

## **World Needs Better “Face of American Capitalism” than Private Equity, Goldman Sachs, Media “Freak Show”**

**December 19 – ([Econotech FHPN](#))**

Dec 19 (Econotech FHPN) – Thanks very much and happy holidays to my readers this past year; the web sites that have been extremely kind to post my articles; Google for freely hosting Econotech; and the friends without whom I would have never started putting my articles on the web. I also express my appreciation for mainstream journalists whose reporting I heavily rely upon, in a non-mainstream way.

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### **1. Private Equity New “Face of American Capitalism”**

I start this article with far more quotations than usual. These credible sources make some critical, almost self-evident points that set the stage for my comments this month.

*“...in the United States, private equity has grown enormously over the last few years. In fact, today, I think, private equity is perhaps the face of American capitalism. In the old days - 1950s, 1940s, 1930s - large corporations that would trade on the New York Stock Exchange might be seen as the face of American capitalism. Companies like US Steel or IBM or General Motors. Those are still very good companies in many cases, but I don't think they are seen as the face of American capitalism. Today I think the face of American capitalism is the large private equity firms that are buying companies, improving them, adding value for shareholders and returning very good returns for their investors ... I think China is probably the single most attractive market over the next five to 10 years for private equity ... predictions. First, that there will be a \$50bn buyout done within the next year. Two: that there will be a \$100bn buyout done within the next two years.” (David*

*Rubenstein, Co-Founder and Managing Director, The Carlyle Group, one of the very largest private equity firms, "View from the Top" interview, FT, Dec 7)*

*"...there are at least two sets of rules -- one for the rich and well-connected, another for the middle class, the Wall Street proletariat ... The upper class is now serviced by a vast and growing industry, loosely called Private Equity. The job of the private-equity investor is - - again, speaking loosely -- to exploit the idiocy of the ordinary investor, and the corporate executives and mutual-fund managers who purport to serve him ... the relationship between the upper class and the proles more explicitly parasitical than it usually is ... the smartest, best-connected money has separated itself from the rest of the stock market, and has gone into the business of trading against that market. It seeks to buy from the stock market cheap, and sell to the stock market dear, and if you need evidence that this is possible you need only look to the returns on private equity, which have been running three times the returns of the public stock market." (Michael Lewis, Bloomberg, Dec 11, author of "Liar's Poker," "The New New Thing")*

*"A surfeit of liquidity in the financial markets is tempting bankers to underwrite and finance deals that may come back to haunt them," a top banker at Goldman Sachs said. Eugene Leouzon, the chief underwriting officer for Europe and Asia who sits on the investment bank's global credit committee, said the current conditions were unparalleled in his experience of investment banking. Leouzon, who approves new loans and debt deals to fund mergers and acquisitions. "The things we are seeing being done, both on the investment grade side and the non-investment grade side, are I would say borderline stupid." "There is just too much capital going after too little by way of deals." But Leouzon said the outlook was for a strong level of new deals going forward, led by lending money to fund leveraged buyouts and cash mergers and acquisitions ... Competition among bankers chasing big bonuses is also likely to keep the pressure on doing deals." (Reuters, Nov 16)*

*"Goldman Sachs reported earnings yesterday that left jaws agape on Wall Street. Quarterly profits soared 93 percent. The bank earned nearly as much per share in 2006 as it had in the last two years combined, both of which were also record years ... the bank is paying roughly \$623,418 for every employee [about 26,000]. Rainmakers in investment banking can expect to see \$20 million to \$25 million each while traders who booked big profits will take home up to \$50 million apiece. In 1997, investment banking and trading and principal*

*investments produced roughly the same revenue. In 2006, trading and principal investments [essentially Goldman's own hedge and private equity funds] produced almost 70 percent of the total net revenue." (NYT, Dec 13)*

*"Goldman Sachs's William Dudley to head the [NY Fed] market's group. former Goldman executives control or influence the oversight of key aspects of the US financial system and hold prominent positions throughout the Bush White House. They include: Hank Paulson, the Treasury secretary and former Goldman chief executive; Reuben Jeffrey, a former Goldman managing partner who is the chief regulator of commodity futures and options trading; Joshua Bolten, White House chief of staff who served as a Goldman executive director; Robert Steel, the former Goldman vice-chairman who advises Mr Paulson on domestic finance; and Randall Fort, the ex-Goldman director of global security who advises Condoleezza Rice. Bush's working group on financial markets is composed of Mr Paulson, Mr Jeffrey, [Bernanke and Cox] - would be Mr Bush's first port of call in the event of a financial crisis. Mr Dudley would also play a crucial role in stabilising the markets in the event of a meltdown ... Goldman represented the biggest single donor base to the Democratic party ahead of this year's mid-term elections. Jon Corzine, the New Jersey governor, and Robert Rubin, the former [Clinton] Treasury secretary, are Goldman alumni." (FT, Dec 4)*

