Prosperity!

Fixing the Foundation of America's Destiny

Federalist No. 86

by PUBLIUS MMX

RECOVERING FEDERALIST

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Recovering Federalist, LLC

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"Perfect freedom is as necessary to the health and vigor of commerce as it is to the health and vigor of citizenship."

—*Patrick Henry*

Contents

Foreword

Permit me to issue and control the money of a nation, and I care not who makes its laws.

—*Mayer Amschel Rothschild*

If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that will grow up around [the banks] will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered. The issuing power should be taken from the banks and restored to the people, to whom it properly belongs.

—*Thomas Jefferson*

I say the Earth belongs to each of these generations during its course, fully and in its own right, the second generation receives it clear of the debts and encumbrances of the first, the third of the second and so on. For if the first could charge it with debt then the Earth would belong to the dead and not the living generation, then no generation can contract debts greater than may be paid during the course of its own existence.

—*Thomas Jefferson*

Acknowledgments

First of all, we acknowledge and recognize the laws of nature and of nature's God.

We acknowledge divine providence and its hand in all things, including this effort. We understand that others may not, but regardless of whether we believe in God, lessons from history, Manifest Destiny, karma, or just plain ol' dumb luck, if we deny the laws of nature and their existence, we do so at our own peril—individually and collectively. We not only recognize those laws but also acknowledge a guiding hand in this work.

We also wish to acknowledge and recognize the founders of this great nation and those who framed the original debates—the Federalist/Anti-Federalist debate and other important debates that we desire to reignite with this work. We are truly concerned about our country and believe that time is of the essence for this discussion, which will continue with ongoing essays, books, and other works produced by Publius MMX, Recovering Federalist.

Preface

This essay is a continuation of the discussion we began with *Bedrock!—Federalist No. 86.* This essay also goes hand in hand with its companion essay, *Enough!,* which was published at essentially the same time. The primary general introduction and preface to this whole discussion are contained in *Bedrock!* and will not be restated here. That essay helps provide the foundation and set the stage for this essay and the others in the *Federalist No. 86* series. Both *Bedrock!* and this essay briefly reexamine elements of the original Federalist/Anti-Federalist debate and relevant issues in the context of two hundred-plus years of history and applied theory. Again, our focus is on principles, not personalities.

While fully recognizing that the laws of nature and personal responsibility, as discussed in *Bedrock!,* are the foundation of our existence, this essay turns from what we can and should be doing as *individuals* at the most foundational level and focuses on what we can and must do as a *country.* Instead of discussing what Band-Aids can be put on symptoms to push core causes forward, in this essay we address what specific structural governmental policy and system changes must happen in order to continue to fix the foundation and correct course in this country.

The Federalists and Anti-Federalists

In *Bedrock!,* which is considered the foundational essay in the *Federalist No. 86* series, we talked a fair amount about the Federalists, the Anti-Federalists, and the Federalist/Anti-Federalist debate. Although most of that debate focused on governmental and political issues, as is often the case, many of the core philosophies and motives behind the

broader political issues had as much to do with money, economics, and, indeed, economic vision as anything. Not as much is commonly known about that because it is not as clearly reflected in the Constitution or stated in the Federalist and Anti-Federalist Papers. But the reality is that, just as other core governmental issues are still with us today, so are the economic issues. And after being essentially buried to some extent off and on for the past two hundred years, in the current financial state we find ourselves in this country, those economic issues have slowly but surely again nosed their way to the fore.

As previously stated, the Anti-Federalists, who tended to come from a more middle-class background, essentially shared a vision of a sustainable, self-sufficient, and self-governing provincial society of farmers, craftsmen, and business owners. They were particularly concerned about the possibility of governmental tyranny and the prospect of infringement of individual inalienable rights. Consequently, the Bill of Rights and the Tenth Amendment were their main focus.

The Federalists, on the other hand, tended to come from the wealthier, more aristocratic and elite class of merchants and plantation owners. Because of the contrast in their economic backgrounds, it is really no surprise that the Federalists had grander visions—economic visions—and saw the need for a much more powerful national government to carry out that vision. The Federalists were much more favorably disposed toward growth, including both national and international growth and expansion as well as continually increasing commerce, including the borrowing and lending of money. They argued that a strong central government would foster the commercial growth of the new country.

Moreover, the Federalist vision of society was more pluralistic than the Anti-Federalist vision. That is, the Federalists did not envision a society that would always be made up principally of self-sufficient farmers but instead viewed it as comprising many different and competing interests and groups, none of which would be dominant in a federalist system of government. The Anti-Federalists maintained that the framers of the Constitution as drafted—the Federalists—had met as an elitist group under a veil of secrecy and had violated the provisions of the Articles of

Confederation in the means selected for ratifying the Constitution. For this and other reasons, many later scholars have argued that the Federalists were more aware of and were even the driving force behind social and economic changes that were already beginning to transform American society as well as the rest of the world.

Indeed, some would argue that the Federalists had much bigger visions. Some would argue that in addition to the idea of Manifest Destiny and the expansion of the new nation to fill the entire continent, robust capitalism, involving ever-increasing automation and industrialization; importing and exporting; borrowing and lending of money; development of financial markets; maximizing efficiencies and production through economies of scale as well as the arbitrage of regional advantages based on climate and natural resources; and fostering greater world trade, ultimately leading to global dominance, might have all been part of the Federalist agenda right from the outset. Looking back, two hundred and twenty years later, we can see now both ends of that vision and have a much better idea of the fruits it is producing and that it will ultimately produce.

In this essay we focus our discussion primarily on the American financial system and particularly on governmental aspects of the financial system and the current state of the financial situation in the United States. As we contemplated writing this essay, we had a number of different thoughts about what the main title should be. Based on current conditions, we seriously considered using *Stop!* as the main title; then we thought about *Start!;* but ultimately we settled on *Prosperity!* because we do believe that prosperity still is, and always will be, possible in this country as long as we stick to sound financial principles and adhere to the laws of nature.

Lasting freedom, peace, and prosperity come from adherence to the laws of nature. If we will get back to the laws of nature, true prosperity—that is, lasting prosperity—is entirely possible . . . if we do what it takes. But it is entirely up to us.

General Introduction

Background and Structural Basics of the American Financial System

After centuries of experience with other financial systems in Europe, primarily feudalism, the American financial system became based—essentially from the outset—on the fundamental principles of capitalism and free enterprise.

In a capitalistic, free enterprise financial system, assets and businesses are privately owned and operated for profit, based on fundamental market principles of supply and demand without undue governmental interference, regulation, or subsidy. Risk and reward are fundamental components of the system. Investment, price, and distribution are determined mainly by private decisions based on supply, demand, and other free market considerations rather than by the state through central economic planning. Private owners take the risk of loss, and when things go right, they reap profits as rewards for putting their time, effort, and capital at risk. These private enterprise businesses typically employ workers who are paid wages for their time and productivity.

In capitalistic financial systems, private ownership implies the right to private control of property and assets, including how they are used, who uses them, whether to sell or rent them, and how to use the revenue generated by them. Capitalism also refers to the process of capital accumulation. There seems to be general agreement that capitalism encourages economic growth and prosperity.

Creation of the First and Second Central Banks of the United States

Based on the authority to create and regulate currency granted to the federal government in Article I, Section 8, of the U.S. Constitution, the first U.S. institution with central banking responsibilities was the First Bank of the United States. It was chartered by Congress and signed into law by President George Washington on February 25, 1791, at the urging of Alexander Hamilton, the first secretary of the Treasury. This was done despite strong opposition from Thomas Jefferson and James Madison, among numerous others. The charter was for twenty years, and when it expired in 1811 under President James Madison, Congress refused to renew it. In 1816, however, Madison revived it in the form of the Second Bank of the United States. Early renewal of the bank's charter became the primary issue in the reelection of President Andrew Jackson. After Jackson, who opposed the central bank, was reelected, he pulled the government's funds out of the bank. Nicholas Biddle, president of the Second Bank of the United States, responded by contracting the money supply to pressure Jackson to renew the bank's charter, forcing the country into a recession, which the bank blamed on Jackson's policies. Interestingly, Jackson is the only U.S. president to completely pay off the national debt. The bank's charter was not renewed in 1836. From 1837 to 1862, during the "free banking era," there was no formal central bank. From 1862 to 1913, a system of national banks was instituted by the 1863 National Banking Act. But a series of bank panics—in 1873, 1893, and 1907, when the panic was particularly strong—provided strong demand for the creation of a new, centralized banking system.

The Federal Reserve

In 1913, Congress enacted the Federal Reserve Act, which created the Federal Reserve System (also known as the Federal Reserve and informally as the Fed). This system was essentially the third attempt at a national banking system. The Federal Reserve System remains in effect

today and is a controlling but little understood and often seriously misunderstood component of our national economy and financial system.

Despite its name and all the efforts to make it appear otherwise, including appointment of the Federal Reserve chairman and board of governors by the president of the United States and with consent of Congress, the Federal Reserve is not a branch of the federal government. In fact, aside from appointment of the board of governors and chairman, the federal government has little, if any, other direct oversight of the Federal Reserve and has no ownership interest in the Federal Reserve System, its component banks, or their assets. Although by law a certain percentage of the profits generated by the Federal Reserve System go into the U.S. Treasury, the principal assets and resources of the Federal Reserve are privately held. The Federal Reserve operates with little transparency and no oversight by, and no direct accountability to, any governmental entity or to "we the People of the United States."

According to the one explanation, "The Federal Reserve Act was enacted in 1913, [purportedly] largely as a response to a series of financial crises and panics, including a particularly severe panic in 1907 [and our government's and the existing banking system's inability to deal with such panics]. Over time, the roles and responsibilities of the Federal Reserve System have expanded and its structure has evolved. Events such as the Great Depression were major factors leading to changes in the system. Its duties today, according to official Federal Reserve documentation, are to conduct the nation's monetary policy, supervise and regulate banking institutions, maintain the stability of the financial system, and provide financial services to depository institutions, the U.S. government, and foreign official institutions."

