malik management

malik on management®

m.o.m.®-Letter 03/12

for Right and Good Management

«Malik is (...) the leading expert on Management in Europe. (...)»
Peter Drucker, Doyen of Management

«Fredmund Malik is one of the most influential business thinkers in Europe.»
Business Week

Market destruction by governments

» Companies forced to take on debt
» Horrifying destruction caused by central banks through zero interest rates
» Final act with a sequel to follow

Keywords: economic crisis

Malik Solutions

Cybernetic instruments and methods for perfect functioning:
malik-management.com/en/malik-for-organisations/solutions-and-methods

Malik bestseller in English

Managing Performing Living:
Effective Management for a New Era

More information on page 47

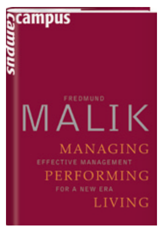


Table of contents

Foreword 28

Market destruction by governments 29

1. The start of the final act with an undetermined sequel........ 29

2. The opening acts of 1995 and 2002: not yet evil, but already criminally naïve 33

3. What comes after the final act? 40

About the author........ 43

Index........ 44

System-cybernetic Malik knowledge 45

Reader services and information 47

Impressum

ISSN 1662-2200 (Internet), Volume 20, appears monthly. **Publisher:** m.o.m.® Malik on Management AG, Geltenwilenstrasse 18, CH-9001 St. Gallen.
Author: Prof. Dr. Fredmund Malik, Malik Management **Obtaining the m.o.m.®-Letter:** Information and subscription: malik.management@malik-mzsg.ch

Foreword

For **entrepreneurs and executives**, the subject of this issue of m.o.m.® is one of the most important guidelines for everything they do.
This issue of m.o.m.® conveys a fundamentally new understanding of the debt crisis for the functioning of markets and the role of governments, central banks and commercial banks. Many readers will really be able to understand for the first time what the **worldwide debts** really mean and why the previous well-meant attempts at a solution only prolong and intensify the crisis in reality.

Together with his colleague, *Professor Otto Steiger* who passed away in 2008, *Professor Gunnar Heinsohn* was the first – and so far virtually the only person since the early 1980s – to properly describe the mechanisms leading to today's **dramatic debt crisis that is threatening the economy, the state and society**. This could have been easily avoided with Heinsohn and Steiger's **«property economics»**. Instead, the crisis was actively brought about through the false economic doctrines that have been taught untiringly at universities until this very day. The work of Professors Heinsohn and Steiger has overturned practically the entire approach of previous economic theory. This is wrong and cannot therefore deliver the right measures for solving these immense problems.

The subject of this issue of m.o.m.® calls for concentrated reading. The result will be enriching and a fundamentally new perspective on today's economic and financial issues, which practically no one understands.

I thank my colleague Professor Heinsohn for this important contribution to m.o.m.® and the solutions it contains for what is probably the biggest threat of the present day – namely a **long lasting deflationary depression** and the destruction of large parts of many societies. Heinsohn's economic theory in conjunction with our management systems and tools offer the solution.

St. Gallen, in March 2012
Kind regards

F. Malik

Prof. Dr. Fredmund Malik

NOTES

Malik Management Systems®

Market destruction by governments

by Prof. Dr. Dr. Gunnar Heinsohn

Malik standard model of effectiveness®

1. The start of the final act with an undetermined sequel

The **trio of governments, central banks and commercial banks** are rehearsing for the grand finale. For in open markets there are no more buyers for the sovereign debt securities of many EU countries. If a market free of manipulation were allowed for sovereign debt securities, only EUR 5,000 or EUR 3,000 would be offered for EUR 10,000 bonds. After all, potential buyers know that shrinking and aging populations, as the citizens of such countries, will never be able to pay interest on or repay these debts

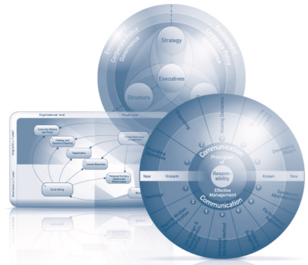
The general public may believe that Greece and other countries on shaky ground will be able to sell their sovereign debt securities again after being relieved of their debts because they will allegedly regain **competitive strength** through «structural reforms» and the strict conditions imposed by the EU. However, the parties involved know that Greece, even in the most inventive year of its history, namely in 2009 with 11 million inhabitants, only managed to register 24 patents with the European Patent Office as opposed to 2,420 registered by the 7.8 million Swiss. At the time the Greeks had an average age of 40. By 2025 it will be 46, which is much closer to pensionable age. EUR 240 billion, or EUR 23,000 per capita, delivered in two packages so far, are supposed to enable the Greeks to sell their bonds on the world market by 2020 and then to repay their debts from the yields. But will a nation that barely manages to make 39th place on Rindermann's World IQ List (Switzerland is in 10th place) really be able to brush up its patent record by a factor of 100 or even of 10? It is more likely that the miserable figures of 2009 will even fall below 0 because the top minds continue to emigrate. No one will ever have to worry about competition from this pleasant region.

Our trio has developed two main methods for bypassing the market.

First, the European Central Bank (ECB) has been buying **sovereign debt securities** on the secondary market issued by countries from Ireland to Greece since May 2010, so that they do not fall too far below their nominal value. Europe's commercial banks have therefore been selling such bonds to the ECB since the end of 2011 for a total of EUR 200 billion – not always at their nominal value, but far above the 25 to 45 percent that they would fetch on the market. Those who become indignant about the banks «unloading» multi-billion losses onto the central bank fail to realize that it is not the ECB, but ultimately ordinary citizens who are bestowing this boon. For the ECB is a bank and not a government agency that can print an unlimited amount of money. It creates fresh money for commercial banks in return for **collateral**. If a commercial bank cannot repay and the collateral proves to be worthless, the central bank has

NOTES

nothing with which to buy back the banknotes that remain in circulation. It then has to make up for the amount that has not been repaid with **equity**. But the ECB, as a subsidiary of national central banks, only has EUR 11 billion of equity, which, after a 50 percent devaluation of the bonds amounting to EUR 200 billion, means a loss of EUR 100 billion. The owners of the ECB, the national central banks and the nations behind them, have to find a replacement for the liquidated capital. It is created by their **finance ministers** through the issue of additional debt instruments. However, as the majority cannot be sold on a one-to-one basis, the ECB that was supposed to be rescued in this way has to come to the rescue itself and effectively keep the price of its new equity artificially high through the unlimited purchase of such instruments.



