Welcome to Ponzi World.

By Joe Average,
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www.lifetoday.com.au

Carlo "Charles" Ponzi (1882-1949).

Born in Parma, Italy, Ponzi immigrated to America in 1903 and was quick to show his entrepreneurial flair.

In 1908 he was imprisoned for two years in a Canadian prison on forgery charges relating to a fraudulent high-interest scheme. Shortly after his release from jail Ponzi was once again arrested for smuggling illegal Italian immigrants from Canada into the U.S. He spent a further two years in an Atlanta, Georgia prison cell.

The next few years saw Ponzi drift through several cities where he picked up various work such as Italian interpreter, waiter, dishwasher, store clerk and typist.

Ponzi finally landed in Boston in 1917 in a job where he answered foreign mail. This position introduced him to International Postal Reply Coupons. His astute mind quickly realized there was money to be made by taking advantage of currency exchange rates to purchase the coupons of weak currencies and eventually converting them back into U.S. dollars. Ponzi boasted of making four-fold returns in a matter of weeks.

Desperate to be rich, Ponzi started The Security Exchange Company in December 1919 (formed with a view to trading International Postal Reply Coupons) which promised returns of between 50% and 100% in just ninety days. Thousand of investors rushed to buy Ponzi Promissory Notes ranging from $10 to $50,000. At the height of the scheme staff were taking $1,000,000 per week, much of it in cash, until the office desk drawers and closets were literally overflowing with dollar bills.

Ponzi became an instant millionaire with all the trappings…a twenty room mansion, gold handled walking canes, the finest of jewellery for his wife, and several fancy cars.

Over the next nine months some 40,000 investors parted with $15 million (around $160 million in today's money) before Ponzi was arrested for fraud. **Many of these investors were lucky to recoup around one third of their money** over the next decade as the scheme was unravelled.

Ponzi was ultimately sentenced to two jail terms of five and seven years, but was released after three and a half, whereby he dropped out of sight.

Surfacing under the alias of Charles Borelli, he then engaged in a pyramid scheme down in Florida selling off worthless land and was again arrested and sentenced, only to skip bail and attempt to flee to Italy. He was recaptured and spent the next seven years back in Boston prison.

Ponzi was deported back to Italy in 1934, worked under Mussolini, finally ending up in Rio de Janeiro where his luck went from bad to worse. He passed away penniless in the charity ward of a Rio de Janeiro hospital leaving behind an unfinished book entitled "The Fall of Mister Ponzi".

"A Ponzi scheme is a fraudulent investment operation that involves paying abnormally high returns ("profits") to investors out of the money paid in by subsequent investors, rather than from net revenues generated by any real business…"

Wikipedia.

A World Ponzi Finance Scheme?

Jim Puplava, host of the Financial Sense News hour (www.financialsense.com) conducted a very interesting interview with Doug Noland, financial markets strategist for David Tice & Assoc, (www.prudentbear.com) on April 21, 2007.

Noland, author of the Credit Bubble Bulletin, believes we are currently experiencing ***"the most reckless credit expansion in history!"*** and that ***"the U.S. and global credit system has become a Ponzi Finance Scheme."*** Noland finds the current ***"data extremely alarming…the most reckless credit expansion in history…liquidity like we've never seen before…unbelievable what's happening…we have credit excesses virtually everywhere"*** and believes that ***"1929*** (is the) ***only time even remotely comparable."***

The following figures for year over year change in money supply seem to back him up; **Russia….up 42%, China…up 18%, India…up 17%, Australia…up 14%, Brazil…up14%, Denmark…up13%, Europe…up 12%, etc.**

Noland lays much of the blame on deregulation which is allowing undisciplined credit systems around the world to inflate, as well as the U.S. current account deficit which is "***throwing dollar liquidity out to every place in the world… credit systems can inflate as much as they want without having to worry about weak currencies"*** in a kind of dangerous race to the bottom.