Under the direction of the Federal Reserve, the U.S. monetary system and its currency, the U.S dollar (USD), have gone from being backed by hard assets, including gold and silver, to being backed entirely by debt and sheer confidence in the system, with a corresponding steady devaluation of the dollar.

It is fair to say that the Federal Reserve System is quite complex and is one of the most controlling and at the same time least understood and often misunderstood components of our nation's banking and financial system.

The Bretton Woods Conference

In the closing years of WWII, most of Europe (including the United Kingdom), Africa, the Baltics, Russia, and Asia were devastated both economically and socially. How could the world repair the damage? Where was the world, coming out of the Great Depression and after fighting a very expensive war, to find the money to rebuild its economies and infrastructures on such a scale? Those questions were the primary issues for discussion at a 1944 conference of major world economists and political leaders held in Bretton Woods, New Hampshire, where the principal architects were John Maynard Keynes and Harry Dexter White, then U.S. secretary of the Treasury. At the heart of the proposals put on the table were two basic principles: 1) the Allies must rebuild the world's nations (primarily the Axis nations of Germany, Japan, and Italy) and their economies, and 2) a new international monetary system must be established, headed by a strong international banking system and a common world currency not tied to the gold standard.

The principal agreements reached at the Bretton Woods Conference were 1) that the U.S. Dollar would replace the British Pound Sterling as the medium of international trade and world reserve currency and 2) that the DOLLAR would still be tied to a gold standard at thirty-five dollars per ounce. Also coming out of the conference were agreements to create or implement the Marshall Plan, the Bank for Reconstruction and Development (World Bank), the International Monetary Fund (IMF), and the Bank of International Settlements (BIS).

End of the Gold Standard

By 1961, just sixteen short years later, the Bretton Woods Conference goals were succeeding, but U.S. dollars were in short supply because of a dwindling gold supply to back additional dollars. The solution was to use the private banking sector to recycle the current number of dollars back into world commerce without merely printing more dollars. The solution was based on a time-honored import/export finance concept called *forfaiting.* The world's top banks would extend the use of forfait finance, which was backed by their own good faith and credit, not by

gold. The extension of credit would be backed by banking *debentures* of all kinds—letters of credit, bills of exchange, and various guarantees.

International Chamber of Commerce

In response to the need to raise more capital and generate more dollars to meet growing demands for dollars as the world's reserve currency, the U.S. Federal Reserve became more active in the International Chamber of Commerce in Paris. Though most Americans view the Federal Reserve as largely a domestic entity engaged in domestic monetary policy, ever since the Bretton Woods Agreement whereby the dollar became the world reserve currency, the Federal Reserve has also played the international role of representing the dollar as the world reserve currency. At this point, the Federal Reserve regulates the supply of dollars in circulation both at home and abroad, and as dollar credits are shipped offshore, they are placed with London bankers for entry into the world's money markets. The London banks have been the international monetary clearinghouse for hundreds of years. The vast majority of nations, large and small, entrust their funds to these bankers, which have been the major managers of Eurodollars (offshore dollars) ever since the dollar became the "pegged" currency, replacing the English pound. The dollar is the sole currency used in forfaiting trading transactions (see below) primarily because it is the accepted reserve currency but also because of the huge numbers of Eurodollars that are in circulation worldwide.

New Rules

As opposed to being governed by any real rules or regulations enacted by our own elected leaders, the Federal Reserve and its operations are now governed primarily by rules handed down by the ICC, World Bank, IMF, and BIS. Based on the situation that existed at the time, new banking laws, rules, regulations, and procedures were enacted by these bodies to expand the money supply by encouraging the following actions:

1. Reducing reserve requirements via offshore transactions.
2. Receiving support by the World Bank, IMF, BIS, and central banks.
3. Implementing off-balance sheet accounting by the banks involved.
4. Legally ranking instruments *pari passu* (on the same level) with depositors' funds.
5. Allowing banks to leverage depositor funds with the applicable central home bank of the depositors' home country in such a way as to obtain the equivalent of federal funds at a much lower cost.

When these leveraged funds are blended with all other accessed funds, the overall blend-rate cost of the funds to the issuing bank is substantially diminished, thus offsetting the high yield given to attract the investor with substantial funds for deposit.

The New Age of *Leverage,* Debt, and Bank-Credit Instruments

Under the new rules, including bank-credit instruments, the Federal Reserve creates money by "monetizing" debt. It does this several different ways.

Completely unbeknownst to most people, the Federal Reserve uses two financial instruments to control and utilize the number of dollars in circulation internationally. These are medium term bank debentures, also known as medium term notes (MTN) and bank guarantees (BG).

Under the new rules, bank-credit instruments provide bankers with the means to resolve other banking issues, such as interest rate risks and meeting capital reserve requirements. Bank debentures became the tool of choice for controlling the amount of dollars floating against other currencies and to help maintain the value of the dollar. It was thought that the fear of runaway inflation could be limited by controlling the number of dollars available to the world market at any given time.

Replacement of the Gold Standard with Good Faith, Credit, and *Confidence*

In 1971 the volume of world trading finally exceeded the volume of dollars backed by hard money and the ability of the United States to

support its currency with gold. During the Nixon administration, the Fed let the dollar float in the world markets—its value not tied to gold or any other standard but tied only to the full faith and credit of the U.S. government and its assets. To secure that commitment, Nixon deeded the bank credit instruments put in place by the Kennedy administration and agreed to work hand in hand with the IMF and BIS as well as the central banks of other Western countries to avoid a collapse of the dollar's value. The value of the dollar was now entirely in the hands of the international currency markets, with the following operating principles in place:

1. Issuing bank debentures would pull dollars out of the private sector and exchange them for guarantees.
2. Once the dollar had been accessed, the issuing banks could recycle them back into the world economy as loans. This process increased the money supply.
3. Alternately, the issuing banks could purchase U.S. Treasury bonds from the Fed, thereby retiring the supply of dollars in the world market back into U.S. hands or selling the treasury notes to the Fed to increase the money supply.

That basically explains the background and core framework for the financial system we have today.

"The bad news is that the dollar is down — the good news is that nobody seems to *have* any."

Chapter 1

Government's Proper Financial Role

In our companion essay *Enough!,* we discuss the proper roles of government generally. The focus of this essay, however, is on the economy, financial matters, and government's proper role in that regard. According to our good friend Worth Woolsey, "As a general rule, the vast majority of people aren't interested in really getting educated about any of this; they just want to be stroked." For us, or anyone else engaged in an effort like this, finding an appropriate balance between stroking and education is a real challenge.

To start this discussion out on the right foot, we're going to repeat the fundamental premise, based on the laws of nature, that government's paramount role—at all levels—is to protect individual inalienable rights, including life, liberty, and the pursuit of happiness, which has been defined as private property, with obvious financial implications. All other roles of government are subservient to this highest-priority role.

The proper role of government with respect to money and finance in this country should be limited to three main areas: 1) creation of currency, 2) collection and expenditure of such taxes as are necessary to carry out essential government services, and 3) maintaining some basic level of general economic stability. Otherwise, as a general rule, the more governments intervene in financial and economic affairs, the more long-term issues and problems they typically create and perpetuate.

The Role of the U.S. Constitution in Our Financial System

Although, as stated in the preface, the development of the U.S. Constitution ultimately had as much to do with economics and economic vision as anything, the Constitution itself says fairly little about government's role in the American financial system. Obviously, this was due in part to the capitalistic, free enterprise basis for our financial system, the foundation of which was already in place at the time, including the fact that in a free market economy, government should have a limited role in such matters. But Article I, Section 8 specifically grants the federal government power to coin money and regulate the value thereof.

Today, *coining* money seems like a completely obsolete and anachronistic term, replaced almost entirely by the concept of *printing* paper money. But such was not always the case. At one point in time, money in this country had *intrinsic* value; that is, the value of the coin was tied directly to the value of the metal from which it was minted. Much has changed in 220 years.

In the Constitution, *we the people* and the states delegated to the federal government the power to create and regulate currency in this country. Unfortunately, at this point, and for the past one hundred years or so, the federal government has further delegated that power to the Federal Reserve, a privately owned entity heavily influenced by forces outside this country, with little transparency, no direct oversight by or accountability to we the people, the states, or even our federal representatives, under whose auspices it purportedly operates.

We will spend some time in this essay talking more about the Federal Reserve, explaining how money is created and how our government spends it; but let's talk first and briefly about government's role in maintaining some level of stability.

Government's Role in Maintaining Some Reasonable Level of Stability

Though our government should have little, if any, role other than that outlined above, in our free market economy it is important that government help maintain some level of economic stability. But it is

not the government's role to attempt to intervene and stick its nose into everything that happens. It is not the proper role of government to act as a homeowner's association or insurance company. Our government is not responsible for insulating individual citizens against any bad thing that might happen to them. Government's limited administration should be blind, without respect to persons or entities. It should maintain stability while keeping intrusions to a minimum. All three branches of government can fulfill this proper role by acting in accordance with and staying within the limited boundaries of their proper constitutional mandates and by adhering to the laws of nature.