Malik Management Systems®

The general public may be forgiven to a certain extent for believing that central banks can create unlimited amounts of money because experts see things in exactly the same way. This is what *Hans-Werner Sinn*, Germany's most distinguished economist, suggests in the ifo Wirtschaftskompass (Hanser) in October 2011. His task is to break down the best expert knowledge for the educated layman. In the chapter entitled «*How does money get into the economy?*» the central bank appears devoid of equity in the attractive charts (page 219). It is not mentioned that commercial banks and non-banks have to provide the central banks with property as collateral. Nor is there any mention of interest. What gives money its purchasing power remains incomprehensible to the reader.

But let us now turn to the second main method of **circumventing the market**. Since December 2011, the ECB has been lending money to commercial banks at a mini-interest rate of 1 percent. Around one billion euros will be paid out in the first two tranches, mainly to banks in southern Europe. Instead of the usual repayment periods of a few weeks, this time bank owners do not need to redeem the debt until after 36 months, so that they can pocket annual profits for several years before they become liable for payment themselves. They are allowed to deposit sovereign debt securities with the ECB as collateral for new money although these securities can no longer be sold at their nominal value on the open market and although they continue to pocket the yields. The recently purchased **sovereign debt securities** now bring two to five percent interest for the 3-year money, which is at most five times the debt owed to the central bank.

On December 21, 2011 alone commercial banks borrowed almost half a billion euros from the ECB, which is intended to become the main weapon against the **depreciation of sovereign debt securities**. But governments do not have the cash available to pay the interest to the commercial banks. So this is also found by selling additional bonds. Thus each billion in profits that banks make from trading **sovereign debt securities** simultaneously appears as an additional billion in debt for ordinary citizens. Interest paid on sovereign debt securities bought by the ECB and its national central bank parents (ECB system) on the secondary market is also raised in this way.

NOTES

What they transfer to their finance ministers in profits does not originate from taxation but from additional **debt** that the same ministers have incurred in the name of their citizens. Government debt worldwide thus rose from USD 11 billion to USD 31 billion between 2001 and 2011. It rose from 75 to 105 percent of gross domestic product in rich countries with their aging populations during the same period, while in the poorer and younger nations it fell from 50 to 35 percent (IMF, OECD, Economist – February 17, 2012).

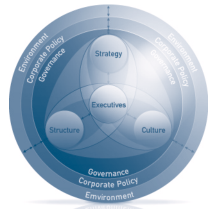
Central Performance Control (CPC®)

All this is occurring in the lofty spheres of the political and the financial sectors. The corporate sector, which is the only one that produces profits and wages for tax to service sovereign debt, does not even come close to our Trio Infernal in these operations. And yet all new burdens end up on the civic shoulders of these private entrepreneurs and employees.

The commercial banks in the trio know very well that they are not supposed to generate their profits through loans so that businesses can increase production and efficiency, but through pure price increases. They realize, therefore, that they are supposed to help combat the devastating **depreciation in the price of sovereign debt securities**. This works strictly according to the textbook. We, the governments, deliver sovereign debt securities as collateral made of air for printing money and you, the commercial banks, keep pumping up the prices of these instruments by diligently buying more and more of them. There is no other way. Ultimately, euro politicians in the stagnation year 2012 will have to issue new bonds for the sum of EUR 800 billion – not to repay debts, but to restructure and take on more debt. The banks who are to buy all this debt, however, can only do so if they can simultaneously sell debt instruments of EUR 570 billion for fresh equity and old restructured debts to investors all over the world. This, in its turn, will only succeed – and no longer only in the south of the EU – if the **over-indebted governments** whose bonds the increasingly instable banks are supposed to buy guarantee the debt instruments that the banks are selling in their own name and if the ECB system accepts these debt instruments secured by doubly instable collateral as security for fresh money. At the beginning of 2012, southern banks were already operating with such debt instruments to the tune of EUR 210 billion (*«European Bad Bank»*, Welt am Sonntag, January 8, 2012).

An exact knowledge of all these tricks does not stop bank owners from joining in a tarantella that they can only leave through a collapse. For competition amongst themselves forces them into **«cheap» money**. If a bank virtuously spurns money at one percent and waits to get five percent while others do business with the godsend, it will go under with decency and integrity. Under the impact of the second zero interest wave of 2002 from the US Fed – after the one of 1995 from Tokyo, which we will be dealing with in a minute – Citigroup boss «Chuck» Prince summed up the new business policy like this in July 2007. *«When the music of hyperliquidity falls silent, things will get complicated. But as long as the [central bank] band is playing, you have to get up and dance. We're still dancing at the moment.»* (Financial Times, July 10, 2007).

NOTES



Malik General Management Model®
GMM®

It is the irresistible temptation of **central bank zero-interest money** that drives commercial banks to all the wheeling and dealing that now has to be combated with continual new rules. Their primary offence will be not increasing equity, which should really grow in proportion to the new commitments, but which can never be had for nothing. Another form of reckless behavior is the secondary use of the collateral of good customers to take out loans for themselves. Until 2007 commercial banks borrowed USD 4.5 trillion in this way. [*«The (sizable) Role of Rehypothecation in the Shadow Banking System»*, IMF, July 1, 2010].