*"...yesterday deals worth nearly \$90bn were announced around the world ... adding to the \$3,500bn of takeovers agreed so far this year. This has made 2006 the busiest year on record for M&A globally, exceeding the volumes of the internet bubble of the late 1990s ... While most observers are expecting favourable conditions for dealmaking to remain next year, there are concerns the market may be overheating, as it did in 1999 and 2000. Worries centre on large amounts of debt being piled on to companies by private equity groups, with critics believing a string of bankruptcies is inevitable." (FT, Dec 19)*

*"Private equity funds are playing much the same role as Santa Claus in the equity market rally. Yesterday brought another four huge private equity buy-outs ... Many in the market assume that there is an effective "private equity put" - named after options that allow you to sell at a fixed price. If things go badly, your company becomes a target. If it catches on to a wave of the moment, buy-out funds will pay more. Either way there is a 'put' ... Knowing there is a private equity put reduces the perception of risk for everyone." (John Authers,*

FT, Dec 19)

*"Heavy debt-raising has continued into the traditional winter slowdown, making this December among the busiest in recent memory for US capital markets. The unseasonable frenzy of deals stems from huge investor appetite for credit-related exposure. It has also raised concerns that debt levels could in some cases be dangerously high."* (FT, Dec 18)

*"Private-equity firms accounted for more than a third of all deals involving U.S. targets in 2006."* (MarketWatch, Dec 18)

*"That's not just a record in dollar terms but is more than twice the amount of private equity deals for all of 2005 ... "There's an endless appetite for credit now, and that's kind of scary," said one high-yield investment manager. "It's all liquidity-driven."* (CNNMoney, Dec 18)

*"Private equity firms accounted for 22 percent of global M&A volume in the first nine months of the year, hitting a record \$570.1 billion in deals. That's up from around 5 percent a few years ago."* (Reuters, Dec 16)

*"U.S. firms could raise \$225 billion in private-equity funds this year, soaring over 2000's \$177.8 billion ... Investments in private-equity firms returned 22.5 percent during the 12 months ended June 30, compared with a 6.6 percent return from the S&P 500. Over the past 10 years, private-equity investments have returned 11.4 percent per year, compared with 6.6 percent per year by the S&P 500. Over the last 20 years, the comparison is 14.2 percent for private equity vs. 9.8 percent for the S&P. "* (Dallas Morning News, Dec 13)

*"This year, the average gain for an IPO of company owned by buyout firms is just 1%, compared to a healthy 30% return for all other U.S. company IPOs ... This year buyout-sponsored IPOs account for 42% of the total dollars raised in the market for new stock offerings ... In the past, private-equity firms typically held onto an investment for several years trying to make the business more efficient before looking to cash out. But now private-equity firms are paying themselves hefty dividends and looking to cash out just months after taking over a company."* (thestreet.com, Nov 27)

*"Billionaire investor Wilbur Ross last week said 'it's inevitable that we will see higher default rates' after announcing a plan to help invest \$685 million in bankrupt companies for a group formed by New York-*

*based Goldman." (Bloomberg, Nov 14)*

*"A group of 12 securities industry associations ... said they have adequate procedures in place to guard against improper trading in the unregulated market for credit derivatives and other markets including loans that are privately negotiated between banks and investors. They will 'educate' and 'inform' members about how to handle information that hasn't been publicly disclosed that could influence markets." (Bloomberg, Dec 13)*

*"Greenspan [said] "I expect that the dollar will continue to drift downwards until there will be a change in the U.S. balance of payments." "There has been some evidence that OPEC nations are beginning to switch their reserves out of dollars and into euro and yen." " (Reuters, Dec 11)*

*"The recent weakness in the U.S. dollar is sending tremors through a popular practice in foreign-exchange trading, raising the potential for further instability in global currency markets. known as the carry trade: Investors borrow money in a country in which interest rates are near zero, such as Japan, and invest it in a country like New Zealand, where interest rates hover above 7%. The trade works best when currencies involved remain relatively stable -- sharp currency moves can wipe out gains from the difference in interest rates." (WSJ, Dec 13)*

*"Bonuses for bankers who arrange structured credit rose 15 to 20 percent on average this year, beating increases of 10 to 15 percent for credit-default swap traders." (Bloomberg, Dec 12)*

*"The bonuses at Goldman and elsewhere on Wall Street are expected to give the New York area's economy a substantial boost, particularly in sales of high-end residential real estate, luxury cars and other pricey goods." (NYT, Dec 13)*

*"...unit labor costs in the nonfarm business sector rose at an annualized rate of 2.3% in the third quarter [and] fell at a 2.4% rate during the second quarter [both below the rate of inflation]." (WSJ, Dec 6)*

*"[Bernanke] said labor costs 'have been rising more quickly of late,' and there is a 'worrisome possibility' employers will pass on costs to consumers, causing inflation to accelerate. Wages as a share of value added in the private sector fell to 50.5 percent last quarter, the lowest*