Haiti as a Useful Case Study

Despite being the polar opposite of the United States in many ways—and even before recent media attention—Haiti was a useful case study. Haiti is the most impoverished country in the Western hemisphere and one of the poorest in the world, yet Haiti shares the same Caribbean island, Hispaniola, with the Dominican Republic, a relatively prosperous country with what appears to be a stable and growing economy. These two neighboring nations share the same climate and have comparable natural resources. Although each has a unique colonial history, as recently as 1960 their respective national gross domestic products were essentially the same. In the fifty years since, however, the Gross Domestic Product (GDP) of the Dominican Republic has increased 500 percent. During that same time, Haiti's GDP dropped by 50 percent. Why the disparity? The main difference comes from diverse government stability and differing government policies. While the Dominican Republic has been relatively stable, Haiti, even before the recent earthquake, was a poster child for political imbalance and instability. This is a disquieting observation, particularly in light of our own government-led economic instabilities, as more fully discussed below.

Let us now shift our focus to how governments spend money and the various consequences—both intended and unintended—of their spending habits.

Private Enterprise Can't Compete with Freebies

Haiti is also an effective case study for other topics as well, including the net effect of government largesse, compassion, charity, and handouts. Despite being the recipient of large amounts of foreign financial aid for decades, Haiti remains the poorest country in the Western hemisphere. Why? At least part of the cause is that government handouts destroy individual incentive and cripple people. Handouts have the same effect on national economies. Haiti's GDP has gone down, at least in part, because of a lack of incentive to work and produce. Even before the earthquake, much of what Haitians consumed arrived in the form of foreign aid. Private enterprise and independently owned businesses generally have a hard time competing with government freebies.

Although these handouts do have a place in some instances, they must be handled wisely. Too much charity over too long a period—particularly government charity—can cripple an otherwise viable economy.

The recent hurricane and tsunami in Samoa provide another example of how this works. Following the disaster, several Samoan-American businessmen and former NFL football players, concerned about what had happened in their country, decided to organize their efforts to help by putting together a cargo container of clothing and aid supplies. One of them flew to Samoa to assess the needs prior to filling the container. He found cargo containers filled with foreign government aid and donations everywhere. The problem was, this free government aid was putting otherwise sustainable local businesses that produced and sold clothing and other goods out of business. They simply couldn't compete with free supplies. One of the unintended consequences of the aid was that people lost their jobs.

Consequently, the businessmen reassessed their plan and decided to assist in a way that would help meet the immediate needs of the people of Samoa without hurting the long-term success of their economy. In lieu of donating goods, cash donations gave the afflicted people the means to buy needed supplies from local stores and businesses and at the same time circulated money and goods throughout the communities.

Utilizing the internal Samoan economy in this way was far more effective for long-term recovery than simply donating goods. Our governments often have good intentions, but their actions often generate the opposite of what they desire. Demonstrably, when people are paid or rewarded for not producing, they quit producing. They become dependent. We'll talk more about that later.

Regulatory Uncertainty

At a recent economic summit, executives from a wide variety of businesses—including those businesses that provide electrical energy to a large region of the United States as well as leaders from state and local governments—repeatedly expressed a wait-and-see attitude about how to proceed. "We're waiting to see what the federal government is going to do," said one executive. "With the instability in Congress and the White House regarding energy policy and other regulations, . . . it's hard to make decisions and do what needs to be done in order to stay in front of needs because we don't know what the federal government is going to come up with next. All of this is diminishing our ability to keep costs down for the future while meeting present demand."

Uncertainties about health care, concern over the cost of new carbon cap and trade regulations, and questions about changing federal and other government policies were driving important business decisions rather than allowing the market or more natural market-based factors to be the controlling consideration. Some industries and markets were getting "stimulus" monies, while others were being thwarted by ever-encroaching regulations that hamper economic growth. It is clear that businesses cannot thrive (or even survive) in an economic environment where instability and unpredictability are everywhere present. Many are asking whether this handicapping of the free market is a natural phenomenon—the organic ebb and flow of economic tide—or is there a more methodical agenda behind it?

The more roles government tries to take on, the harder it is for private sector businesses to compete. And if government attempts to usurp all other roles, what is left for the private sector?

Roles Best Left to the Private Sector

If governmental roles are confined and limited as outlined above, who, then, is and should be responsible for everything else? We are, in the private sector—individuals, families, neighborhoods, communities, churches, charities, and private sector business. That's how it has been and should be.

Individually, we have the personal responsibility to feed, clothe, and house ourselves, our dependent children, and other family members. We are personally responsible for our actions and should experience the natural consequences of both our mistakes and our triumphs. Anything else would violate the fundamental laws of nature.

Beyond the individual, the family has primary responsibility to provide food, clothing, and shelter. The family shares in the responsibility of protecting, defending, and nurturing its members as well as promoting their emotional well-being. The family—not the government—ought to provide for the teaching of values, morals, and character as well as more temporal education.

We don't live in a perfect world. Stuff happens. No matter how well we outline roles, no matter how sound our intentions, everyone needs help sometimes. That is where extended family, friends, neighbors, communities, businesses, churches, and charities step in. In being more responsible and accountable ourselves, we naturally become more able and capable when others are in need. And when we voluntarily help others, we're exercising our own personal liberty—our fundamental freedom of choice—to do so.

In our way of thinking, it is the proper role of private sector business to create commerce and markets, and to generate financial resources and capital, without subsidy, partnership, or interference from government. This happens naturally when the private sector is allowed to reap the reward for putting time, effort, and capital at risk and for being innovative and productive. When a business does generate increased financial resources and capital, it has the opportunity to be generous with its resources. Not all business owners choose to be so, but there are many examples of Americans who have been blessed with financial resources who have been extraordinarily generous. Private philanthropy has done

much good in this country, and the increased opportunity for success that occurs when both government competition and interference are removed will create the ability for additional numbers of successful people to share. For this to happen, it is imperative that individuals retain the paramount freedom of choice to decide for themselves when or how to administer their charitable efforts and substance. Churches and organized charitable institutions have traditionally played a large role in the distribution of these private, freewill donations.

When government steps in to these roles using taxpayer money, it takes away our fundamental freedom of choice. Instead of having the liberty and freedom to choose whether and how to contribute, we have a government that forces those decisions upon us through the mandatory collection and expenditure of tax revenue. When Warren Buffet, Bill & Melinda Gates, and others who are counted among the extremely wealthy in this country, recently donated large, previously unheard of amounts of money to a variety of charities and other causes, they undoubtedly did so with an eye toward the future, and the increasing likelihood that eventually the government will take an increasingly larger percentage of such resources by force (taxes), and at that point they would no longer have freedom of choice as to how those financial resources are spent.

In accordance with the fundamental principles of the laws of nature, the way it should work is that after individuals have done all they can to help themselves and have enlisted the help of close friends and family, then is the time to turn to an organized church or charity. When churches and charities provide assistance, part of their role is to teach and improve self-sufficiency and accountability. These charitable entities often strive to apply a version of the parable of the fish: give a man a fish, and feed him for a day; teach a man to fish, and feed him for a lifetime. As part of this process, recipients who receive assistance should, to the best of their ability, provide something—some work or effort, however small, in exchange. This concept is completely foreign to government entitlement programs, which operate on the misguided concept that people are naturally entitled to something (assistance) without doing anything in return.

There is another aspect to this idea that an individual ought to work in return for assistance. There is something demeaning in accepting charity on the basis that it is somehow deserved. Time was in this nation's history when a man took pride in being able to provide for his own needs and those of his family. He was likewise diminished by his willingness to accept a handout. When an individual is given the opportunity to work for the assistance he accepts, he retains his sense of dignity. And who can measure the worth of that?

Before spending more time talking about government spending and entitlements, we want to talk more about the current state of our economy in general.

"Let's have some fun — let's make them responsible for their own actions."

Chapter 2

The New Economy: Consumer Spending, Leverage, and Trading Securities and Debt Instruments

Instead of production, which was once the foundation of this nation's economy, the new economy is based almost entirely on consumer spending, leverage, service industries, and the trading of securities, including securitized *debt instruments.*

Most people are acquainted (often personally and intimately) with the concepts of consumer spending and service industries. Leverage is likewise a concept that we have become increasingly well acquainted with. And many have some general, superficial grasp of the concept of "securities." But less is generally known about the trading of debt instruments, which often goes hand in hand with leverage. As a general rule, many of these debt instruments have little (if any) intrinsic value. They are just paper. But the trading back and forth of these debt instruments has now become a multitrillion-dollar, worldwide industry that fuels the entire financial system.

This is the system that brought us such things as financial derivatives, credit-default swaps, and most of the other previously unheard of financial buzzwords of the past two or three years. One of the latest pushes has been to securitize portfolios of real estate transfer fees so that more money can be made trading these portfolio securities. For those unfamiliar with how this works, a typical piece of real estate, say a house, changes hands, on average, once every 5–7 years. To capitalize on this turnover, a document is recorded which states that every time the property changes hands, a "transfer fee" based on a percentage of the total

transaction (typically 1–2 percent) is paid out of the closing back to the holder of the right to these transfer fees—often the original real estate developers. But since many real estate developers are strapped for cash and need the money now, instead of over the course of the next 10, 20, 30 years, transfer fee rights are being bundled into portfolios that are then "securitized" so that they can be bought, sold and traded in the securities markets, based on their present market value. This is just one example of the creativity that is brought to bear to find new ways to make money without producing anything.

Again, these are often instruments that have little, if any, intrinsic value for anything but trading fodder. But it is this so-called "trading," which is considered a "service," rather than any kind of actual, tangible physical asset, production, or product that has become the foundation for the modern world's financial system, including the current financial system of this country. It is this trading back and forth of these creative securities and debt portfolio instruments that now generates a good share of the GDP in this country. That is one of the reasons that it is said that "services" now constitute well over half of our country's entire GDP.

At this point, our entire economy is based on leverage. Based on the financial system and framework described in the introduction that is now in place in this country and indeed our modern world—with credit, debt, good faith, and confidence as the only things backing the whole shebang—growth, expansion, and inflation are absolutely critical to continuation and perpetuation of the system. Without continued growth and expansion, people get real nervous because the whole system is built on the concept of perpetual expansion and constantly rising values. When growth and expansion start to slow or, even worse, slip into reverse, people begin to panic because the transmission that drives the system does not include neutral or reverse. Everything depends on the economy continuing to move upward and onward. We'll explain more about that later.

