Attitudes about Debt Need to Change

REAL MONEY column for The Santa Fe New Mexican
By Rob Rikoon

December 6, 2011

Now that the financial world has turned upside down again, this time from Europe's spending excesses, the central banks of the richest countries have banded together to calm skittish investors. With the salve of easy money and joint communiqués, they have, so far, been able to stabilize stock markets but keep your eyes on a much more important indicator of the global money system's health: government bond markets. Absent massive ongoing triage, places like Italy and Spain look like black holes.

Behind the scenes, the International Monetary Fund and Federal Reserve have come to the rescue. Whether the European Union hangs together or some of the southern periphery countries get hung out to dry separately isn't the key issue anymore. Everyone knows, on some level, that the easy money and good times it created are over for most of Western Europe's populace. The privileged upper class, known as "the 1%", probably gets to keep their piles of capital and continue with their conspicious consumptive habits but what can the rest of us do to secure a decent lifestyle in this new world of slow growth, government defaults and reduced social benefits?

One important thing to keep in mind is a sea change in attitude about debt. For the past 60 years, governments waged wars and consumers bought houses and toys with borrowed money. If the war was won, the debt was paid off except in England, whose long tenure as a world power ended with the devastation of their empire in World War II. As long as wages grew and stable job opportunities abounded, it was no problem for people to take on big mortgages that could be paid off with cheaper, inflation adjusted dollars. It made for good business for everyone: Main Street and Wall Street both feasted on the profits that this kind of juiced up, economy wide growth produced. Real estate developers and investment banks thrived because the more money they borrowed, the more money they made. This held true only so long as prices were going up. When prices for real estate, labor, and manufactured goods became stagnant and started falling, things began to fall apart.

The growth model of the West has been to borrow against the future. This basic premise is vulnerable to any kind of sustained loss of the public's sense of confidence. The stock and real property markets depend on people's willingness to take risk. When the primary basis of an economy stops being its productive capacity and instead comes to rely on ever increasing levels of consumption based on paper promises, any major jolt to investor's feelings of security can become the death knell for even the "safest" assets. All the global banking mechanisms that are about to be applied to the current crisis in Europe so it doesn't spread here or to China will not work on a permanent basis. There will be defaults, currency devaluations and/or rampant inflation.

In 2007, some banks couldn't show they had the ability to make good on their own borrowings. In 2011, a wide variety of governments lack any way to pay their current or future debts. Both banks and governments have been able to get past these basic structural flaws by creating financial instruments that they have been able to sell to an unwitting public. Those days are coming to an end. Investors are flocking to U S government debt as one of the last refuges of stability but what is really behind that curtain?

In preparation for the unknown and unthinkable (government bond defaults, monetary devaluations, or revocation of currency privileges), many individuals who can afford to are paying their debts off for the same reason that companies who can are hoarding cash. Most Western governments are unable to pay their debts off and unwilling to tell the truth to their citizens. My advice is to move assets into places that do not depend on government or the banking industry's support. This is not easy to do as the long arm of debt reaches many quarters. In my next article, I will describe some creative efforts to match up investors' desires for a different kind of security with local agricultural ventures.

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