*since World War II.” (Bloomberg, Dec 7)*

*“Executive-pay consultants, about to lose their anonymity as the result of a new federal [SEC] rule, are asking the companies they advise to shield them from lawsuits by shareholders angry over lavish pay packages for corporate executives.” (Bloomberg, Nov 15)*

*“In 2000, the top 1 percent of the world's population -- some 37 million adults with a net worth of at least \$515,000 -- accounted for about 40 percent of the world's total net worth. The bottom half of the population [over 3.2 billion people] owned merely 1.1 percent [in total] of the globe's wealth. ” (NYT, Dec 6)*

*“The [media] Freak Show is new. Its incentives for divisiveness are embedded deeply in political and media culture. These incentives—for publicity, for influence, for money, for votes—favor more extreme and uncompromising positions, provoking the ruthless tearing down of adversaries ... The Freak Show is the enemy of ideas. But ideas are also the enemy of the Freak Show ... The cumulative effect of these incentives and the actions they inspire is a political system constantly staggering toward the irrational ... Its incentives breed division even when the underlying issues are of minimal relevance. It obscures legitimate debate behind clouds of accusation and spite.” (“The Way to Win, Taking the White House in 2008,” new book by Mark Halperin, political director ABC News, John F. Harris, national political editor “Washington Post”)*

## **2. Private Equity Is Unfair, Wastes Capital, Distorts Corporate Resource Allocation**

In addition to the inequitable nature of private equity deals highlighted by the Lewis' quote above, my main criticism of private equity and the rest of the global hyper-speculators, such as hedge funds and investment banks like Goldman Sachs (mainly a very large hedge and private equity fund), is the economically unproductive ways in which they “earn” their extraordinarily high returns on leveraged legal looting (ROLLL) (see the section with that title along with several others in my 18-section Oct 27 article, “Global Strategic Bargain: Positive Reality Therapy for America’s Critical “States of Denial,” [link](#))

In the case of private equity buy-outs, this done is by leveraging and cosmetically re-packaging companies to then sell them back to the public markets, adding very little real value, especially in the form of innovative new products and services.

Leveraged buy-outs were rationalized back in the 1980s as necessary to shake-up an admittedly then sclerotic and complacent corporate America.

But since that time, supposedly "efficient" and "free" capital markets have supposedly incentivized CEOs, via exorbitant stock options, to "enhance shareholder value," via layoffs, outsourcing, pension and benefits cuts, wage suppression, working condition changes, etc. As a result, corporate profit margins are at all-time highs, while the percent of employee compensation is at an all-time low.

If all this shareholder value enhancing was supposedly done by CEOs already, then after two decades of it, what could possibly be the role of private equity in now supposedly greatly providing even more of the same?

However, if public companies haven't enhanced shareholder value by such draconian actions and now need to be wholesale replaced by private equity, then the whole system of "free capital markets" and corporate governance that the ex-Goldman Sachs U.S. officials mentioned above are trying to persuade China and the rest of the world to adopt was a legalized fraud perpetrated for the benefit of the very few who have become unfathomably rich.

Even if the day of reckoning of the current immense wave of private equity deals were continued to be postponed another year or two, this unproductive use of capital already has greatly distorted global capital market flows, corporate incentives, and thus corporate allocation of scarce and critical resources, especially all-important human talent.

*"...all the wheeling and dealing stems from lots of money sloshing around the global markets, as interest rates remain low ... That suggests many deals are financial bets, not strategic business moves, perhaps reducing their chance for success." (WSJ, Nov 22)*

In reality, private equity buy-outs have become essentially what I have called return on leveraged legal looting (ROLLL). It is not unique in that, but simply one manifestation of many types of global hyper-speculation with the same purpose, to greatly enrich the very few by ROLLing the rest of the world's population.

In that, the global hyper-speculators, which would include their corporate CEO collaborators, have already exceeded beyond their

wildest dreams. For them, it is a very happy holiday, every day of the year.

*"When it comes to wealth, one in every 325 [American] households had a net worth of \$10 million or more in 2004, more than four times as many as in 1989 ... the winners include numerous partners in recently formed hedge funds and private equity firms ... Seventy-five percent of the chief executives in a sample had a net worth in 2004 of more than \$25 million mainly from stock and options. That was up from 31 percent for the same sample in 1989, adjusted for inflation." (NYT, Nov 27)*

The massive unproductive use of debt in the current private equity buy-out boom is similar to but larger than the unproductive use of equity by another form of private equity, venture capital, in the huge TMT equity bubble of the late 1990s, which eventually resulted in an \$8 trillion loss in equity value.

In both cases, private equity depends, as Lewis says, on the "idiocy" of the mutual and pension funds (and also hedge funds, whose returns are much lower than private equity, with a far smaller dispersion of results between best and worst, both indicating much more competition among hedge funds in the public market than exists among the small, exclusive private equity "deal clubs").