Now let's look at some of the numbers that define our current situation.

Understanding the Basic Economic Numbers and the Situation We Find Ourselves in Today

In some cases, finding accurate numbers is hard to do. And it is hard to know what numbers can be trusted. Both the government and the media have their own agendas. With that caveat, discussion of the current numbers does not need to be lengthy. The basic numbers should be able to give us a pretty clear and sobering picture of where things stand.

Although the numbers don't lie, they do change. Recognizing that all these numbers change from day to day, month to month, and year to year, and that as a nation, the United States is currently adding federal government debt at the rate of over $4 billion a day, it is fair to say that the only thing we can really do is cite ballpark figures. And we recognize that there may be some room for discussion or argument about some categories of numbers. But they should still be more than adequate to help us understand, conceptually, where things stand financially in the United States today—and probably more important, the direction we're headed.

At this point, the total value of all domestic assets in the United States is estimated to be approximately $131 trillion. According to some sources, total liabilities are estimated at roughly $110 trillion. In other words, in everyday terms, as a country our house is worth $131 trillion, but we owe $110 trillion on it.

The good news is it appears that we still have a little equity—roughly 16 percent—between solvency and insolvency! But the bad news is, instead of paying down the debt, we're adding to it at an alarming rate.

Though the United States still has by far the largest GDP in the world (with China now in second place and growing fast), for the past several years, our GDP and Gross Domestic Income (GDI) have hovered right around $14 trillion. As most people know, there have been several consecutive quarters of decline, and growth has otherwise been pretty flat since about 2007.

Private consumer spending, often said to account for 70 percent of our economy, still amounts to about $8.55 trillion a year (after being adjusted to subtract government healthcare spending included in the

70 percent figure), with the vast majority of the total consumer spending figure funded by credit. Business spending for fixed assets hovers around $1 trillion, and total annual government (federal, state, and local) spending is somewhere close to $10 trillion a year, including $6.5 trillion a year in deficit spending, based entirely on new debt.

That means at this point, as a country, collectively between the public sector and the private sector, we consume, borrow, and spend approximately $19.5 trillion a year, while only producing $14 trillion. This means that we consume, borrow and spend about 40 percent more than we produce each year. Think about that—we consume 40 percent more than we produce on an annual basis, much of it funded by increasing debt! And we currently import 50 percent more than we export. To understand the conundrum, imagine how that formula would work in your personal finances. How long and under what conditions can the United States possibly sustain this scenario?

For the first time ever, in 2010 our total federal government debt alone—at $13 trillion—is almost equal to our total annual GDP. But it's not just the federal government that is borrowing money to spend. When we add $1.4 trillion in new annual combined state government debt and $1.3 trillion in new annual combined local government debt to the existing tens of trillions of dollars in private debt, we start to get the picture.

But the most sobering aspect of the whole discussion involves the trends. Despite our current financial predicament as a country, our governments can't seem to "get it" and exercise the restraint necessary to rein themselves in. Consequently, the continuing trends in borrowing and spending are looking worse than ever. In 2009, the federal government added $3.5 trillion in new debt, and state governments combined for another $1.3 trillion. It is estimated that in 2010, the federal government will add $3.7 trillion in debt and the states another $1.4 trillion. It is anticipated that in 2011, the federal government will add an additional $3.8 trillion in debt, and states will add an additional $1.5 trillion. Combined new federal, state, and local government debt will be at least $6.7 trillion—in one year! And none of this includes the costs of the new healthcare plan that will start to be added after that.

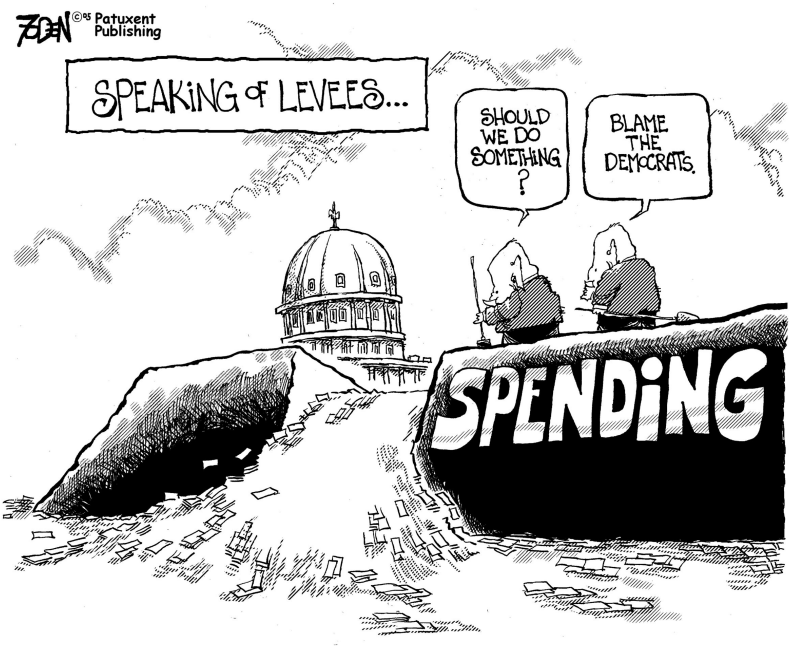
To help put this in context, in 1998—just 12 years ago, when many thought debt was already bad—total government spending (total spending, not debt) by federal, state, and local governments totaled 28 percent of our total annual GDP. In 2010, by contrast, just the new debt alone added by federal, state, and local governments (let alone total spending) is estimated to be over 40 percent of anticipated total GDP. Our government spending at all levels is growing by leaps and bounds—and at a time when our GDP is almost completely flat or in decline. At the rate our governments are borrowing and spending money, within a few years, our total government debt will be several times our country's total GDP.

To wrap up our discussion of basic numbers, consider the following numbers recently reported by one leading commentator on the subject: "Federal workers have been awarded bigger average pay and benefit increases than private employees for nine years in a row. The compensation gap between federal and private workers has doubled in the past decade. Federal civil servants earned average pay and benefits of $123,049 in 2009 while private workers made $61,051 in total compensation. . . . The Federal compensation advantage has grown from $30,415 in 2000 to $61,998 last year. U.S. government workers, who enjoy the greatest job security of any Americans, now earn twice as much in pay and benefits as the average American."

And, as we pointed out *in Bedrock!,* the thing we need to remember about all these government jobs is that aside from paychecks, *they produce no tangible, marketable products; they produce nothing of value!* While such jobs may produce a paycheck and other plush benefits, which may be "assets" to the people who receive them, there is a corresponding liability for everyone else who have to pay the bill, without any corresponding production or generation of marketable goods or services that can contribute positively to the American GDP. In other words, at this point and increasingly, as a nation, we are burning equity much faster than we are adding value to produce and build it, with no corresponding production, return, or even reasonable hope of corresponding return.

And though many like to point the finger exclusively at the current administration and the Democratic Party that currently controls Congress when it comes to government spending, let us not forget that most of the fat years for the federal workforce came while Washington was being run by so-called "conservatives," while big-government Republicans controlled Congress and the White House.

No wonder the Tea Party movement is targeting both parties. And we are too. Though it is true that we are experiencing a real spike in government spending right now, for at least the past ten years, government spending has been completely out of control, regardless of which party has been in office.



Chapter 3

Beyond the Numbers—the Real Problems

It's not just the numbers that are a problem. In fact, as we discuss in *Bedrock!* and in this essay, the numbers are just symptoms of the real problem. The real problem is that we have ignored and continue to ignore the basic laws of nature.

Remember the Laws of Nature?

Just as with all laws of nature, the fundamental laws and principles that apply to economics do not involve rocket science. They are really pretty simple. We've mentioned many of them before.

- You can't have your cake and eat it too.
- You don't get something for nothing.
- If you spend more than you make, you're broke.
- Failure is a prerequisite to success—practice makes perfect.

The Rule of 72, a method for determining an investment's doubling time, is likewise a natural law of economics. While, as explained in *The Richest Man in Babylon,* the principle of interest can be used to double and subsequently multiply one's "investments" over time, for most of us the principle works in reverse. Through the use of credit and the application of interest, we end up paying two or three times more for goods and services than we would if we paid cash.

What about the Laws of God?

The bedrock principles of the laws of nature and nature's God are freedom of choice—liberty, personal responsibility, and accountability. Our Creator—Deity, the God of Nature—has given mankind stewardship over all the abundant resources of the earth. Everything is created for a purpose and is intended to be put to beneficial use. Just in nature alone, our Divine Creator has given us many examples and patterns that we would be well advised to follow. Through good, responsible stewardship, these resources can be put to good use to benefit mankind, bless all living things, and in the process be multiplied many times over. Through poor stewardship, they can be lost forever. Regardless of whether one believes in God in any conventional sense, ultimately, nature will hold us accountable for our stewardship.

At this point, one of the biggest foundational problems we have in this country is that in all the *prosperity* and greed of the past fifty to sixty years, we have forgotten not only the laws of nature but also nature's God, our Divine Creator, the source from which all blessings flow. Unfortunately, for most people there is a direct inverse relationship between their comfort level (often linked to their bank account balance) and their interest in Deity. As a general rule, the more comfortable they are, the less interest they have in God. The more uncomfortable and humble they are, the more concerned they become about God. As long as things are going well, we all have a tendency to forget and turn our backs on God. It's a natural cycle—one that plays itself out over and over.