So while governments pass more and more laws for increasingly better fire extinguishers to be used against such dubious practices, they simultaneously fling more and more fire accelerants into the market in the form of zero-interest money. Fallen women are chastised, but their seducers are allowed to make ever more shameless offers. In 2012 this was no different than in 2007. When even **German savings banks** helped themselves to ECB three-year tenders at 1 percent interest from December 2011, because the competition was doing it as well, Savings Bank President Henrich Haasis sensed calamity just like *Chuck Prince* once did. *«For savings banks and cooperative banks, which usually have more deposits than monies on loan, it does not make sense to take cheap money from the ECB and put it into risky investments.»* (Financial Times Deutschland, March 15, 2012, p. 15). This may well be true, but it was nevertheless enforced by the ECB!

In the final act currently unfolding since 2008 the rhythm – which started in Japan in 1995 and accelerated in New York in 2002 – is getting even hotter. Since then, the world's biggest central banks in Tokyo, New York, London, the EU and also in Bern have been playing in a global big band without a pause because the fall in the price of sovereign debt securities has to be covered up by increasingly loud music. It should never get out that it is overindebted governments alone that guarantee the new debt of these very same governments. For when the air escapes from their debt instruments, there will be no holds barred. They are tied up in the **equity capital** of businesses, banks and central banks and serve as collateral for most debts. They therefore fill up the pots to cover losses and are the DNA of the economic system. If the artificial value of a € 10,000 bond then ultimately drops to a market price € 5,000 after being sold by a major buyer, the commercial banks and investors who buy the bonds nevertheless owe the full 10,000.

What the central banks of the countries of southern Europe (plus Ireland) owe in the German Bundesbank's euro system (Target-2) does not represent a threat solely due to the volume of € 360 billion, but because of the **sovereign debt securities** that national central banks provide as collateral. If their price on the open market falls to 50% or 180 billion, this will have to be covered in Frankfurt by 180 billion from equity. But this only comprises EUR 132 billion (January 2012). So the total from both positions has to be passed on as a debt to be shouldered by ordinary citizens. From the very beginning – the author together with *Otto Steiger* (1939-2008) has published

NOTES

about a dozen articles on the subject – it was an **error in the construction of the euro system** that national central banks from Lisbon to Helsinki are allowed to issue the euro banknotes with the same validity for their commercial banks against collateral of different quality. When the Bundesbank issues euro banknotes against triple A collateral, the Greek national bank does the same against junk-status collateral. But the banknotes from Athens can nevertheless be used to redeem debt at the Bundesbank on a one-to-one basis. And this junk-status collateral – usually unserviceable sovereign debt securities – serves to secure the credit extended to the **Athens central bank** by the Bundesbank.

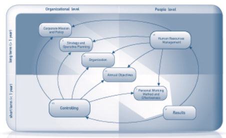
It is one of the rare moments of happiness in the life of an author to see someone like *Hans-Werner Sinn* – who previously, without any knowledge of the central bank system, put blind faith in the euro system – now coming to grips with the material on the basis of the Target problem.

But let us return to the sovereign debt securities and the simultaneous depreciation of its value in all portfolios. No one can cover 5,000 lost in an investment (purchases, loans) by 5,000 lost in equity at the same moment. The economic system breaks down and the search for unencumbered property with which to run new central banks and commercial banks begins all over again. But let us take things in turn. The strange artificial economic system that causes us so many problems today began a lot earlier.

2. The opening acts of 1995 and 2002: not yet evil, but already criminally naïve

From 1970 to 1989 Tokyo's Nikkei rises as high as 39,000 only to plummet to 15,000 by 1995. The index initially rises because intelligent people in Japan produced goods that were eagerly snatched up by people all over the world, bringing a huge cash flow to Nippon which is primarily invested in equities and real estate. After they appreciate in value, they are pledged as collateral for higher debts. These are then used for further **price increases** until the earnings from the purchased assets fall below the interest paid on the loans used to finance them. While this *slow-motion crash* is going on, the Bank of Japan, the second largest central bank in the world, slashes interest rates in hectic steps from six to one percent.

Unlike ordinary citizens for whom the exchange rate is the price of money, the Japanese and their colleagues in the West consider **interest** to be the price of money. It is believed that businesses can be literally flooded with money and re-launched by cutting interest rates. But interest is the price that a borrower pays to a creditor for encumbering his property as collateral for money, i.e. tying up the property. So it is not the borrower who offers the highest interest who gets the money, but the borrower with the **safest collateral**. The better the collateral, the easier it is to withdraw the borrowed money from circulation and to free up the property encumbered as collateral.



The Integrated Malik Management Model IMS®

NOTES

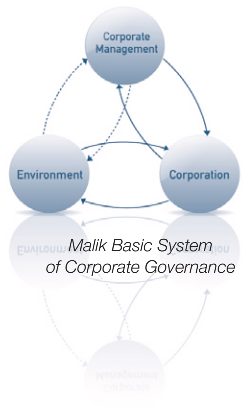
Borrowers with the best collateral make such encumbrances the least risky and thus pay the lowest interest (*prime rate*).

In a **crash**, the value of the collateral automatically falls with the price of the property. After 1995, Japanese central bankers are alarmed at their ineffectiveness because they do not have the crash-induced loss of collateral on their radar. This is why the even more frantic cutting of interest rates from 1 to 0.1 percent between 1995 and 2002 also did not help the corporate sector.

It is only when one-sixtieth of the initial dimension was reached (from 6 to 0.1 %) that they make their confession to the world. Despite an increase of 30 percent in loans to commercial banks in 2002, the amount that commercial banks lend to companies grows only by some 3 percent. At the same time, **international companies** are paying 20 percent to Tokyo's loan sharks, 200 times the central bank interest rate. They can do this because their capability for hypothecation is declining in the crash, but their cash flow for interest payments remains the highest in the world. For banks at home or abroad they are therefore not creditworthy, while loan sharks by definition make up for the increased risk by charging usurious interest rates.

While the **collateral values** of companies are falling in the crash, their **debts** remain as high as ever before. Debts are always of fixed amounts, while the property that serves as collateral for money and as collateral for loans so that money can be lent to others always fluctuates in price. But we usually understand little about something as abstract as property, even though it forms the basis of our economic system. So please allow me a brief digression into the realm of economic theory.