*"What is worrying institutional investors is that [private equity] funds are coming back to them too quickly for money ... The value of private equity-backed buyouts this year doubled to \$602.4 billion from last year, on 1,912 deals. At the same time, the value of their exits is down 23 percent to \$176.8 billion. The number of exits, which include selling to other buyers or public offerings, is down 24 percent to 698 ... buyout firms used to take four to five years to spend their funds. institutional investors had money going out and money coming in. Right now, the money is mainly going out. Indeed, so many big funds are spending money so fast that it's sucking demand from investors." (Reuters, Dec 16)*

It was much easier for the public to eventually, albeit far too late, see the unproductive use of capital in the TMT equity bubble, when in retrospect after the bubble collapsed all those previously highly praised "business models" were finally recognized for what they really were, essentially legalized fraud, though virtually no hyper-speculative perpetrators did time for them, unlike some corporate essentially co-conspirators. Corporate America politically paid for the sins of Wall

Street with Sarbanes-Oxley, which then further drove corporate CEOs into the arms of the private equity buyout firms.

However, it is virtually impossible for all but the financial and corporate elite to see a similar unproductive use of capital at work in the deliberately less transparent current buy-out debt bubble, and in the deliberately even more opaque derivatives/structured finance markets, so non-transparent and over-extended that even the regulators, usually compliant yes-men for Wall Street and the City of London, have increasingly expressed their concern.

### **3. Da Boyz Simply Never Know When Enough is Enough**

Like the current version of Britney Spears, all sorts of hyper-speculation which started out as once relatively harmless, perhaps sometime even good, ideas have been pushed way too far, as is usually the case, simply due to that age-old malady of the elite that is unfortunately hard-wired into parts of the human brain, obsession with greed, power, status (and Freud would add sex).

In the case of derivatives and structured finance, their legitimate role in risk management, often extolled by Greenspan, has been turned into a veritable orgy of paper speculation on a scale many times the global economy that is hard to grasp by anyone, including the regulators.

*"The use of derivatives grew at the fastest pace in eight years during the first half of 2006, boosting earnings at securities firms. The face value of derivatives jumped 24 percent to \$370 trillion, according to the BIS. It was the biggest percentage rise since the bank began keeping records in 1998." (Bloomberg, Nov 17)*

In both types of private equity, buy-outs and venture capital, the original intent was perhaps actually somewhat justified. Especially with venture capital, the tech equity bubble story was very easy to sell the public, because it was initially true.

Venture capital did play an indispensable role in financing risk-taking innovation making America and the world more productive and creating great new products and services, often tied to the Internet (though the key role of government in its initial development was usually omitted in the telling by the later commercializers).

The private equity buy-out story has a lot less sex appeal, hence the

public has been kept largely unaware of it. How can you put a positive economic spin on these stories?

*"Clayton Dubilier & Rice, Carlyle Group and Merrill Lynch put up \$2.3 billion of the \$15 billion they paid for Hertz in December [2005]. The owners have received a dividend of \$1 billion and plan to get another payout of about \$420 million. Coupled with the group's remaining 72 percent stake valued at \$3.46 billion, the owners more than doubled their investment. shaved cash and cash equivalents almost in half. net income slumped 77 percent. Total debt increased 32 percent to \$14 billion. Interest expense almost doubled to \$672.6 million."  
(Bloomberg, Nov 16)*

*"After Weetabix Ltd., the maker of Britain's best-selling breakfast cereal, fired 7 percent of its workers and canceled the employee bus service to free up cash for debt from a leveraged buyout, the company borrowed 130 million pounds (\$249 million) so it could enrich owner Lion Capital."  
(Bloomberg, Nov 1)*

*"Kohlberg Kravis Roberts and Carlyle Group, the manager of the biggest U.S. buyout fund, are among 13 private equity firms accused in a class-action lawsuit of rigging the market to take companies private. `Investors in the target company are deprived of the full economic value of their holdings and `squeezed out' at artificially low valuations,' the suit says. The U.S. Justice Department launched an informal antitrust investigation into allegations that private-equity firms collaborated on leveraged buyouts, according to a person familiar with the matter."  
(Bloomberg, Nov 15)*

In the case of both the venture capital equity bubble and now the buy-out debt one, the first and most obvious deals are usually the best, and often provide huge real economic value. E.g., with venture capital, Yahoo, Amazon, E-Bay and Google have greatly helped change the world.

But as with all the ridiculous IPO's that were funded in addition to the healthy ones, with the "plausible denial" excuse that one couldn't tell the difference, the current buy-out mavens simply don't know when to stop, or rather they know, but simply can't help themselves, like all obsessive-compulsive addicts.

I maintained at the time and since that every "professional" involved probably knew, on some level, that the huge number of stupid business plans going public in 1999 were essentially legalized frauds,

but that didn't stop the vc's and investment banks from shoveling out many hundreds of them that year to the public, to their enormous self-benefit, nor Lewis's "idiot" funds from buying them, much to their investors' later loss, anger and chagrin.