Once we get back to bedrock principles, lasting freedom, peace, and prosperity come from adhering to the laws of nature. But since we have completely ignored these financial principles for so long, sooner or later we will inevitably experience some pain. We have set ourselves up for it. As some say, we've got it coming.

Unintended Effects of Government Entitlement Programs

Although governmental compassion, charity, and bailouts may put temporary Band-Aids on symptoms, they don't work as long-term

economic solutions. Such approaches don't address core causes of economic problems but instead seek to relieve them temporarily through quick and easy fixes that actually compound the problems.

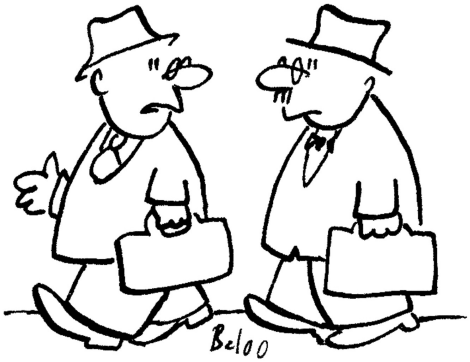
In this age of government entitlement programs, we must acknowledge that here at home we have lost much of our own drive to produce and create economic strength as a result. Few families, communities, or even states live within a balanced budget or are self-sufficient. Charity-style programs, while an asset at the church or community level, become an affront to the laws of nature when enacted at the federal level. When we work hard for a thing, we work hard to keep it secure; we work hard to maintain and increase it. This natural phenomenon stimulates a strong economy. But when economic benefits are received at no immediate cost, we begin to believe there *is* no cost.

Helping people is good. We believe charity and compassion to be two of the finest attributes of mankind. But it is a cruel form of help to rob someone of their ability to be self-sufficient and to allow that help to become a handicap. "But," some may ask, "aren't we being cruel if we don't help people in their time of need?" The answer is that we must help wisely, and we must help within our means. Any other "help" is no help at all.

How can we continue to be a strong nation if we cripple others and ourselves through handouts? Aid must be handled wisely—both foreign and domestic. Many of the social aid programs currently in place on our home soil handicap recipients and cause dependency. Programs such as food stamps, Medicare, and other components of the New Deal were once a leg up, grudgingly accepted by recipients only in the most desperate of circumstances. Not anymore. They have now become expected and necessary handouts—entitlements we can ill afford, with their bill being continually pushed forward for another day, rolled over for another generation to repay. But the due date can't be pushed forward forever. As often happens when things come "free," we have forgotten their true cost.

The same principles apply in spades to business. We're certainly not the first ones to say this, but if we reward companies for their bad decisions and behavior by bailing them out, what are we teaching them?

What are they learning from their experiences? Not the lessons they should be learning from their mistakes and failures in accordance with the fundamental principles of the laws of nature.



"I know we can't repeal the laws of nature, but I don't see why we can't *amend* them a little."

Federal "Emergencies"

The same principles apply just as much to state and local governments as they do to individuals and private sector business. In this country, we have developed a hair trigger for declaring "federal emergencies," creating entitlement to all kinds of federal emergency relief. Completely out of line with the laws of nature and the U.S. Constitution, the federal government has usurped power and created multiple departments and legions of bureaucracies to deal with these "emergencies" and address situations that are rarely true national emergencies or disasters. More often, they are state or local issues, and state and local governments should be equipped to deal with them.

In reality, when disaster strikes, the only relief "handouts" should come in the form of insurance payments from legitimate insurance companies engaged in a balanced, free market system. Individuals can

and should be responsible and ready to do all they can personally. With proper planning, communities, church groups, neighborhoods, and state resources can be adequately prepared for most true emergencies. If and when they are not, it is often due, at least in part, to the expectancy of federal intervention. Because federal institutions have usurped this state role, many states will have to relearn to be self-sufficient and remember how to be prepared to handle unexpected challenges. Charitable help, though it should be available from family, friends, neighbors, business, churches, and other private entities, is not the proper role of government.

End Results of Violating the Laws of Nature

Whether we are individuals, state and local government, or private sector business, the reality as a general rule is that "we can't get something for nothing," even in times of disaster—including financial crises. Even when we think we're getting something for nothing, someone has to pay. There may seem to be exceptions, but there is always a cost. Moreover, when we think we're getting something for nothing, we often take it for granted and don't take care of it—it's too easy to take and spend someone else's money! Somehow, in some way, *someone* will have to pay the bill. And the worst part is we are robbed of the opportunity to learn from our mistakes and experiences. We must learn to understand these basic principles.

To help further illustrate this point, we'll relate a story from our friend Worth, a story that may help us better understand how principles of the laws of nature apply under such circumstances and reveal natural, unintended consequences when we attempt to be *too* helpful.

It seems that Worth and a friend were involved in a conversation with a part-time farmer who had a day job as an insurance agent. The farmer/insurance agent explained that he had been exposed to much hard work and responsibility as a youngster growing up, and had to deal with a lot of dangerous farm equipment. He had also seen "what can happen" through his day job in the insurance industry. Because of his experience, like many *helicopter parents* today who hover around trying

to save their children from every possible misstep, he had gone to great lengths to shield his children from what he had seen and experienced. He didn't want them to have to work so hard or be exposed to any risk of making a mistake or getting hurt. When the concerned parent was done expressing his philosophy, Worth leaned over to his friend and whispered, "No wonder he hasn't raised a single kid that amounts to a hill of beans."

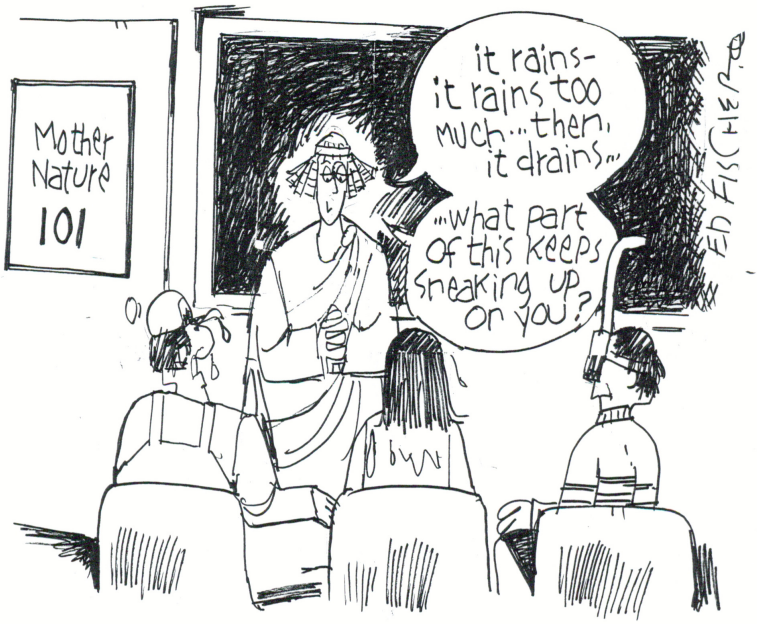
This may sound mean, and it may seem harsh, but let's reconsider the laws of nature. Whether we act in accordance with them or not, the laws of nature will invoke their power on our lives. "Survival of the fittest," "failure is a prerequisite to success," "we reap what we sow," and other natural, commonsense laws may seem to reflect a callused attitude, but even when we are consistently shielded from mistakes or regularly create dependencies, these irrefutable truths will still make themselves known. "The ultimate result of shielding men from the effects of folly is to fill the world with fools."

New Orleans and Hurricane Katrina

Undoubtedly, this next example will stick in some people's craws, but it is too salient not to at least mention in passing. Based on the irrefutable laws of nature, natural cycles, and pure statistics, what is *eventually* going to happen when you build a city below sea level at the head of Hurricane Alley? When the inevitable eventually does happen and the city is flooded, what kinds of lessons are people going to learn when, just for the sake of tradition, sentiment, and a whole bunch of other warm fuzzies, the federal government insists on rebuilding the city as before in the same place? And how long can artificial, man-made seawalls hold back the sea?

Natural Cycles

At this point, we should make an important observation. We feel compelled to say something about cycles. How does nature work? There is nothing more natural than cycles. Our entire existence is based



on natural cycles. The earth revolves on its axis once every 24 hours. The earth revolves around the sun once every 365 days. Cycles dictate the seasons. Cycles are natural. According to natural laws and the cycles of nature, there are seasons and natural cycles—feast and famine. The laws of nature dictate that if you don't save seed in the fall, sow in the spring, nurture in the summer, and harvest in the fall, you won't eat in the winter.

For the past one hundred years or more in America, we have worked steadily to try to find ways around these natural cycles. Who in the natural world gets a steady paycheck? Although the laws of nature offer no security in the conventional sense except in the constancy of change, seasons, and cycles, we have been conditioned to think in terms of straight lines and to try to even out the cycles. We all want a steady paycheck even though there is no precedent for steady anything in nature—except for change.

Although we try to avoid *too* much repetition in these essays, we're

going to retell part of the Matt James story from *Bedrock!* because of its relevance to the financial issues we are discussing here.

Matt James Revisited

As you may recall, Matt James was a successful stockbroker in Chicago. He made a good living and sought a lifestyle in keeping with his image and position to show off the fruits of his labors.

But after a time, Matt grew weary of trying to keep up with the Joneses, and, for the sake of his children and family, he quit. Matt simply walked away from a successful career and a thriving brokerage and went back to the farm he had grown up on.

At that point, Matt had some investments, and, for a time, things seemed easy enough while he and his family lived on those investments. On the farm, they enjoyed much about their new situation and lifestyle. As long as they had money, the farm seemed like the best of both worlds. But they really had no idea how to produce and actually make a living on the farm, and eventually their principal ran out. For the first time, Matt and his family experienced financial difficulty. In fact, at times they were flat broke or, like many farmers, land rich and cash poor.