Bank officials and their teachers of economics only know of **possession**, which they mistakenly call **property** and consider a physical asset like money. But it is only in a society based on property – in contrast to tribal communities and the feudal system – where immaterial property rights coexist with the possession of assets. Both are in operation at the same time. While **property titles** are activated as **collateral for money**, this does not affect physical possession and the use of the asset. If the asset in question is a field for growing cereals, the earth, as a possession, can be used for sowing seed and harvesting the fruits, but at the same time it can be used as property to serve as collateral for money. Money, however, is not a thing, but a right of intervention or a right of redemption in relation to the immaterial aspect of the field as property. Property that serves as collateral may not be used to serve as further collateral and it may not be sold or given away. It must be kept in case money is converted into property or if it has to be used to withdraw money that has not been repaid from circulation. So the owner temporarily loses the freedom to freely dispose of the property activated in this way. And it is this essential, but non-physical loss of the right of free disposal by the creditor who provides money that the borrower has to make up for by paying interest. No goods are passed around, either when money is created or when it is lent to oth-



Malik Basic System of Corporate Governance

NOTES

ers. If we take our field and see the fence as a property title, then only the fence is used for economic transactions, i.e. pledged, collateralized, sold and made subject to debt enforcement measures. The earth itself, which is a possession, is used solely and eternally for production. In the case of a meadow where cattle graze, not a single cow will leave the banker's meadow when the meadow as property is blocked as collateral for money. The banker lends a piece of metal stamped with the impression of a cow – as with the Roman *aes rude*. But his living animals continue to graze and be milked in his meadow. There is no loss of milk or assets which Nobel Prize economics uses to explain interest and which the borrower, on returning the cow, has to make up for by paying interest in the form of cheese. But every banknote nevertheless implies a command to create more property than is activated for its collateralization. This banknote made of mere paper can be used to purchase assets with a property aspect and a possession aspect, such as a house that serves as collateral (property) and at the same time as a home (possession), because it is secured by **property**.

Malik standard model of effectiveness®

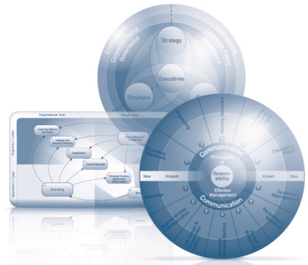
If a central bank waives interest, this does nothing to help asset-free businesses in the productive sector, but it encumbers its property, which is indispensable for the collateralization of money, for no consideration. How can this waiver of interest be of use to banks although they do not pass the money lent in this way on to the productive sector? In a normal transaction, a commercial bank finds an entrepreneur as a borrower who is forced to carry out modernization or who may also be one of the **creative destroyers**. The entrepreneur only obtains a loan for his reconversion if he provides collateral and pledges to pay interest and if his bank can borrow money from the central bank that it then lends to him – likewise in return for collateral and interest.

If this transaction starts out with zero interest rates, banks first have to look for **investment opportunities**. Borrowers from the productive sector will not take out a loan a second time, due to a sudden drop in interest rates. They will take out a loan because they have to, because the value of their company is threatened by innovation from the competition. If this value is one billion and the modernization loan is 100 million, three or five percent interest will make a difference of two million. If interest rates should happen to fall exactly at the same time as the entrepreneur is forced to carry out the modernization work, then he will naturally be pleased to save two million. But if the interest rate is higher at the time, then it will be paid because it is of secondary importance compared with the billion that has to be rescued.

On the other hand, if the interest rate is too high, this can quickly have devastating effects, as was the case in the final countdown to the **world economic crisis in 1929**. Politicians allowed interest rates to rise at that time in order to prevent a few hundred thousand speculators from borrowing to buy equities by pledging equities that had recently appreciated in value. For all companies in the USA interest rates have now risen so high that many are no longer able to invest even when driven by the competition. At the same time, governments are cutting down on expenditure so that compa-

NOTES

nies that are already bearing an excessive interest burden now lose orders as well. If buying equities on margin had been prohibited instead and government expenditure kept constant, the crisis would not have escalated into a **hyper-crisis**. However the only lesson that has been learned is that in times of crisis the right thing to do is the very opposite of what happened in 1929 – so this time interest rates go down and government debt goes up.



Malik Management Systems®

It is this certainty that brings us back to 1995, when Japan's central bankers allowed interest rates to slump from 6 to 0.1 percent, but only managed to cause market bubbles. All investments, namely those whose yields – say 4 percent – are not worthwhile when the central bank also charges 4 percent, will become a gold mine at 0.1 percent although nothing changes in terms of quality. Banks invest in appreciating prices as long as the yield remains above the mini-interest rate. What costs a million and brings 4 percent or 40,000 still has a yield of 40,000 after prices have doubled to two million, although the yield now accounts for only two percent.

But this is also a staggering twenty times higher than the 0.1% charged by the central bank. The **bull market** is celebrated until the bubble bursts. But then everyone has to sell before their «cheap» debts become higher than the prices of the assets they bought with them. From 1995, cheap money from Japan merely served to unduly overheat the boom that led to the crash in 2000/2001, but which nevertheless had an innovative basis in the form of the Internet. The boom that crashed in 2008, on the other hand, was driven almost entirely by a wave of cheap money which the Fed – always arm in arm with the Bank of Japan – really started to unleash in 2002.