The same thing is happening today. So if investment bankers at Goldman Sachs admit that these deals are "borderline stupid," from a quote in the lead section, then why are they still being done in record number and size?

Duh?! Academic fairy tales of "efficient" and "free" capital markets to justify this supposedly "rational" behavior are spun for the very same reason that it exists in the first place, excessive greed.

It really doesn't take an economics ph.d., in fact it helps not to have one, to see that private equity and all the other global hyper-speculators are obsessively driven by their "need" for yet another mega-home, another yacht, another private jet, another luxury car, another private school, another vacation, another facelift, another plaything, another "experience," another trophy wife, another mistress, another another.

To constantly grasp for more of everything, the global hyper-speculators just keep "pushing the envelope," with each deal becoming more unjustifiable and ridiculous than the next.

With the paper dollar adrift from real value since 1971 and absolutely no financial "adult supervision" in the credit and derivative/structured finance markets and central banks reining in those out-of-control adolescent emotions, these waves of deal-making and speculation play out until economies, nations and their ordinary citizens eventually really do get unjustifiably hurt, one way or another.

In the process, the well-educated and perhaps even once well-meaning (especially in the case of venture capital) perpetrators have lost all sense of perspective and culpability (see the section titled "Self-Described 'Schmucks' of the Financial World" in my Oct 27 article, "Global Strategic Bargain," [link](#)).

#### **4. Why Are Management Buy-Outs Even Legal?**

With corporate profit margins already at all-time highs, and the share of employee compensation at all-time lows, the last thing corporate America probably needs is even more incentives, either to avoid or

participate in buy-outs, to do even more of the same.

Are the private equity owners going to actually spend out of their own pockets on development of great new products and services, capital investment, employment, etc.?

Again, duh?! Of course not, they wouldn't know how (they're not actually as smart and capable as they claim), even if they wanted to, which they don't.

They are simply going to leverage with even more debt, loot the companies they buy, pay themselves a huge cash dividend, then flip the sucked-out leveraged company back to the public.

As I mentioned earlier, the impact on corporate decision-making to avoid this fate is one of the biggest negatives of private equity. Since this was well expressed in the following quote, I'm repeating it from the section titled "Return on Leveraged Legal Looting (ROLLL)" from my Oct 27 article, "Global Strategic Bargain" [link](#):

*"Cheap credit is everywhere ... the most avid consumers of leveraged loans have been private equity groups. Many corporate executives sniff at what they see as financial engineering, especially when private equity groups quickly sell their investment or lock in their returns by floating a portfolio company on the stock market. It is even harder for a CFO to announce that he is planning to trash his employer's credit rating just for the sake of returning capital to investors. The current situation has created an arbitrage that is being exploited by private equity groups at the expense of public shareholders. Either defaults begin to rise and corporate credit conditions tighten again, limiting the scope for buy-outs, or companies will inevitably conclude that they should be more aggressive in their borrowing." (Peter Thal Larsen, FT, Sep 26)*

The very largest private equity funds and investment banks belong to an oligopolistic "deal club" dominated by a very small handful of firms that make far higher returns than others in their hyper-speculative "industry," including hedge funds.

Unlike corporate investment, which generates innovative new products and services and jobs, these hyper-speculative entities do very little economically and socially useful.

Unlike another form of private equity, venture capital, there is not

even the pretense of buyout funds investing for progress. It is simply legal looting for the sake of a very small group.

Thus, it is not unreasonable to ask why is this looting activity even legal. Ben Stein asked that question, specifically with respect to management buy-outs, I'll repeat the quote again from the ROLL section from my previous article, "Global Strategic Bargain" [link](#).

*"[management buyouts] should simply not be allowed at all as a matter of law ... they buy the assets on the cheap and sell them off for their own management benefit, or they manage the company differently for the benefit of themselves and their buyout partners ... breaching that fiduciary duty ... management is seeking to pay the least it can get away with for the assets of the public holders, while the public holders want the most they can get. irreconcilable conflict of interest ... lack of full disclosure ... [buyout] memos are not disclosed to the stockholders or to the market generally ... insider trading. what is a management buyout other than trading on inside knowledge?" (Ben Stein, NYT, Sep 3)*

This is now a global issue:

*"Management buy-outs are fraught with conflicts of interest anywhere. In Japan, MBOs take these risks to even higher levels - as shareholders are learning to their cost. The actions of some Japanese management teams, and the private-equity funds bankrolling them, are notable ... Minorities [shareholders] are effectively being bought cheaply. Worse, from investors' perspective, their options when faced with an inferior offer are severely constrained." (Lex, FT, Dec 4)*

One powerful group is trying to protect itself.