For Matt and his family, it was a rude adjustment from their previous lifestyle, and they tried to ease the impact by using credit and mortgaging the farm. Although they had plenty of paper equity, their cash flow was often insufficient to service their debt. So they felt forced to continue to borrow more and more, servicing their debt with more debt. The financial challenges seemed to go on and on. At times they would get an influx of cash as crops came in or as various other ventures experienced success, but inevitably their cash would go quickly, leaving them out of money again.

Like virtually everyone else, Matt and his wife had been so conditioned to think a certain way while enjoying the security of a steady paycheck that it was a challenge to start to see that in nature exactly the opposite is true. Birds fly south to warmer climes in the winter. Some animals prepare for winter by gathering seeds and nuts. Yet other animals store fat to get them through the natural, seasonal time when it will otherwise be very difficult, if not impossible, to find food.

Matt started to see that so much of what we do in this world—from relying on artificial light to burn the candle at both ends to having steady jobs and paychecks in order to level out the cycles—is really just an effort to circumvent natural cycles. He could see why so many people like government jobs—they provide a greater sense of security and insulation from natural cycles and the laws of nature. He could see that many people, particularly children of the Great Depression, had became government bureaucrats essentially for that reason alone—the perceived security that such jobs and careers could offer. But he also came to see that this was a false and unsustainable sense of security and that true security comes from understanding the laws of nature, comprehending natural cycles, and learning to work with them instead of fight against them.

Like Matt, many of us have forgotten how to work with and manage our lives in accordance with the fundamental laws of nature, including natural and financial cycles. Instead of saving for next winter—or even a rainy day—we want it all now. Matt and his family, after years of living the good life, had never really learned to make do, save up, and wait for the things they wanted. Old habits of living on credit were heavier to bear because the farm afforded less predictability. Each time successes or windfalls came along, the income they brought in was gone as quickly as it had come.

As financial winters came and went, Matt's family continued to struggle. They ended up digging themselves into a pretty deep hole. Hard financial times were very humbling, which was actually a good thing. Matt and his family started thinking about and acknowledging things they had never really considered before. Some of those things were tied directly to their values, moral compass and previous lifestyle. Eventually, they were forced to make a serious decision and, in Matt's own words, to "keep it up and turn to government for help or shape up and turn to God." Rather than turn to government programs, Matt and his family decided to shape up and turn to God. They turned to their Creator—the God of Nature—for both understanding and help.

During Matt's heady career as a stockbroker, God hadn't really factored into the equation or been much a part of Matt's life. Matt hadn't

felt that he needed God. He believed in God in some generic sense, but his belief had made little difference in how he lived, and he didn't feel that he had any kind of personal relationship with God. But prolonged financial hardships and overwhelming debt eventually humbled Matt to the core. He sought divine understanding and intervention. "I came to know my Maker and how He operates," Matt said. It took awhile, but slowly things started to change. The first changes happened on the inside, and Matt and his wife soon sought to bring their lives more into alignment with their newfound understanding of how God wanted them to be and to act.

According to Matt, his understanding of how God operates is kind of a chicken-and-egg scenario. Did God, as the Creator, create the laws of nature, or does God simply operate in accordance with those laws? Matt hasn't been able to completely resolve that question in his mind, but he has ultimately concluded that it doesn't matter because the end result is the same.

Coupled with his understanding of another basic law of nature—get tough or die—Matt worked steadily to turn things around. He began to realize that all he really needed to do was quit ignoring God and trying to get around the laws of nature, particularly as they apply to money and finance. In addition to producing, Matt had to live within his means and understand and live within the constraints of natural cycles. It wasn't rocket science, but it wasn't always easy, and it took some time. Old habits die hard! But eventually Matt took a whole new interest in self-sufficiency. He began to live in accordance with fundamental principles of producing what he consumed, living within his means, accepting the seasons and natural cycles, and saving for a rainy day.

As Matt and his family sought divine help and lived in accordance with the natural laws of prosperity, they started to see and capitalize on new directions and opportunities described in *Bedrock!* that proved to be both profitable and rewarding. Eventually, without credit and without debt, Matt and his family found themselves much better prepared for a wide range of possibilities that life might dish out. They could live happier and without fear—as true assets to their family, friends, and community instead of as liabilities. And perhaps most important, they were happier than they had ever been.

Natural Laws of Prosperity

In summary, what are the simple laws of nature that apply to the creation of sustainable, lasting prosperity? Among others, there are natural cycles and seasons. Consequently, for centuries people have learned that if you want to eat in the winter, you have to harvest in the fall, being careful to save something to plant in the spring, nurture in the summer, and harvest again in the fall. You can fight nature and attempt to get around seasons and natural cycles, but you will be successful only temporarily and usually at great cost. Debt is not a part of the natural laws of prosperity. Many people, including our governments, have come to use debt as a means—an artificial tool—of leveling out natural cycles, but it is an unnatural crutch, with a strong natural tendency to become an enslaving master.

Additional core principles include saving a portion of excess production for a rainy day, paying as you go, saving now and buying later, and living within your means. It's really that simple—both for individuals and for governments.

But above and beyond that, there is a direct correlation between spiritual prosperity and financial prosperity. While everyone—both the just and unjust—experiences adversity at one time or another, and to varying degrees, when we become spiritually stagnant and morally degenerate and start to lose our core principles, values, and guiding moral compass, we experience a corresponding negative effect on our prosperity. It is a natural cycle, well documented throughout history. As important as getting our financial houses in order is, getting our spiritual and moral houses in order—individually and collectively—may be even more important.

Economic cycles are natural. But attempting to manipulate natural cycles with leverage and debt is not natural. These measures may work temporarily, as many things do, but in the end, as always, the laws of nature will prevail.

Unnatural Leverage

Although leverage is a natural law of physics, it's not a natural law of economics. When it comes to economics and finance, leverage is

artificial and unnatural. In the world of the modern financial system, just as with most creative securities and debt instruments, leverage is often used to make something out of nothing—to create value out of thin air without producing anything. As we have mentioned previously, the inescapable laws of nature apply just as much to nations as they do to individuals. We can try to manipulate and attempt to get around the laws of nature—and we may succeed temporarily—but in the end, there is no way to permanently circumvent those laws. Sooner or later, they will hold us accountable. And sooner or later, debt will enslave us.

Like the passage of time, accumulating interest never stops. But the thing about our modern debt-financed financial system that is most concerning is that it is one big Ponzi scheme. To succeed, our financial system depends completely upon continued expansion, growth, and *inflation.* The problem is that like much of what we deal with in the modern world, our modern financial system was never designed to last. It was designed from the beginning to fail. For those on the early end, that seems okay—for as long as we are able to perpetuate it. But the problem now is that the chickens are coming home to roost, the mess is now squarely in our laps, and fixing the real issues and problems cannot continue to be put off indefinitely. Eventually, someone will have to pay, and without the slightest bit of conscience, we are doing everything we can to make sure that our children, grandchildren, and great-grandchildren get stuck with the tab.

Underlying Issues, Problems, and More Symptoms

Perhaps our single biggest financial problem in America today—both at the individual level and at the government level that almost single-handedly fuels the leverage our system is based on—is our insatiable desire for instant gratification. The insistence on buying now and paying later has become a common, cultural expectation, which we see in virtually every aspect of our society, from farming practices to foreign policy. These constant attempts to shortcut the system and circumvent the laws of nature are undermining our economic vibrancy and promise to ruin our way of life.

This addiction has led us right into a trap. In our modern financial system, expansion, growth, and debt—leverage—are essential to the function and survivability of the system, which requires ever-increasing inflation (expanding money supply) in order to service interest costs. Those who get the money first will profit most as that money loses value while changing hands. Thus the government and banks reap the most benefit. But in the end, someone (us) gets stuck in the trap, and left holding the bag.

Unfortunately (or fortunately, depending on how you look at it), it is mathematically impossible for this game to continue forever, which creates the second problem—debt saturation. This is the point at which people and governments can barely service the debt they have and cannot take on new debt. The debt-saturation point is flexible and can move up or down based on interest rates (the cost of the debt) and other factors.

We first started to hit a debt-saturation point in this country in the mid-1990s. In response, Alan Greenspan, then chairman of the Fed, created "sweep programs," in which average checking account balances (demand deposits) were swept into savings accounts and loaned out, thus creating more leverage and more money in the system. We hit that point again in 2000 and 2001. At that point, Greenspan lowered interest rates to a fifty-year low, again raising the debt-saturation point. This resulted in the final reckless plunge into the global debt pit that now consumes us. We have now hit that debt-saturation point again, but interest rates can't go much lower at this point without lenders basically offering interest-free money. As others have said, the Fed is running out of ammunition. Regardless, all such measures are short-term Band-Aids that simply postpone the inevitable without even addressing, let alone fixing, the real problems.

According to credit-rating services, individuals should never have debt service that exceeds 36 percent of their annual income. That is the upper limit. But look at where we are as a nation. Our federal government is currently adding debt at a rate of over $4 billion a day, with a good share of that going to just pay the interest on existing debt. Combined *new* federal, state, and local government debt is being *added* at a rate of over 40 percent of U.S. GDP per year.

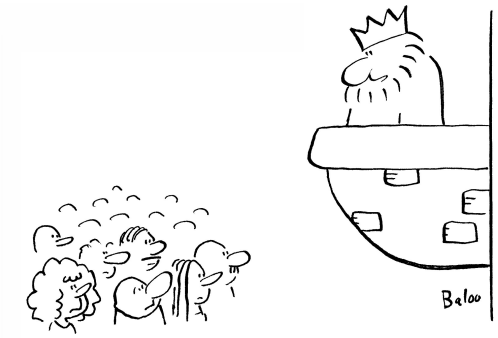
The third problem is fraud, corruption, and collusion between public and private sectors—government and big business—at all levels of government. This collusion, which includes both interference and competition from government, as well as government handouts, that have put some businesses out of business while allowing other private sector entities to benefit to the tune of billions and billions of dollars, much of it at taxpayer expense. All this has gone on during the worst financial crisis this country has experienced since the Great Depression.