If a country's central bank starts to introduce zero interest rates, commercial banks in other countries suffer **competitive disadvantages**. However, from 1995 many banks were also able to soak up yen through their branch offices in Tokyo, change yen into other currencies (carry trade) and then make a killing by contributing towards the appreciation of all asset classes. In December 1996 – i.e. 18 months after the introduction of the 1 percent interest rate in Tokyo, the stock market turbulence this causes is noticed, but not understood, by Fed chief *Alan Greenspan*. *«How can we know when irrational exuberance has unduly escalated asset values which then become subject to unexpected and prolonged contractions?»*

What are ordinary crises as opposed to those intensified by government intervention? They result from the fact that entrepreneurs always defend the value of their property. This is why all members of a sector are forced to keep up with **innovations** made by a competitor, when switching from typewriters to computers, for example. The emphasis then is not on supply and demand, but on a business's survival. Computers, for example, lower the price of typewriters and also the price of their manufacturing companies and force them to upgrade. While their prices are falling and their value as collateral is decreasing, they rush to the banks before their **creditworthiness** has been reduced to zero. Modernizers perfectly understand that once the upgrading has been com-

NOTES

pleted, all competitors together can produce faster and more can be sold. So they are forced to consciously participate in the overproduction of tomorrow or sacrifice their property. There is no third way. They only have a choice between disappearing right away and the mere chance of belonging to the eight out of ten computer companies that will survive, i.e., that can endure the depreciation needed to remove overcapacity. The same applies to their banks. They too can only guess whether their borrowers will go under when cutting back overproduction or whether it will be the borrowers of the competitor bank who cannot then sell computers although they are highly modern.
In contrast to comparatively minor crises in certain sectors, almost all branches of industry simultaneously get into debt before a big crash in order to defend their property. At the same time, a glut of money backed by collateral is created and used for productivity, so it is not unrelated to the productive economy.

This also **increases the prices** of all the highly coveted work and equipment that are so vital for modernization, but which also have to come down when the modernization is completed, thus ushering in the crisis. Such prolonged booms follow innovations in transport, the transfer of information, and in the case of materials and sources of energy. The simultaneous appearance of several such breakthroughs characterizes the beginning of a super boom, which then ends in a major crisis. The **Internet boom** from 1989, which brought millions of companies and billions of individuals online, ending in the crash of 2000/2001, is a textbook example of such a process. The boom from 1922 to 1929, when money had to be lent across all sectors and to all sorts of consumers for radios, telephones and assembly-line produced cars, also stands for a genuine **crisis of innovation**.

While **Japan's government** drives the Internet boom beyond reasonable price increases through cheap money in their own country and the possibility of the global carry trades until 2000/2001, a further governmental bomb of market destruction is being ignited elsewhere, although no one in Tokyo can foresee this. This monster weapon had been under construction since 1977 when the Carter government passed the Community Reinvestment Act threatening US commercial banks with exclusion from deposit insurance if they refused to lend to borrowers without collateral. The intention at the time was for 19 million families with 60 million people to be able to take out home loans without providing any security in order to escape from an existence as tenants. This axe striking at the roots of half the US credit business was sharpened once again in 1995 because banks are constantly being caught adhering to credit rules and are therefore given fixed quotas for accepting high credit-risk borrowers. The increase in lending, however, does not increase equity.

The global resale of home loans as **mortgage packages** is then supposed to provide relief from the distress of this deterioration in the balance sheet. However, this splendid idea for clearing the books does not take off until Japan introduces 1 percent interest rates in 1995. Commercial banks who, through competition with each other, have

Central Performance Control (CPC®)

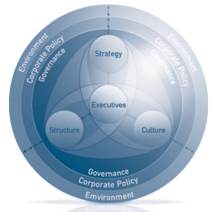
NOTES

gorged themselves to saturation with central bank money see subprime packages as investment manna from heaven. Buyers gain four or five percent securities, although they themselves only have to pay one percent. Nobody is naive about this. They all know that they will get nothing from **subprime borrowers** if the worst comes to the worst. So they all insure their brand-new asset class against default for a fraction of the profit margin. But when all the houses start burning at the same time after the interest rate hikes between 2004 and 2007 in the USA, together with supplementary claims against propertyless subprime borrowers, insurance companies start burning as well – including the world leader American International Group (AIG).

But the subprime market does not properly heat up until 2002 when the Fed depresses real interest rates to minus 0.75 percent (nominally 1 to 1.25 percent). Once again, money is to be poured into businesses after a crash, in order to *«promote satisfactory economic performance»* (according to Greenspan). What fails in Japan certainly does not work in America either. Central banks cannot help companies. They can be *«lenders of last resort»* when cash-strapped, but nevertheless propertied commercial banks threaten to collapse overnight.

Then central banks buy up their **assets** in a lightning operation or accept these assets as collateral. In return they demand higher interest rates so that they are not approached by commercial banks without new borrowers. It was precisely this concern that led *Walter Bagehot* to formulate the basic rule for central banks in Lombard Street [1873]: *«These loans [to solvent albeit illiquid banks] should only be made at a very high rate of interest. This will prevent the majority of applications by persons who do not require them.»* That money should not be lent at zero rates did not need to be drummed into anyone at the time. After all, small, cheap discs of metal and notes are only valuable as long as they are secured by price-stable property of the issuing bank. Only this **collateralization through property** makes it possible to purchase property with cash. And since a central bank ties up property when it uses it as collateral for money, it is entitled to claim interest as consideration for the loss of this right of free disposal. If the central bank waives this interest, Bagehot, 135 years before *Chuck Prince*, feared a price-bubble tarantella by banks that *«do not require loans»*.

And this is exactly what happens in the USA. Four dollars from the Fed's zero interest rates for commercial banks only result in one dollar of new gross domestic product. But by 2007 the indebtedness of commercial banks has risen to 50 percent of all debts of US businesses – as opposed to a normal rate of 10 percent in 1980. In 2007 the debts of these banks stand at 116 percent of US gross domestic product – as opposed to 21 percent in 1980. With only 5 percent of the US employees of 2007, US banks pocketed 40 percent of the profits of listed companies - through appreciation in the prices of equities, commodities, real estate, works of art etc. Between 2002 and 2004 and then again from 2008 to 2011 the Fed lends USD 29 billion to bank owners at zero interest rates. So already in June 2009, 98 dollars out of 100 USD net growth in



Malik General Management Model®
GMM®

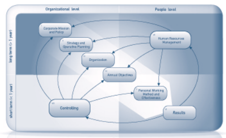
NOTES

assets is accounted for by mere **price bubbles**. The carry trade becomes even more voluminous because central banks in Indonesia, Brazil and China are still demanding correct rates of interest and their commercial banks angrily see how the distant competition is buying assets from them with cheap money and driving exchange rates. In 2010 the Bank of China was already complaining that the West *«is creating huge problems through a dollar carry trade of 1.5 billion»* (FT, January 29, 2010) distorting markets on a global scale.