*"Bondholders worldwide are suffering a double whammy this year because more than 80 companies controlled by LBO firms have borrowed at the expense of workers and debt investors just so they can pay themselves dividends ... The payments have helped the [buyout] firms recoup 86 percent of their investments within two years." (Bloomberg, Nov 1)*

*"The world's biggest bondholders are determined to make an example of Henry Kravis. Pacific Investment Management Co. and Advantus Capital Management, frustrated by the sudden losses caused by leveraged buyouts, are forcing companies to guarantee immediate payment of principal whenever the borrower is acquired by Kohlberg*

*Kravis Roberts, Blackstone Group or any of the dozens of LBO firms that have ravaged the corporate bond market." (Bloomberg, Nov 7)*

## **5. Private Equity Is a Bad Global Financial Model for Industrializing Nations**

I have a final criticism of private equity. The combination of its capital market distortions and inequity has made private equity a terrible "business model" and "brand image" of the current version of Wall Street-City of London hyper-speculative financial capitalism for those regions of the world that might learn from a better model, most especially China, India and the Middle East.

*"...the aims of foreign policy go far beyond the misnamed 'war on terror' ... Equally important are maintenance of a prosperous world economy, management of the rise of new great powers, economic development, not least in the Islamic world, and management of the global commons ... The victories over communism were not secured through force of arms, but through the attractions of the west's prosperity, freedom and democracy ... The right way ahead ... should go via the power of US example rather than its military power and via its ability to give a lead rather than unilateral dictation. The great US policymakers of the 20th century understood that well." (Martin Wolf, FT, Nov 28)*

Wolf is the well-regarded chief economic writer of the FT. Without minimizing the importance of the use of military power when justified in legitimate self-defense, I fully agree with his emphasis on the critical role of economic development and America's example. Btw, the division in academic international relations theory between "high" (security) and "low" (economics) politics has always been silly since the real-world of course makes no such distinctions.

If the 20th was "America's century" and the 21st may eventually become China's, how China develops should be of major importance to Americans, yet they are being very badly misled on the China issue, by the "Freak Show" media and both Republicans and Democrats (such as Pelosi, Schumer, etc).

China and Asia had devastating first-hand experience in the so-called Asian financial crisis of 1997-98 and fully understand that the current American-Anglo version of so-called "free market" capitalism is designed solely for the benefit of the global hyper-speculators, and they will only play along with it so long as doing so is perceived to be

to in their self-interests.

This major, permanent shift in Asian perceptions, both elite and popular, of Wall Street-City of London hyper-speculative "free market" global capitalism was totally lost on most Americans, with the exception of a few such as Nobel economist Stiglitz, then at the World Bank, due to the "Freak Show" media pre-occupation with Clinton's sex life in 1998 (Rubin was Clinton's Treasury Secretary at the time, economist Summers his key aide).

China is in the midst of a multi-year effort to try to reform its financial system. The U.S., led by ex-Goldman chief Paulson, is strongly trying to influence it in the direction of the American-Anglo "free market" model, rather than perhaps the more traditional Asian one of state dominated banking systems that produced remarkable results in the industrial rise first of Japan then later S. Korea, both under authoritarian regimes. (For more on this, see the section titled "Whither China?" in my Oct 27 article, "Global Strategic Bargain," [link.](#))

China going from the huge problems of its own state-dominated banking system to the Wall St-City of London hyper-speculative "free capital markets" model would be somewhat like jumping from the frying pan into the fire, but that limited choice is the way the issue is always framed.

*"Some bankers have expressed dismay at bureaucratic hurdles and funding requirements, which analysts have said are designed to soften the impact of foreign competition on inefficient and often largely insolvent local [China] banks. Some [global] banks have protested local incorporation will complicate global operations. But Beijing has insisted it is necessary for consistent oversight and in line with global practice." (FT, Nov 15)*

*"Reform of China's banking sector has only just begun. Despite pouring more than \$18 billion into minority stakes in Chinese banks over the last few years, foreigners haven't made much headway in changing their partners' outdated lending practices ... it's in the [Communist] Party's interest that banks like Citi succeed." (editorial, WSJ, Nov 22)*

I would make a similar argument with respect to the Middle East. The very real problems caused by millennia-old feuds over religious identities are not going to be solved until more practical issues are also

addressed, such as the lack of good jobs and education for unemployed youth, and clean water.

But rather than trying to address such issues, burgeoning massive Arab oil wealth is currently trying to build up its own version of Wall Street-City of London hedge and private equity funds and financial centers. This is simply not going to help solve the ethnic, religious and sectarian violence in that region.

To help solve the many often seemingly intractable global issues, including global warming, the world needs to see a better "face of American capitalism," a more progressive, technology-based industrial renaissance, seriously addressing the needs of global urban and rural development, clean sustainable energy, universal quality health care and education, etc., etc.

Right now, the distorted U.S. financial system and economy is so far away from addressing these needs, due to its free ride of massive credit creation on the basis of the paper dollar, and the prospects of that changing look so remote, that ultimately China, India (new U.S. nuclear deal notwithstanding) and the rest of Asia, with or without U.S. ally Japan, along with Russia and other countries, will simply keep moving further away from the U.S. into their own economic development bloc.

