and the related economic security of nation-states; and (3) because of the convergence of these forces with the current political trends, particularly in the U. S., there is the very real threat that the political response to the present crisis will result in regulatory overreach in the financial markets and other measures that will be destructive to capital formation, enterprise, and economic growth.

Many observers have blamed the financial market deregulation of the 1980s and 1990s and the failure of regulation for the crisis in the first place, but I believe that there is much more to the real story. In fact, the market, which always leads and never lags public policy, had already run circles around the antiquated 1930s financial markets regulatory system by the time the Glass-Steagall Act (which prohibited the combination of commercial and investment banking) was repealed in 1999. This was a fait accompli on the ground in the market for at least 20 years before it was ratified.

Not that I am exonerating the investment bankers or the regulators. In fact, as I wrote in the wake of the Enron meltdown in early 2002, the investment banking industry has been headed in the wrong direction since the major firms began offering their shares publicly a couple of decades ago. The concept of privately owned, self-regulated, general partnership governance of these firms served us well. As unlikely as this may be, we would probably greatly benefit by a return to the days when investment banking, accounting, and commercial banking were conducted based on the concept of the "trustee" by partners with full liability and a significant personal financial stake in their stewardship.

The late Walter Wriston, former Citicorp Chairman, had the new realities pegged in his book, *Twilight of Sovereignty*, in 1991 when he noted that the days when nation-states can control economic events are numbered and that technology has produced a new “gold standard” in the form of the then 200,000 computers (now many multiples of that number) run by money managers worldwide who never sleep and who “vote” on public policy and discount its implications often before the policy pronouncements by politicians. And this was before the explosion of the Internet! Of course, the key is full and complete transparency of information, and that is what has obviously been left behind in the blinding speed of the effect of Moore’s Law on computer capabilities to drive market innovation. And despite the diminished ability of governments to control events, they continue to have a way of pursuing micromanagement with unintended consequences.

The over-indulgence in the subprime mortgage market of the past several years shouldn’t have been much of a surprise after 30 years of misguided social policies in pursuit of “affordable housing”, manifest in the Community Reinvestment Act and its mandated affirmative action lending practices in low socio-economic markets, compounded by the well-documented explosive growth of Freddie Mac and Fannie Mae that was directly tied to cronyism in the various Congressional relationships, the financing of which was made possible by Federal Reserve monetary policy that produced significant misallocations of resources to this high risk market. This crisis has many parents, but the real culpability should not be difficult to identify.

This too shall pass. We won’t know where the bottom is until *private* capital begins to move back into the markets in critical mass. Sooner or later, this will happen. But with the change of political regimes in January 2009, I worry less about where the market bottom might be than about the movement toward the socialization of risk indicated by the tendency to cure the problem with massive asset acquisitions by the government and the resulting increase in moral hazard, along with regulatory overreach, the combination of which would have serious long-term detrimental consequences for capital formation and our competitive position in the world. We already have a Sarbanes-Oxley bill, courtesy of Enron, that is a severe overreaction and has already significantly damaged the competitiveness of U. S. capital markets; we don’t need a Sarbox II for the financial institutions, nor do we need government ownership of these institutions without a definitive exit strategy and unemployment for those CEOs whose firms accept the infusions. The “too big to fail” policy should also be revisited. Someone recently said that if an institution is too big to fail, then it’s too big, and I agree. We could also use some fiscal policy response, and I don’t have in mind a so-called stimulus package of tax rebates, but rather a significant cut in the tax rates on capital formation, i. e., capital gains tax and the onerous corporate income tax. Good luck on that with a Democratic Congress.

So get ready in January—at a minimum, we are certainly in for much more government oversight and intrusion, at least until the governance and self-regulatory functions catch up with the markets, and right now they are not even closing the gap.

Where is the Apology?

After 55 years, we can finally close the case of Ethel and Julius Rosenberg, who were executed as Communist spies in 1953, but whose guilt has been consistently denied by fellow travelers on the left in this country, in spite of the evidence presented then as well as condemning revelations from KGB files released upon the fall of the Soviet Union in 1991. Now comes Morton Sobell, the 91-year old co-defendant in the trial, who finally admitted, after maintaining his innocence for all of these years, that he and Julius had in fact been Soviet agents.

