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The high price we pay for price manipulation

Real Money

By Rob Rikoon | The New Mexican

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It's summertime and the sweltering streets of New York and Washington, D.C., are empty of all but those hapless few who failed to make arrangements to get out of town or who have to work for a living. Wall Street is quiet except for the public relations and law firms assigned to dealing with the recent uproar in the press over LIBOR — the London Interbank Offer Rate. Very few individuals outside of the world of finance understand what LIBOR is or realize what impact it has on the lives of everyday people.

Here's a hint, if you have money in a bank and are not happy about your paltry earnings rate, you are a victim of the LIBOR manipulation scheme which has pitted you against the large banks and governments who collaborate to keep things "calm." At the height of investor fears in 2008, regulators were guided by political leaders to allow cheating so that the public would not abandon many institutions which were in danger of losing funding from the market. This would have caused a "run on the banks" in much the same way that Spanish depositors presently are withdrawing money en mass from their weaker regional savings and loans, necessitating federal government intervention paid for by taxpayers somewhere, someday.

The banks rigged interest rates for the same self-serving reasons as Social Security underreports inflation: It lowers their cost. A major goal of every elected official is to say that they helped promote growth; another goal is to avoid being blamed for any "meltdowns." LIBOR was manipulated for profit and this was sanctioned by authorities so the public's confidence in the markets' stability could be maintained, and so it has been.

This is evidenced by the fact that interest rates have remained steady and stock returns have been positive, though tepid. Nonetheless, we have not seen any major upsets other than in real estate, and there the government has intervened to help temper the downturn. By and large, the Great Bailout of the banks, of which the unfolding story of the LIBOR scandal is part of, has worked. One unforeseen nonmonetary cost of public financing of private mistakes has been a loss of faith in the fairness of the public securities markets. This deep-seated skepticism is well founded. Eventually, if there is no trust, there is no system and that is a huge problem.

Banks no longer primarily function as conduits of capital to new businesses because they make most of their money playing games with securities and selling stuff for fees. The widespread, behind-the-scenes control of the markets not just for LIBOR rates but of all price levels is one reason this economic recovery is bereft of jobs for the middle class. We saw in 2008 that mispricing by the big investment banking players in mortgages and derivatives ended up as an expense of the taxpaying public while the benefits of government-approved borrowing went to private salaries and bonuses. This situation continues today due to totally ineffective government mandated "reform" under the hollow Dodd-Frank Act. Bankers do not want the public to know how much they make on trading individual contracts as that would cut into their profits. Without transparency, which means instantaneous, public access to private trading, wealth will continue to accumulate in the hands of those with real-time information. The lesson here is that we can’t have it both ways: Individual investors will get fairness and opportunities for solid long term investments only if the financial giants lose some of their power.

Watergate was a watershed event for politics in the sense that the duplicity of the president was revealed and the power and prestige of that office has never been the same. The U.S. Congress’s ineffectualness to take a leadership role in dealing with our budget deficits is obvious, and so everyone knows that swapping out the old guard for the new in November isn’t going to make a difference; therefore our current style of democracy is structurally flawed. LIBORgate may be the event that indubitably shows the complicity of the financial institutions in the decline of fortunes of the middle class. As a member of that industry, I am determined to find ways to get around the inherent negative bias of financial instruments. It involves taking actions that are neither convenient nor totally secure but no one said it was supposed to be easy.

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