LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

Capitalism without failure is like religion without sin.
– Allen Meltzer, Economist

A capitalist system by nature is cyclical, and by itself, also provides remedies to excesses that develop. It is basically a self-correcting system. Unfortunately, governments believe it is necessary to *help* this natural process and, in effect, make things worse for a longer time than they would have been if the system were allowed to function by itself. A government's role should be to set limits and police them, not try to fine tune an economy. For example, beginning in 2001, the U.S. Federal Reserve drove the Fed Funds rate down to a level of 1% in order to avoid a consumer recession. A recession would have been the normal capitalistic corrective process following the excesses of the Technology stock bubble which had just burst. Congress at the time also decided to *help* the consumer with record tax cuts and rebate checks paid to American taxpayers.

The government succeeded in its mission of avoiding a consumer recession, but at what cost? Imbalances already apparent were allowed to continue unchecked. Record low interest rates and the incredible amount of money in the economy allowed dollars invested in Tech stocks to move over to the credit side of the economy and into the real estate market. Capital will flow to the fastest expanding sector where it can earn the most. With the Fed desiring low interest rates and Congress wanting everyone to own a home, the real estate market was the place banks could add leverage and get the most *bang* for their buck. In other words, banks could borrow money at 1% and lend to consumers for real estate purchases at much higher rates than anywhere else. The assumption in all this was that home prices would not fall.

Today we see the results of this ten-year process. Many individuals were lured into the real estate boom. The enticement was just too much. Why not borrow when a financial institution offers you so much? Zero percent down with a low single digit interest rate and no income requirement. This lending was so profitable that eventually predatory lenders entered the industry and contributed more to an ever-building bubble. Encouraged by the Fed's excessively low rates and almost total lack of oversight by regulators, millions of home buyers in the end were financially crushed. But was this the fault of capitalism? We think not. We feel the real fault lies with a government that believes a system isn't equitable unless everyone shares equally. In a capitalist system, prices are set in the free market and providers of capital bear responsibility for their losses. We're not seeing any responsibility taken. The government is bailing out the very firms that were the guiltiest. Also, in a capitalist system the cost of capital to an enterprise should rise in line with risk.

The response by the government to the U.S. financial meltdown has centered on aid and assistance to the financial industry. Sessions of Congress have focused on whose fault the meltdown was as opposed to finding a solution. Company CEOs and Regulators have taken the majority of the heat. But who watches the watchers? We believe the answer to this question is—Congress. It is interesting to note that the very ones who are blaming the failure of the system now, were espousing the benefits of that same system when all was well.

Now that the government has decided to guarantee virtually all financial company debt, how does any institution truly know its true cost of capital these days? What happens when the government removes the guarantees? Thanks to government *help*, we taxpayers potentially own insolvent insurance companies, bankrupt auto companies, and failed banks. Good luck at getting back much of the $700+ billion TARP money. We currently have a very distorted financial system in the United States. We believe the economy would have been better off without all of the government's help.

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