Carry traders belong to banks, but like any other trader they only want to earn more on their investment. However, unlike other traders they have access to the counters of the central bank. This is why at Goldmann Sachs, for example, the percentage of profit generated by trading rises from 28 to 76 percent between 1998 and 2009. Only, Greenspan's *«satisfactory economic performance»* fails to materialize. But as money at zero interest rates also serves to boost the prices of commodities, businesses are faced with even greater expense.

The same thing happened to **respectable home-loan borrowers**. At the end of 2011 it is not only the subprime borrowers from the crash of 2008 who are effectively underwater, but also around 50 percent of all US mortgage borrowers, who cannot raise the deposits and fees to buy new houses with the attainable prices (*«Half of US Mortgages Are Effectively Underwater»*; CNBC.com, November 8, 2011). While cheap money cannot make subprime borrowers creditworthy, it destroys the creditworthiness of the middle classes, whose foreclosed houses represent a massive depreciation of their most important asset.

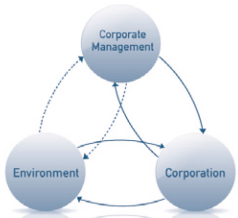
That is simply the way things are: after a crash, central banks cannot bring about «satisfactory economic performance» by cutting interest rates to zero. For they have **no property to serve as collateral for new loans** for businesses that are incapable of hypothecation, no innovative patents with which to trump the competition and no brilliant minds to carry out such innovations. By cutting interest rates they can only delay, but not prevent the crash which represents the necessary depreciation to remove overcapacity. The **Bank of Japan** already tried to achieve this feat in 1999 by buying up corporate bonds – at zero interest rates into the bargain – and still finds itself fighting deflation today. For bank owners, on the other hand, zero interest always pays off. As in Tokyo in 1995 or in New York in 2002, they continue to pocket interest from their borrowers as was previously the case, while not paying any interest on their debts with the central bank. In this way, US banks alone pocketed around USD 13 billion in extra profits between December 2008 and November 2011 (Bloomberg, November 28, 2011).



The Integrated Malik Management Model IMS®

NOTES

The picture looks quite different as far as businesses are concerned. Even the two percent of the richest US companies, who raise around USD two trillion through their own bonds thanks to the Fed's mini-interest rates offering a lower yield, save only 0.5 percent interest; other Americans save nothing at all (*«Stimulus by Fed Is Disappointing»*, NYT, April 24, 2011). On February 7, 2011 President Barack Obama attacked companies as **«investment shirkers»** for merely parking these huge sums. He does not understand that given low interest rates companies create reserves in case they are forced to modernize due to innovations somewhere in the world.



Malik Basic System of Corporate Governance

3. What comes after the final act?

If two individuals manage their economic affairs on a property basis, they are still not doing the same thing. Just as the faster runner is ahead on a racing track, it is the brightest minds who win in business. If they originate with particular frequency from minorities, such as Ashkenazis or East Asians, they are often the subject of envy inside a nation, but also of admiration. Globally it is the **Jachincos** (Japan, China, South Korea) who climb fastest to the top and they are also exposed to suspicions although they are simply better in math (PISA; TIMMS).

If they lose out against the competition, the insolvent have to surrender the pledged property in the place of the money that has not been repaid and so they disappear as wealth holders. Such **erosion through bankruptcy** inevitably leads to a concentration of ownership. Even Cicero (106 to 43 B.C.) complained that, *«In our state there are not two thousand people who own private property»* (De officiis 2, XXI: 73). As the Forbes lists of the world's richest people show, the situation is hardly any different today. And the ETH study by James Glattfelder and Stefano Battiston (10/2011) shows that the owners of almost 800 conglomerates control 80 percent of the world economy.

Poverty means the lack of debt capacity on the part of individuals or entire nations without property structures. Property can be recut to size, but not brains, which is why, after equal distribution at 8 in the morning differences already reappear at 8 in the evening. The mistake made by politicians in 2008 was not to call upon the asset volumes held by those 800. Instead of this, their claims are passed on to **ordinary citizens**. But they do not produce anything either and have no recoverable assets. What could have been obtained from the very rich is revealed only by **Goldman-Sachs**. Before the crash its 860 partners reported assets of USD 30 billion. Goldman's losses through subprime loans amount to USD 12.9 billion. They are insured with AIG. The US government prevents it from going bankrupt through nationalization and USD 180 billion for the bank capital which had actually been destroyed. Goldman gets a full USD 12.9 billion. Its 860 partners do not need to slim down from 30 to 17.1 billion. Deutsche Bank gets USD 11.8 billion; the Swiss UBS gets USD 3.8 billion. None of them revealed what their owners could have raised themselves.

NOTES

No billionaire wants to retrain as a multimillionaire. But the **Occupy movements** of this world are aimed not so much against politicians who spare such people distress; instead they fuel old resentments. On October 18, 2011 members of the parent movement march to the homes of John Paulson (Paulson & C.), Stephen Schwarzmann (Blackstone Group) and Jamie Dimon (CEO of JP Morgan Chase). The severed head of Lloyd Blankfein from Goldman decorates a poster. The fact that Jamie Dimon is not Jewish does not help him. The very suspicion caused by the name is enough (NYT, October 19, 2011).