What Really Has Been Done to Address These Issues?

Throughout this financial crisis, the powers that be have done little, if anything, to return to the laws of nature. One well-grounded source has written, "In most of the world, we have been experiencing an extended and devastating economic recession. It was brought on by multiple causes, but one of the major causes was widespread dishonest and unethical conduct, particularly in the U.S. housing and financial markets. Reactions have focused on enacting more and stronger regulation(s). . . . The lack of internal control by individuals breeds external control by governments. . . . [These controls] may dissuade some from unprincipled conduct, but others will simply get more creative in their circumvention. There could never be enough rules so finely crafted as to anticipate and cover every situation, and even if there were, enforcement would be impossibly expensive and burdensome. . . . *This approach leads to diminished freedom for everyone."*

In *Bedrock!,* we talked about the dam of sand that Congress and government regulators are attempting to build to defy the laws of gravity. As the dam erodes, regulators and Congress try to hold back more and more water. But the damage is done, and it is now only a matter of time. Even the inspector general of TARP (Troubled Assets Relief Program), the Treasury's new office of financial stability, says "It is hard to see how any of the fundamental problems in the system have been addressed to date. The substantial cost of TARP will have been for naught if we do nothing to correct the fundamental problems in our financial system, and we may end up in a similar or even greater crisis in two or five or ten years' time."

Indeed, if we don't stop ignoring the natural laws of economics and finance, this dam is not only going to eventually overflow, but there is a good chance it will also collapse, and many who have built far out on the *natural* flood plain will get destroyed in the resulting tidal wave of financial destruction.



"True, but fraud and waste in government is an important part of our economy."

Chapter 4

Blatant Examples of Government Misguidance, Corruption, Collusion, and Financial Mismanagement

Government, as witnessed thus far, is generally (and notoriously!) inept at management. But banks, historically, have typically run a much tighter ship than government. How then have our banks gotten into the kind of mess they are in? A better question is how did they get us into such a mess? Why have they abandoned the fundamental laws of nature more fully discussed in *Bedrock!*?

Why, when hundreds of years of precedent indicate the wisdom of sound banking practices, did they abandon them? What made banks feel safe enough to make dramatic changes in the 1970s and 1990s and even more so in the early years of this century?

Fannie Mae and Freddie Mac

The answer is that banks responded directly to federal government programs and direction. Programs such as the FHA's little-to-no-money-down program and the Community Reinvestment Act were the equivalent of building a dam out of sand with no spillway. These programs were implemented in an attempt to centralize power and control banking decisions.

Congress created Fannie Mae, Freddie Mac, and other entities that work against the laws of nature. Fannie and Freddie led the way when they began to do what no private entity was willing to do: they started buying mortgages in which the borrowers had no "skin in the

game"—no true investment. Soon afterward, private mortgage insurance was created for loans with inadequate down payments, leading more and more bankers to say, "Good enough. We're safe. All is well. We can now take shortcuts without fear of the consequences."

By changing the rules, they changed the essential functions of the system. Now a little bank in Pocatello, Idaho, that historically had a pool of 150 to 165 mortgages and provided financing on maybe 10 or 15 new homes a year could sell off that whole pool of mortgages—heavily leveraged debt instruments—to Wall Street. Instead of 10 to 15 homes a year, they could now finance 150 to 165 or even, due to the leverage in the system, several multiples of that. At the peak of the market, using such leverage, even small banks were financing 700 to 800 new homes per year. Because they were peddling the loans on the stock market, they no longer cared about the financial quality of the borrower—they simply passed the buck (and the liability) to Wall Street. Banks received a fixed percentage off the top, meaning the bigger the loan, the more money they made. And since the property appraiser worked for the bank, it was easy to get higher and higher valuations.

This is just one aspect of the myriad building blocks used to construct the housing dam that has since given way. Changing the commonsense rules of the industry opened the door for more and more banks to get in over their heads. Based on new ideas, they felt a false sense of security in their ability to balance an impossible load. No longer did each bank need to rely on its own good sense in order to thrive. Changing the rules weakened the structure. Similar to cracks in a dam, the weakness of the system made failure inevitable. And fail it did—leaving all of us with a bill that will take generations to pay.

As mortgages were bought and sold at an ever-increasing pace, they made their way up the financial food chain, ultimately ending up in the bellies of the GSEs—huge government-sponsored corporations created by Congress to enhance credit flow to target economies. Fannie and Freddie, the biggest of the GSEs, securitized the loans (sliced and diced them) into large pools that were then sold to investors. Industry practice was further modified to allow large national and global banks to get in on the game. When nature began to take its course and

homeowners found themselves unable to pay the bill, banks turned to the insurance providers to pick up the tab.

Most turned to American International Group Inc. (AIG). Headquartered in New York, with offices in London, Paris, and Hong Kong, AIG is one of the largest insurance companies in the world. When mortgages began to sour and banks began to struggle, they turned to AIG insurance policies for the solution. AIG bailed out the mortgage holders when mortgages went bad, but who bailed out AIG? We did.

With several billion dollars in mortgage claims waiting to be paid to suffering mortgage holders, AIG in turn suffered. The Treasury stepped in, taking the bad investment and allotting AIG more than $170 billion in federal money.

Who, then, ultimately bailed out the mortgage holders? When the federal government encouraged bankers to neglect the commonsense rules of banking, and they got caught in the trap, who paid? Many would say "the federal government." But who funds the federal government? We the taxpayers do! We, the taxpayers bailed out AIG.

With bailout money in the hundreds of billions to just the top three—Freddie Mac, Fannie Mae, and AIG—not to mention bailout money to dozens of other banks, the names of whom our government refuses to disclose, American taxpayers carry the load for an entire flawed system. When the buck finally stopped, it stopped on the backs of we the people. The federal government moved the liability onto the taxpayers, creating a monstrous bill that is virtually impossible to pay—all without our consent! In fact, most of us never even complained! But that's only because we haven't had to pay the bill yet. When one state's voters passed initiative legislation outlawing same-sex marriage, and another state passed a law that illegal aliens didn't like, thousands of protesters swarmed the streets and organized an outcry that included everything from boycotts to picket lines to outright violence. But when Congress passed a bill that enslaved our children, grandchildren and great-grandchildren with overwhelming debt, the extent of the American reaction was virtually limited to a few noisy blogs and radio talk show hosts.

With all that in mind, consider the following.

How to Spend Up to $1.5 Trillion without Congressional Approval

Step 1. The Federal Reserve purchases $1.5 trillion in Fannie Mae and Freddie Mac securities, creating a $1.5 trillion monetary base to pay for these purchases.

Step 2. The U.S. Treasury quietly announces unlimited three-year support for Fannie Mae and Freddie Mac on December 24, 2009, indicating that it is acting under the authority of a 2008 law (HERA) that was originally written to insure a maximum of $300 billion in total mortgage principal (not losses but principal).

Step 3. The Fed chairman testifies to the House Financial Services Committee on February 10, 2010, "I currently do not anticipate that the Federal Reserve will sell any of its security holdings in the near term. However, to help reduce the size of our balance sheet and the quantity of reserves, we are allowing agency debt and MBS (mortgage-backed securities) to run off as they mature or are prepaid. In the long run, the Federal Reserve anticipates that its balance sheet will shrink toward more historically normal levels and that most or all of its security holdings will be Treasury securities. During the interim, the Federal Reserve indicates that it expects to limit the extent to which banks lend out the base money created in Step 1 through a policy of paying interest on bank reserve balances.

Step 4. On February 11, 2010, with Treasury backing in place, Fannie Mae and Freddie Mac (whose delinquency rates have more than doubled over the past year) announce the purchase of $200 billion in delinquent mortgages that they had previously guaranteed. The entire remaining principal balance will be paid to investors at face value. This action provides a glimpse into the future: Fannie and Freddie take bad mortgages onto their balance sheets, extinguish the MBS at face value, and rely on Treasury funding to fill the gap.

Step 5. In the next few years, the U.S. Treasury can be expected to issue up to $1.5 trillion in new Treasury debt to the public, taking in much of the $1.5 trillion in base money created by the Fed in Step 1.

Step 6. Proceeds (base money) received from new Treasury debt issuance are periodically transferred to Fannie Mae and Freddie Mac in order to cover cumulative balance sheet losses.

Step 7. Over a period of years, Fannie Mae and Freddie Mac use the proceeds to redeem mortgage securities held by the Fed, thus reversing the Fed's transactions in Step 1, without the need for liquidation or any other *unwinding* transactions. If the mortgage-backed securities extinguished in Step 4 are not directly held by the Fed, the Fed can be expected to simultaneously sell an equivalent amount of its own holdings to the public so that the publicly held stock of MBS remains constant. In any event, the base money created by the Fed ultimately comes back to the Fed, and the mortgage securities purchased by the Fed disappear, burdening the American public with a new, equivalent obligation in the form of U.S. government debt.

The outcome is that the Federal Reserve closes its positions in Fannie Mae and Freddie Mac securities, the quantity of outstanding Fannie Mae and Freddie Mac liabilities declines by as much as $1.5 trillion—thus allowing their remaining assets to repay the remaining liabilities despite insolvency—and the outstanding quantity of U.S. Treasury debt expands by as much as $1.5 trillion in order to protect the lenders. Meanwhile, ordinary Americans continue to lose their homes and jobs while retaining the responsibility to pay back the debt. This would all be really clever if it weren't so insidious.