## **6. Some Extraordinarily Good News for the Holidays ...**

This being the holiday season and my not wanting to completely appear to be Ebenezer Scrooge, I want to very briefly counter-balance this "bah humbug" tale of Wall Street greed with some very good news.

For example, despite the tech equity bubble, not because of it, the Internet already really is one of the greatest communication and social innovations, ever, in terms of sheer global scale and scope, spurring unfathomable amounts of world-class creative collaboration that is changing the world greatly for the better. Bioscience really is in the middle of one of the most potentially awe-inspiring and beneficial scientific and technological revolutions, ever.

While most Americans would agree with this, they don't share my view that the "peaceful development" of China, India, Russia and some other major countries really is one of, and potentially, the most unprecedented, positive economic and social transformations, ever,

again especially in terms of sheer scale and scope.

Failure to understand these profound changes in the global economy is one of the main reasons economic, political and social critics and doomsayers and investment bears (often concerned with avoiding the very real "this time is different" trap) have tended to get things wrong so far in the 21st century.

Those who have tended to make this mistake also often intensely dislike Greenspan, an authority figure, who far better than most more clearly understood, starting in 1996, the positive impact on controlling inflation of two successive massive global positive "supply shocks," first of the Internet in the latter half of the 1990s and then China's unprecedented growth in global manufacturing following its WTO accession in 2001. Nonetheless, Greenspan of course did get monetary/credit policy wrong, for which eventually a price will be paid.

## **7. ... And Some Very Bad News**

All of human history has shown over the long run not to bet against human creativity and progress. But all of human history has also shown that it is just as unwise to bet against the negative aspects of excessive human greed and power. Human progress is not pre-ordained, nor does it go in a straight line.

Establishment supporters and apologists and investment bulls and cheerleaders tend to make this mistake. They tend to conflate and confuse the extremely positive trends in the real economy, such as those mentioned above, with another extremely negative trend, the complete hijacking by private equity and hedge funds, investment banks and all the rest of the hyper-speculators of the global financial system, solely for their own selfish benefit.

The hyper-speculator practitioners and their apologists would have you believe that they represent "free capital markets" and are one of the prime causes of global peace and prosperity and the extremely positive real economy trends that I mentioned above.

Whereas the exact opposite is actually true. These so-called "free capital markets" are actually oligopolistic control of the world's financial system by a handful of extremely powerful firms, whose domination of a virtually unlimited supply of global credit, supported by compliant supposedly "independent" central banks, enables them to earn inordinately excessive returns on leverage legal looting (ROLLL)

and thus expropriate the real wealth of the real economy for a very select few.

The true innovators in the Internet felt that the financial shenanigans of Wall Street were the sideshow. Google's founders clearly felt that way during its own IPO after the bubble collapsed.

But to Wall Street, the Internet and all other real wealth-producing innovations is the sideshow. Wall Street could care less about the actual, real-world benefits of the Internet, or of bioscience, or China for that matter, viewing each as simply the next "new, new thing" to exploit solely to line its own pockets.

Wall Street readily moved on without skipping a beat from the Internet bubble as soon as it collapsed to the real estate bubble, leaving the investors and denizens of the previous hot arena to pick up the pieces. Btw, venture capital private equity has modestly picked up the pace this year. Unfortunately, one area of focus is Web 2.0 ad-based narcissistic social networking, not what the world needs more of.

The stakes are so high in real estate and in China that Wall Street and the Fed will first try to do everything it can to take to prevent a true crash in the former and to heavily penetrate the financial system in the latter. But make no mistake about where Wall Street's ultimate loyalty will always solely lie, its own pocketbook, it has no national loyalty.

## **8. Weakening Dollar, Déjà Vu All Over Again, and Again, and Again**

The first quote in the beginning of this article about private equity being the new "face of American capitalism" from the co-founder of the Carlyle Group (which, btw, Bush Sr. has been associated with) shows the same level of hubris as Bush/Cheney, and although it is far more "reality based," such arrogance may eventually suffer a similar setback.

But for the moment, while Bush/Cheney are under pressure, private equity has been very safely flying under the radar screen of the vast majority of Americans, who barely know it exists, let alone what it is doing and the effects it is having.

One of the main points in Lewis's article quoted in the first section is that the American middle-class seems so surprisingly complacent

about being fleeced by private equity. He writes:

*"One of the miracles of Wall Street is its ability to create a class system without class resentment ... There is, you might think, a war waiting to happen between the Haves and the Have-Mores. And yet no one much complains ... from time to time ... the proles take to the streets with their pitchforks and torches. But they don't seem to be disturbed by the inequality inherent in the financial markets in good times ... the investment lower class is surprisingly docile ... But it's going to be hard to keep them distracted ... Trust me. The ordinary investor is now and forever cast in the role of the peasant at the king's banquet. He's so happy to have any food at all that he fails to notice that bone between his teeth isn't the meal. It's the scraps." (Michael Lewis, Bloomberg, Dec 11)*

I've mentioned in the past the many "déjà vu" similarities between the current global economic/political situation and the one in the early 1970s (Middle East wars, rising oil prices, and increasing terrorism being a few of them).