Malik standard model of effectiveness®

As in 1995 in Tokyo or 2002 in New York, **politicians** also failed to understand the economic system in 2008. This would have meant making it possible for the productive sector made up of businesses and workers to get credit, even after the destruction of their banks. To do this, they could have been granted direct access to the counters of the central bank for a set period of time where they could have obtained money in return for interest and good collateral. This would have been nothing new in historical terms. During this period, the banks that survived could have expanded their business. Wealthy and productive businesses – such as **Siemens** in 2010 and the big automotive companies long before that – would have built up new banks themselves. The 800 big groups of owners would have realized losses, but would not have become small. Life insurance companies that primarily invest in government debt and bank bonds would have had to be sorted out to secure the **pensions** of their clients. Even purchases of government bonds in secondary markets with the announcement of a time limit would have had a less devastating effect than the unlimited purchases being carried out now. At the same time, these bonds would have done better than after the new borrowing made since 2008. For while bank owners accounted for 50 percent of all debts in 2007, in 2009 it is governments, reaching as much as 62 percent worldwide, and the citizens of many nations, beyond the limit serviceable from taxes.

The **German bond index** (Rexp) for the measurement of gains from the purchase of German government debt admittedly grew by 320 percent between 1990 and 2011. But German citizens, who are allegedly the world's soundest borrowers, will never repay the **debt**. Between 1970 and 2011 their debts rose from EUR 800 to EUR 22,000 per capita, while the average age leaped from 34 to 44 during the same period. US citizens, as the second best borrowers, increased their debt from USD 1,700 to USD 43,000 during the same period and aged from 28 to 37. In Germany, one-fifth of the new generation is incapable of vocational training and need cash from cradle to grave. In America, **Africans** and **Hispanics** from backgrounds with mostly lower levels of education now make up more than 50 percent of newborns for the first time. Even today, their seventeen-year-olds only manage to attain the school level of thirteen-year-old white children and twelve-year-old Jachincos. If the global elite no longer flocks to the New World, it will never again become capable of servicing debt.

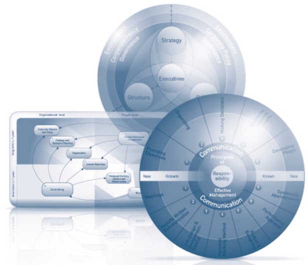
NOTES

If **government debt** is once again to become as good as money, governments must ensure that owners take responsibility for the losses. In 2008 they took on the losses of **major owners** by issuing further bonds in the name of their citizens. But at some time, more and more elegantly stamped paper without collateral will be recognized as fraud. All that an investor – large or small – wants for his money is property that at least does not depreciate in value. Those who vilify the investor as a «dictator of the market» due to this desire only show how much they would really like to force the investor to accept worthless paper. Politicians try to improve the collateralization of their government debt mainly by burdening the middle class and small and medium-sized enterprises (SMEs), since the lower classes do not have the means and the rich are difficult to pin down.

But achievers in the middle would need government budget cuts for **«satisfactory economic performance»** so that their property does not continue to go to the non-achieving transfer sector. If even more of their property is taken away from them through taxation, this only impairs the «self-healing powers» of the economy. The long-awaited «self-sustaining recovery» will only happen by **providing collateral for new borrowing** in order to defend property. This **enforced innovation** becomes even stronger during times of crisis and it is the only way out of the crisis. In 2009 half of the top Fortune 500 companies were formed during a recession. So the call for higher taxes to repay government debt is always misguided. Lowering taxes cannot force anyone to take on debt either, but it does facilitate borrowing for those forced to make innovation due to the competition. Cuts in expenditure hurt the sector dependent on aid, which is why its politicians protest. Since social policy is usually used to buy votes and not for altruistic reasons, majorities against cuts are quickly formed and very rich owners come more sharply into focus. However, they will not follow a well thought-out policy or hand over their property to the incapable.

But after the prices of government debt have plummeted and unencumbered assets need to be found as equity to secure a new currency, the hour has also struck for the very rich. The same applies to the equity of banks that evaporates in a **sovereign debt crash**. The absence of help from the taxpayer already guarantees that their owners will plug the big holes from their even bigger assets in order to **avoid a total loss**.

Part of the unencumbered property of citizens will be allocated to a new central bank by law and will remain without interest and inaccessible until independent equity has been formed from the profits. This would be nothing new. Even the German Rentenmark after the **hyperinflation of 1923** was secured with real estate from agriculture and industry. The situation stabilized immediately. The credit contract for good money is thus the father of the market contract. This is why markets also disappear when **money is destroyed by governments**. They can only be secured for the future if the new central banks are allowed to lend solely against interest and good collateral.



Malik Management Systems®

NOTES

About the author

Professor Gunnar Heinsohn, is professor of sociology and economics at the University of Bremen. The focal point of his research is demography. He became famous through his book *Söhne und Weltmacht: Terror im Aufstieg und Fall der Nationen* (2003) and his theory of a «youth bulge».

Professor Heinsohn was born in Poland and studied at the Free University of Berlin. His best-known works are *Eigentum, Zins und Geld: Ungelöste Rätsel der Wirtschaftswissenschaft* (1996, 9th edition 2009) and *Die Vernichtung der weisen Frauen* (1984). Professor Heinsohn is the author of more than 750 publications and co-editor of the magazine «Zeitensprünge». He also writes for major international newspapers.

In *Lexikon ökonomischer Werke: 650 wegweisende Schriften von der Antike bis ins 20. Jahrhundert* [Düsseldorf: Wirtschaft und Finanzen, 2006] he is the only living German-speaking author and four of his works are mentioned. Since 2000 the core ideas of the book *Eigentum, Zins und Geld*, which he presented together with Otto Steiger, are confronted with the monetary theories of Aristotle, Adam Smith, Bernhard Laum and John Maynard Keynes at the Money Museum of the German Bundesbank (Frankfurt am Main).

