

G-20 Was About Big Government Getting Bigger

There's a new committee to save the world in town!

They got together and had a fancy dinner. They blamed hedge funds, corporate fat cats, tax dodgers, and the credit ratings agencies. They threw some more money at the IMF so that it can send gift baskets of currencies to poor countries. Then they took a silly class photo and immediately began congratulating themselves on how smart and courageous they are.

There you have it. The summit in sixty-two words.

Yes, the G-20 meeting has ended in London and its results have been met with rapture by participants and the media alike. But looking at the group photo this morning, we couldn't help thinking these guys are absolutely clueless (or very good actors). It looked like a room full of American auto executives who don't fully appreciate the existential threat their institutions face.



Mission Accomplished!

*U.S. President Barack Obama, Italian Prime Minister Silvio Berlusconi,
Russian President Dmitry Medvedev, and Chinese President Hu Jintao.*

We're talking about the institution of government. Because that's what this G-20 meeting was all about. It was about Big Government getting even bigger. It was about Big Government using the crisis as a chance to put the shackles on the free market. And it was about Big Government defending the way it funds itself (through debt and paper money).

But we suppose we should at least let you know what the G-20 leaders agreed to. They've tripled the lending power of the International Monetary fund to US\$750 billion. This is mostly in the form of creditor countries like Japan loaning the IMF money so it can loan it out to debtor countries like Mexico. Loans to make loans.

They've also expanded by US\$250 billion the IMF's Special Drawing Rights (SDR), which are an obscure but emerging kind of uber reserve currency. No one is really sure what this means yet or where it is taking us.

As far as we can tell, the rest of it was just bashing of the private sector. A new Financial Stability Board will be set up at the IMF to oversee the vague new agreements on the regulation of hedge funds and the treatment of tax havens. The French wanted to 'name and shame' the tax havens for non-compliance with OECD rules on transparency. But the Chinese apparently shot the naming and shaming down.

So really, what do we have here? Is this, "the day that the world came together to fight back against the global recession," as British Prime Minister Gordon Brown said? Is it, "A turning point in our pursuit of the global economic recovery," as President Hopeychanger added? Or is just a bunch of well-heeled guys in suits trying to convince the world they are in charge and know what they are doing? Our take on that below. But first, how are markets taking the news?

Stocks are up and gold and government bonds are down. That's the short story. It wasn't news, but the summit statement reiterated a plan floated by the IMF last year to sell 403 tons of gold. The IMF planned on doing this last year to fund its operating deficit. It's advancing the idea again to raise money. Gordon Brown said, "Gold of the world is now being used to help the poor of the world."

When Gordon Brown sells gold, it's usually good for gold. In his role as Chancellor of the Exchequer, Brown infamously decided to sell half of Britain's gold at rock bottom prices in May of 1999. Not content with selling gold at the bottom of a 20-year cycle, Brown actually announced the move ahead of time, depressing gold prices even further before the selling began.

Gold sold for an average price of US\$276 an ounce that May. It bottomed around \$252 in July of that year and is up 247% since then, if you're using yesterday's futures price of US\$876. This is why Bill Bonner's trade of the decade-sell stocks, buy gold-was so successful in the last ten years.

But what about the next ten years? Can gold do even better? Or is this concerted effort by the G-20 to reflate the credit bubble, sell gold, and increase debt and spending going to lead to temporary rally in stocks and a sell-off in gold?

Let the G-20 leaders have their self-congratulatory moment in the New World Order sun. **Their plan is a failure because it blames the credit crisis on de-regulation, fraud, free markets, and bad bankers. This is a deliberate attempt to obscure the origins of the credit crisis and the recession/depression we now face: the credit boom that preceded it.**

Governments themselves were largely responsible for that credit boom. Their coordinated interest rate cuts and the dollar-pegged global currency system led to an explosion in money, credit, and

inevitably, leverage, risk-taking, and now, losses. They are trying to prevent those losses by throwing more borrowed money at the recession to “fight it.”

That’s moronic. “A recession is the liquidation period following an inflationary cycle,” writes Harry Browne in “How You can Profit From the Coming Devaluation.” How right he is. More from him in a moment.

Don’t get us wrong. Greed and poor regulation certainly had a huge role in the credit boom. Leverage was allowed to go unchecked. Lending standards were lax and in many cases, non-existent. Ratings agencies gave gold-plated credit ratings to the collateralised assets flogged by Wall Street to pension funds, insurance companies, and Central Banks.

Mistakes were made. But it’s clear the G-20 leaders have no desire to admit their Prime Mover role in the formation of the credit bubble which has now popped. It is politically unacceptable to endure a recession which liquidates the bad investments. It means you have to stop pretending that bad bank assets are merely “impaired” and admit they are worth a fraction of their nominal value.

Instead what you see is the G-20 moving to consolidate the position of government as the most powerful and intrusive institution in your economic life. Their tax harmonisation efforts would normally be called anti-competitive collusion. But by branding nations that offer low tax rates as renegades, they hope to make it impossible (practically speaking) for you to move your money and your assets to places that treat capital well.

So yes. It’s just more of the same. A wealth and power grab. Steal from the future with borrowing. Rob from savers with inflation. Use the coercive power of the law to accomplish your goals. And wine, dine, and fly at taxpayer expense to achieve it all.

Realistically, we think this counter attack by Big Government to stave off the second wave of the credit crisis gives you time to sell stocks into a rally and diversify your assets ahead of the coming devaluations and inflation. Ultimately, the credibility of national governments and their currencies will be eroded and damaged beyond repair, based on unsustainable fiscal and monetary policies.

But for now they are pretending it will work and that everything is fine. Maybe that’s what they really think. Or maybe that’s all they know. “In thousands of years of monetary history,” writes Harry Browne, “only one temporary solution [to warding off recession] has ever been discovered.”

“Governments know only one way of holding back recession. What do you suppose it is? Yes, the only solution they can think of is to continue the inflation. The ‘boom’ is regenerated with more bank credit and government subsidies. Companies appear to come to life again.”

“Prices go higher, but in such irregular patterns that businessmen and wage earners are unable to make rational decisions from the distorted price structure. Inefficient businessmen stay in business with more credit-at the expense of other companies.”

We think Harry is right. But the question is, which prices? It doesn’t look like consumer prices will be rising any time soon. There is still massive global production over capacity.

But the money bomb dropped on markets by the G-20 — “more money than ever before,” said Gordon Brown—may sucker people back into the stock market and ignite a short round of leveraged risk taking. What should you do?

The IMF may be selling gold. But we reckon a lot of people are happy to buy it. With the massive expansion in global stimulus, borrowing, and spending, we are approaching the next phase of this crisis. And we reckon when the G-20 meets in New York again in September, they may not be smiling anymore.

Regards,

Dan Denning

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