But even more worrying is the realization that a huge part of this credit expansion is now outside the banking system. Noland points out that Wall St is now driving and perpetuating the current credit excesses in the form of a huge Merger and Acquisition Bubble and a Securities Lending Boom, which has sprung up to replace slowing Mortgage Credit. ***"The numbers have now got so huge…an unbelievable amount of liquidity."***

It is clear the U.S. credit system is inflating dramatically (despite M3 having been dropped to try and hide this fact), and that this inflation is being recycled through the Central Banks. As the U.S. current account deficit expands it is now sending nearly a trillion dollars of new finance out to inflate credit systems around the world. And Wall Street, with its new ***"flexibility and aggressiveness in this contemporary financial system"*** is providing much of the impetus as it keeps on increasing the leverage on new-style securities in a chase for high yield.

Noland believes the Federal Reserve no longer has a lot of control of the credit system through bank loans, but that we are now at the mercy of unfettered Wall St securities-based finance…that Wall St can now circumvent attempts at tightening by the Fed. He has no doubt that Wall St is well and truly convinced that (like his predecessor Greenspan) ***"Bernanke will not pop bubbles…they (the Fed) will aggressively ease if there is any systemic threat. The financial sector is driving the real economy, not vice versa."*** And why shouldn't Wall St feel safe? It seems clear they are even being assisted whenever there is some kind of systemic threat by the clandestine manoeuvrers of the Plunge Protection Team (aka The Working Group on Financial Markets) which was formed by Ronald Reagan in 1987 following the stock market crash.

Jim Puplava has studied the balance sheets and debt structure of the top five brokerage firms on Wall St and is amazed at their total liabilities, and alarmed at the equity base supporting it all (especially when their mind-boggling derivatives books are added in)…(it's) ***"one of the most frightening things I've seen in my 30 years in the business!"*** Puplava was referring to how Wall St firms have ratcheted up debt to equity to an astounding 22 to 1 over the past five years. During the past twenty-five years (most of which was under Alan Greenspan's stewardship) he has noticed how the credit structure has evolved, from junk bond financed mergers and acquisitions in the 1980's, to the technology equity bubble of the 1990's, morphing into the sub-prime real estate bubble this century, and now the private equity driven M&A bubble.

Puplava's wit led him to joke…*:If they keep expanding the credit at this rate, they're going to have to start chopping down all the trees"* as the printing presses work overtime. Little wonder that Puplava sees nothing but inflation as far as the eye can see, culminating in a devastating hyper-inflation before an all engulfing recession/depression.

Hyman Minsky (1919-1996).

Wikipedia has this to say about Hyman Minsky;

"British economist John Maynard Keynes had written about unstable financial markets, but Minsky was the first to explain how this instability developed and interacted with the economy. Minsky wrote in 1974, '…the financial system swings between robustness and fragility and these swings are an integral part of the process that generates business cycles'.
Disagreeing with many mainstream economists, he argued that these swings, and the booms and busts that can accompany them, are inevitable in a free market economy, unless government steps in to control them, through regulation, central bank action and other tools that in fact came into existence in response to the Great Depression. He opposed the deregulation that characterized the 1980's."

Minsky believed the three types of finance firms could choose from (depending on their risk tolerance) were hedge finance, speculative finance, and Ponzi finance. He described **how in a protracted period of good times the markets moved through several phases…from Easy Credit to Over-trading; to Euphoria (dare we say "Irrational Exuberance?"), to Insider Profit Taking near the end of the Ponzi Finance Scheme, and finally Revulsion as the stream of new players dries up, panic sets in, and the Ponzi scheme collapses and rapidly self destructs.**

Minsky would have, no doubt, shaken his head in disbelief at the position the Federal Reserve now finds itself in. After having been in bed with Wall St for so long it remains to be seen how the Fed will extricate itself from this delicate relationship when the crunch finally comes.

If foreign investors finally cry "enough is enough" and dump the increasingly worthless U.S. dollar, will the Fed at last be forced to step back in to somehow try and shut down the runaway credit expansion we are now experiencing? Will it punish a profligate Wall St to stop the American economy being wrecked? If it doesn't, will the American currency, people and economy still be afforded the special status and consideration they received during the last century if the rest of the world suffers from the fallout?

All the best, Joe.
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