Email: ***gunnar.heinsohn@uni-bremen.de***

Central Performance Control (CPC®)

NOTES

Index

B

bull market 36

C

cheap money 36
Chuck Prince 38
Cicero 40
collateral 33
competitive disadvantages 36
competitive strength 29
crash 34
creative destroyers 35
creditworthiness 36

D

debt 31
debt securities 31
depreciation in the price 31

E

enforced innovation 42
equity capital 32
European Central Bank 29

G

German bond index 41
German savings banks 32
Goldman 40
Greece 29
Greenspan, Alan 36

H

Hispanics 41
hyper-crisis 36
hyperinflation 42

I

innovation 42
interest 36
Internet boom 37

J

Jachincos 40

O

Obama, Barack 40
Occupy movement 41

P

possession 34
poverty 40
price-bubble 38
price increase 31
property 40

S

securities 32
security 31
Sinn, Hans-Werner 33
sovereign debt securities 29
Steiger, Otto 32

W

wealth 40
world economic crisis in 1929 35

Z

zero interest rates 39

NOTES

System-cybernetic Malik knowledge

Beyond all fashions and undesirable developments in management teaching, Right and Good Management is possible in every organization if the natural laws of how complex systems function are applied.

Tools for leadership in the 21st century

We have devised our globally unique system-cybernetic management systems for the practical mastery of complexity and the optimal functioning of organizations. This enables them to define what Right and Good Management is and thus set the standards for the manager's role. They are the tools for leadership in the 21st century. To this end, the Malik Management Systems have special characteristics and features.

Characteristics of the Malik Management Systems®:

1. UNIVERSAL: The Malik systems are universally valid and can thus be applied in any organization and culture.

2. SELF-REGULATING AND SELF-ORGANIZING: Our systems empower organizations to regulate and organize themselves.

3. MODULAR AND CONFIGURABLE: Our systems are modular and can thus be configured for any purpose. Their elements are logical, their content and methodologies networked, and compatible and scalable across the board. They grow with the organization.

4. MODEL-SUPPORTED: The Malik Education is model-based. They enable quicker learning, easier retention and highly effective application many times over.

5. COMPATIBLE: Our models ensure the uniformity of language and concept, and in this way compatibility in all applications.

What you will learn to understand with the Malik Management Systems…

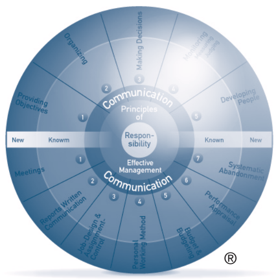
… are the wrong management teachings to enable you to develop the right solutions all the better and to put them into action. For example, we were the first to prove that the «shareholder value approach» taught everywhere leads to massive mistakes in managing economic resources and to undesirable developments in managing human resources. We have pointed out the risks in the financial system, and published them in a timely manner – and designed functioning solutions to manage them.

NOTES

The Basic Malik Management Models

The working tools for the Malik Management Systems are models. The way they function can be compared to dynamic maps. The inner core is made up of the three following basic models, which contain all components for Right and Good Management, for the optimal functioning of organizations and for the effectiveness, performance and success of people.

MANAGING ORGANIZATIONS



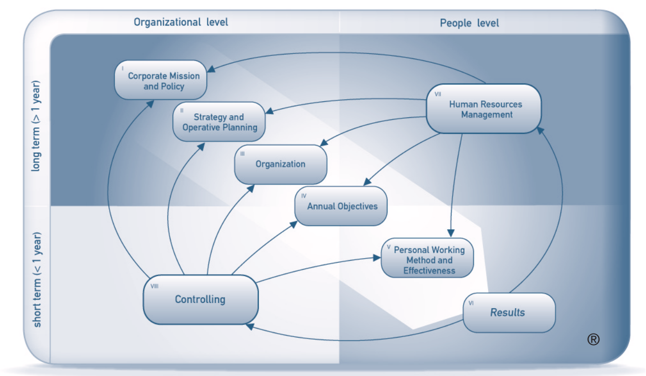
MANAGING PEOPLE

The Malik General Management Model® GMM® It defines the functioning of organizations and contains all components for the overall management of an organization in its environment.

These are the seven elements of Environment, Policy, Governance, Strategy, Structure, Culture and Executives. Managing Organizations

The Standard Model of Effectiveness It defines the profession of the professional manager and contains those components that all executives need at all times and in all places to effectively manage themselves and other people.

They are the five elements of Tasks, Tools, Principles, Communication and Responsibility. Managing People



MANAGING THE INTEGRATED SYSTEM

The Integrated Malik Management Model IMS® It is produced from the combination of the General Management Model and the Standard Model of Effectiveness. The IMS comprises all relevant elements for the successful leadership of a result-producing unit and its people. It can be applied in any organization. Managing the Integrated System

NOTES

Reader services and information

m.o.m.®-Letter in the internet
Platform for subscribers:
m.o.m.iliasnet.net

» online archives with all m.o.m.®-Letters which have been published since July 1993 for download as PDF in German and English.

» m.o.m.® forum for exchange and discussion with Fredmund Malik and m.o.m.® subscribers.

» As m.o.m.® subscriber you will receive a monthly announcement mail with your personal access data.

Further products

» m.o.m.®-Letter in German.

» All m.o.m.®-Letters are also available on CD and MP3 as of March 2001. Spoken by the author himself.

Information and order
T +41 71 274 37 00 oder
E-Mail: **malik.management@malik-mzsg.ch**
Online: **malik-management.com**

MALIK PUBLICATIONS IN ENGLISH

Corporate Policy and Governance –
How Organizations Self-Organize

Uncluttered Management Thinking –
46 concepts for Masterful Management

Management – The Essence of the Craft

Managing Performing Living –
Effective Management for a New Era

Effective Top Management –
Beyond the Failure of Corporate Governance and Shareholder Value

malik-management.com/en/malik-corporate/publications/books

MALIK SOLUTIONS

Malik SuperSyntegration®
Exponential amplification of leadership effectiveness. *malik-management.com*

English seminars in China
For managers working in China we offer Malik seminars in Shanghai and Beijing which fit this fast-growing region perfectly.
malik-management.com/en/malik-for people