One of the most obvious is that back then, while the antiwar left and liberals were pre-occupied with the Vietnam War and Nixon's impeachment, virtually no one outside a very small circle of financial insiders really understood the profound ramifications when the post World War II "Bretton Woods" monetary/financial system was changed by a stroke of a pen on August 15, 1971.

That change led to the current financial/economic system and its problems that the world is currently facing. It was no accident that from the very next year, 1972, the strong post WW II rise in average weekly real (inflation-adjusted) earnings of American workers stopped dead in its tracks, and have declined -17% since then, a profound break with the previous three hundred-plus years of American history, while income and wealth inequality have reached an all-time high.

A similar thing is happening today, this time with Iraq replacing Vietnam. While public debate in the "Freak Show" media and opinion polls are completely dominated and divided over that issue, virtually nothing is being said about the profound transformations in the global financial system, changes which may eventually lead to various crises, as was experienced in the 1970s.

E.g., the potential of a dollar crisis somewhere down the road is very slowly ebbing into the news once again, driven by the continued

explosive growth in non-productive debt for their benefit by the global hyper-speculators.

*"Rubin, Treasury secretary under Clinton, and former Fed Chairman Volcker said foreign investors probably won't keep increasing dollar holdings, raising the risk of a slump in the currency. ``It seems almost inconceivable that this will continue indefinitely," Rubin, who now chairs Citigroup's executive committee, said. ``It's incredible people have gone on so long holding dollars," Volcker said."*  
(Bloomberg, Nov 15)

*"Fed Dallas President Fisher clashed with United Arab Emirates Central Bank Governor Sultan al-Suwaidi, who said the euro will overtake the dollar by 2015" (Bloomberg, Nov 17)*

*"...comments from Wu Xiaoling, deputy governor of the People's Bank of China, indicating her unease at the rapid build-up of \$1,000bn of reserves in China. She said Asian foreign exchange reserves were at risk from the dollar's fall." (FT, Nov 24)*

There is always the possibility, as is analyzed by many on the web sites that post my articles, that the financial system itself may either implode (deflate) or explode (inflate) under the weight of increasingly unproductive debt creation by the global hyper-speculators.

Even if that day of reckoning continues to be postponed, then at minimum the tremendous increase in global inequality, both between and within nations, will tend to continue to produce more social and political tension.

Because of America's historical social/political "exceptionalism," greatly aided by the benefit of incurring its unprecedented debts in its own currency, significant political reform probably will not happen in the U.S. But that simply means that these rising tensions will keep getting pushed abroad.

Very unfortunately, the "Freak Show" of both old and new media continually exploits the fact that the world's population has always been divided, to the immense benefit of a globalized elite, by overly zealous nationalism, religious fanaticism, racial and ethnic hatred, and other modern if anachronistic manifestations of ancient clan/tribal identities deeply hard-wired into the human mind.

This makes it much easier for U.S. workers, and Democratic party

leaders, to get angry at China than at the CEO of the global corporation company that moved the factory there in response to the incentives of the global hyper-speculators (whose predecessor moved it to the American south from the north many decades before that for essentially the same reasons, to exploit divisions in the population).

*“Democrats are returning to power on Capitol Hill just as two powerful wings of the party, labor and Wall Street, are colliding over economic issues. The dispute over trade and budget policies prompted a high-level private meeting earlier this month between AFL-CIO President John Sweeney and former Treasury Secretary Robert Rubin, who is now chairman of the executive committee at New York-based Citigroup.” (Bloomberg, Nov 22)*

Contrary to popular opinion, Wall Street has always been a “powerful wing” of the Democratic party. But Rubin is not FDR, Sweeney is not the labor leaders of the 1930s, Pelosi gets her wealth from her real-estate developer husband, and it’s no accident that Hillary Clinton moved to become one of the senators from Wall Street, the other being Schumer, the most important Democratic fund-raiser in the mid-term election (along with Clinton's Democratic Leadership Council protege Rahm Emanuel).

For more on “Any Hope for the Dismal State of Politics in America,” see the final section with that title in my Oct 27 article, “Global Strategic Bargain” [link](#).

Until some political party, and as I said in that section I honestly don’t care which it is, eventually comes up with the 21st century version of a “New Deal” for globalization, the “Freak Show” will dominate American politics and hence the world will remain at great risk of being drawn into yet more wars in the coming year, with the Democrats being just as inclined to do so, if not more so, than Bush/Cheney, especially in parts of the Middle East.

Once again, thanks very much to all those who have read my often overly long articles this year and best of luck in 2007. [econotech](#)

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