

Only way out is to let long-overdue recession happen

From Dr Walter Grant Scott.

Sir, Capitalism is under attack on all fronts - a little unfairly. Capitalism is a mechanism, and a very effective one, for matching the needs of capital, labour, material producers and consumers. Effective as it is, its outcomes are dependent on the boundary conditions within which it operates.

Governments' responses to the present crisis are towards increased national ownership/management and increased regulation. Yet in many ways our present predicament is a consequence of both such involvements in the last 20 years.

The bail-out of Long-Term Capital Management in 1997 established a pattern for printing large quantities of cheap money. This is not the capitalist mechanism at work.

The introduction of regulation to the greater part of the financial industry worldwide has accomplished little more than clearly defining the areas not regulated: the zone where the fast and loose could operate, specifically the hedge funds, alternatives, structured investment vehicles and so on. The result of these was that moral hazard ran rampant.

In the absence of governments' interventionist activity from 1997 onwards, a shortage of credit or money would have been met by a rise in interest rates that would have prevented bubbles forming. In the absence of the regulators there would have been no twilight zones for the fast and loose. The constraints on market excess would have been *Caveat emptor*, and My Word is My Bond - the old "City" code of ethics. Break them - and you will never work in the City again! The very existence of a regulator superseded and nullified these more fundamental principles.

The lessons are clear - all governments are rushing headlong into repeating on a grand scale the mistakes that have created the situation that we find ourselves in. The laws of arithmetic can be postponed but cannot be altered. Government intervention and regulatory freneticism will surely exacerbate our present predicament in the long run.

Unpalatable as it seems, the only way out is to send the regulators home, stop pouring taxpayers' "good money" after bad, and let the long-overdue recession happen.

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