Earlier I wrote of the need for a Russian “truth commission” on the conduct of the Soviet regime in the 20th century. Well, here is more evidence for the need for such a commission. But, in the meantime, how about a mea culpa from the New York Times for their reporting during this period, and how about a posthumous apology from some of these fellow traveling leftist intellectuals to Joseph McCarthy, Whittaker Chambers, and Richard Nixon? Don’t hold your breath.

Rethinking Outdated Institutions

My wife and I just returned from a delightful 12-day tour of New England, one of the stops on which was the beautiful old Mount Washington Hotel in Bretton Woods, New Hampshire, which of course was the site of the international monetary conference in 1944 that established the world monetary system that lasted until 1971. I won’t belabor the details of how the system came unwound, but my point is that, in walking the hallways of this magnificent old place, it occurred to me that here was spawned several of the institutions reflecting the reality on the ground at the end of World War II that are now functionally obsolete. Others include the United Nations, or at least its Security Council, and probably NATO. There are several reasons, all of which have been provided high relief by the events of the past decade, most recently the Russian intervention in Georgia. The UN is worthless as a security forum, as has been well documented. With a few exceptions, notably Great Britain and the former Warsaw Pact members, Europe is no longer a serious player in world security matters, and is easily intimidated or blackmailed by rogue states, including Putin’s Russia. Candidly, on this point the U. S. presently has no realistic policy for dealing with situations like the Russian intervention in Georgia, nor with a resurgent Russia generally.

What all of this means is that we need to seriously consider abandoning these obsolete institutions in favor of new multinational organizations, some of which could be organized on regional bases, both for security issues as well as trade, and I believe that the new format and criteria for membership should be those of a league of democracies, not the nominal ones, but those whose leaders and institutions are truly responsive to the consent of the governed under the rule of law. Incidentally and not surprisingly, I have heard nothing of this kind of thinking from either of our presidential nominees.

Texas Transportation Infrastructure: Establishing Policy Priorities

I am pleased to include the following commentary and pass along an invitation to the 23rd Public Conference of The Texas Lyceum Association, an organization of which I am proud to have

been a founding Director 28 years ago as well as a Past Chairman. The Texas Lyceum continues to perform a commendable service to the state in its periodic forums and publications, but most importantly in its cultivation of emerging leadership for Texas. This commentary is submitted by Melissa Castro Killen of the firm Tuggey Rosenthal Pauerstein Sandoloski Agather LLP, a member of the Texas Lyceum Board of Directors:

Prioritizing and financing transportation infrastructure has become one of the greatest challenges facing Texas today. Financing options and priorities are particularly challenging because the Federal Highway Trust Fund, the primary source of funding for maintenance and improvement of the interstate highway system, does not generate enough money to accomplish its mission. The impact of this deficiency in funding cannot be overstated. Texans can no longer rely solely on our national highways as a means of transportation.

While highways will continue to be a vital link in the state's transportation arteries, we must plan for a changing transportation dynamic by exploring supplementary and complementary options. Once these options are identified, they must be prioritized to determine the best course of action to implement their integration into our overall transportation system.

The issue is one of balancing feasibility and benefits. Examples of complementary or alternative transport modes include bike lanes, bus rapid transit, toll roads, and commuter rail. Each offers value in reducing the strain on the highway system, but at varying levels of return on investment. The costs and benefits of each alternative will vary by region and community.

This alternative transportation infrastructure requires identification of funding sources. Traditional federal and state funding mechanisms are inadequate. There are a number of options that communities can explore, including issuance of bonds, public/private partnerships, and other solutions. No single solution will work for every community, but unless the funding can be identified and secured, the arteries of the Texas transportation system will become too clogged to meet our growing needs.

The Texas Lyceum public conference in Houston on December 3, 2008 will enable participants to participate in dialogue involving this important issue as well as other closely related topics and to provide input to the results of the conference proceedings, which will be presented to the Texas Legislature in advance of the 2009 session.

For more information on the conference and registration, visit the Texas Lyceum web site at www.texaslyceum.com.