T-Bill Debacle

Bonds are a valuable tool when used correctly for capital infrastructure projects at a state or local level. At the federal level, only war bonds should be allowed during times of properly declared war. A typical bond is basically an interest-only loan. The borrower makes interest payments each year, and at the end of the loan period, he repays the principal amount. The time period for a bond can range from only a year or two up to twenty or thirty years. Most of the time, however, governments just issue a new bond to pay back the old one and continue making interest-only payments. This is generally referred to as *rollover* because they are rolling over the loan—paying off old borrowed money with new borrowed money, but the debt stays the same.

However, many rollover problems can develop, including 1) rising interest rates, 2) inability to find a willing party to loan new money at

the end of the period, 3) difficulty keeping up with interest payments, and 4) a combination of these factors.

Generally, when the appetite for debt shrinks—in other words, when loan money is harder to come by—interest rates increase in order to create incentive for institutions to loan. When this happens, we not only continue to roll over debt but also increase it as we go.

Based on this background, consider this: According to recent reports regarding rollover risks to the outstanding U.S. Treasury portfolio, nearly 40 percent of all issues will mature within the *next year,* making the rollover risk for the U.S. government massive. Even the smallest unexpected change could make the refinancing of roughly $5 trillion in debt very problematic. Yet the U.S. government is not alone in this quandary of how to keep short-term Treasury loan, or T-Bill, interest rates at record lows. Moody's Corp., which provides financial analyses on commercial and government entities, reports that the banking system is in far worse shape than the government. Average maturities of new debt issuances rated by Moody's fell from 7.2 years to 4.7 years globally over the past five years. This is the shortest average maturity for new debt in thirty years of bank-funding history. Moody's estimates that banks will face maturing debt of about $10 trillion between now and the end of 2015, $7 trillion of which will occur by the end of 2012.

So let's do the math: U.S. governmental entities (federal, state, and local) will need to roll $6 trillion-plus (and increasing) in new debt every year, commercial real estate has a $3 trillion-plus refinance deadline around 2014, and the banking system has a $7 trillion-plus roll maturity by 2012. In other words, at or about 2012, the American economy will be straddled with not only the ongoing burden of issuing approximately $6.5 trillion in new debt each year to finance ongoing government budgets but will also have to finance roughly $15 trillion in rolling maturities.

To summarize, we will need to come up with multiple trillions of dollars from new loans to pay off old debt over a very short two-year time span. If it gets hard to find this money, interest rates will naturally rise, perhaps by a substantial amount. If interest rates go too high, or if we can't find countries, institutions, or people to loan new money, then we

default because we cannot repay the old loans. If we default—if we run our massive ship of state aground financially, which has never happened on this scale in the political history of the world—there will be drastic consequences, the likes of which will make everything we have experienced up to this point (including both the Great Depression, the Great Recession, and everything in between) seem like a Sunday picnic.

And all this doesn't take into account the massive amounts of new debt currently being created! The current administration's 2010 budget deficit is currently estimated at more than $3.5 trillion. Most astonishing of all is that NONE OF THIS IS BEING REPORTED IN THE MAINSTREAM MEDIA!

Meanwhile, Back at the Ranch (House)

Looking again at the past two decades, we see elite politicians demanding that more and more insane loans be given out, as if by the laws of men they could do away with gravity. When Fannie and Freddie couldn't give out or buy up any more loans because they had exceeded the limits their reserves would allow, Congress should have seen the dam breaking, but instead, behaving as though they were untouchable, they simply added more sand to the top of the dam and ignored the leaks. They pulled government entities out from under the regulators required of similar financial institutions and broadened the license, reducing the amount of reserves required by half, making collapse virtually inevitable.

The Federal Housing Administration (FHA) is the latest government institution to pick up the housing slack. FHA loans now account for 30 percent of all new home loans and 20 percent of refinanced mortgages, up from just 2.7 percent of the market in 2006 near the height of the housing bubble—an increase of nearly 1,000 percent in under three years. FHA loans require only a 3.5 percent down payment. The FHA doesn't directly make the loans but instead insures the loans. According to a CNNMoney.com article in February 2010, seriously delinquent (more than ninety days late) FHA loans jumped 62.1 percent in 2009, up to 9.4 percent of all FHA loans. The conservative expectation

is for housing values to drop at least another 8 percent in the coming year. That puts FHA loans insured with 3.5 percent down payments underwater—without any homeowner having a "skin in the game" whatsoever. The popularity of the low-down loans has blown out FHA loss reserves, leaving the FHA in need of yet more federal bailout funds.

This repetitive high-risk loan process demonstrates federal government insanity: doing the same thing over and over again and expecting a different result. And the most devastating part of this catastrophic, Progressive federal plan is not that government entities are in trouble but rather that it is making slaves of borrowers with no good way out.

The Fox Guarding the Henhouse

Beyond massive system-wide and administrative-induced banking failures in the private sector, corporate America is also struggling under the burden of governmental abuses, which are furthered by financial bonds. Employers and businesses are forced to compete with the government, either directly or through quasigovernmental entities often referred to as public-private partnerships (PPPs). This creates many challenges.

In the early part of 2009, federal bank regulators from the Office of Thrift Supervision (OTS) told prospective applicants to withdraw their applications for approval to become new chartered national banks or their applications would be promptly denied. A consultant for one of the prospective banks asked one of the regulators in an off-the-record discussion, "Why, especially when these new banks are exactly what this country needs?" Here were groups of investors who had each spent as much as $2 million and several years in red tape just to get to this point. Furthermore, they were prepared to raise hundreds of millions more to capitalize the new banks in order to provide loans to borrowers within the communities they intended to serve.

"I don't get it," said the consultant. "Some of these applicants are good. The banks that can grow out of this will not have the bad debt or assets with old property valuations to contend with. . . . They will be able to behave in a conservative manner and look aggressive compared

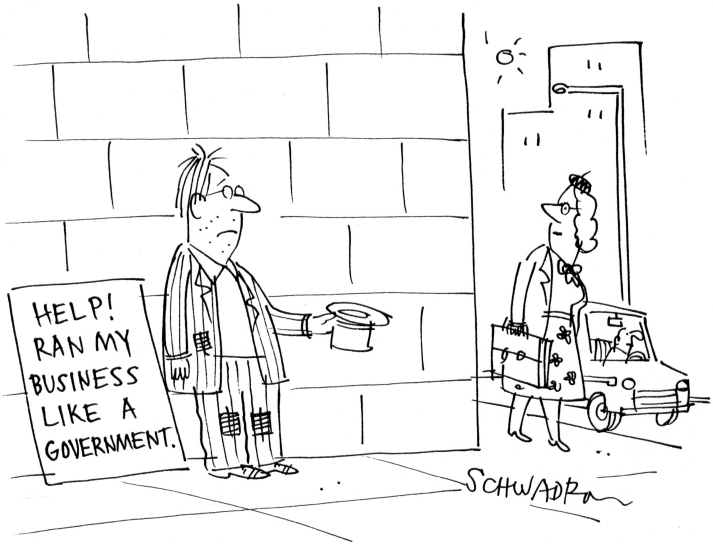
to their competitors because they will not have all the dead wood hanging around their necks to deal with. . . . Isn't this exactly what we need as a country, to get credit going for small business?"

The regulator reluctantly admitted that he was aware of the benefits but was under orders not to approve any new banks, declaring that the "powers that be" did not want any new banks competing with the new federally controlled banks. The message of this brief conversation could fit into multiple sections of the Federalist No. 86 essays. So many laws of nature are being violated, and the proper role of government is being misused. Perhaps the most basic message of this misuse of government power is simply: "It never pays to play a game that's rigged."

It's hard to say on which side of the ocean this latest round of government-sponsored takeover of the private sector began. A decade or so ago, all the talk was about free enterprise and privatization of business and industry in Russia. But within the past two years, Russian news agencies gleefully reported that their national government had just completed a major milestone. The milestone? The government had just bought 51 percent of the shares in another major company. That purchase gave the Russian government controlling interest in just over half of the Russian private sector, tipping the scales away from free market capitalism.

Sounds scary. But look how recent bank bailouts have ultimately been structured here at home. Government went from buying troubled assets to buying preferred stock that was later converted to common stock. This eventual switch gave the Treasury Department control of whole companies and even whole industries.

Federal, state, and large local governments have been buying up equities for some time now. They have large holdings through their off-budget entities, all in the name of taking care of citizens. Some entities shift debt onto taxpayers while retaining or regaining the assets at a lower basis, rarely ever flowing any of the earnings to their parent governments. Normally, in private-sector business, investors share in both profits and losses. But in the bailouts and recent public-private partnerships we're seeing, that is definitely not the case. The federal government is making sure that someone else takes the vast majority of risks and losses while these government entities themselves have kept profits.



Lessons from the Private Sector

This greedy scenario is similar to a story told to us by an electrical contractor from Santa Clara County, California. His company had a foreman we'll call Jim. On occasion, Jim would get a side job. He would go to the electricians under him and line them out, and get them to do all the work on his own private "side job" (they never knew the difference). Then they would go to the company's supply house, get the needed materials for the job, and complete the job. Jim would then bill the time and materials to the company he worked for, attaching the expenses to another job, and send an invoice for payment to the side-job client in the name of his wholly-owned company. Pretty sweet deal for Jim—all the pay with virtually no cost or financial risk. But his unaware employer would probably be less thrilled about the arrangement!

In a real sense, we the people are like Jim's employer. Except these are not small electrical side jobs; our risk (our loss!) amounts to trillions of dollars. What made matters worse for Jim's employer was that when Jim eventually broke off to build his own company, he had a stocked arsenal of information and clients, not to mention a huge financial war

chest—all at the cost of his employer. Jim knew what the company had bid on its next six months' worth of work and was able to underbid his old employer and win most of the contracts, putting his former employer out of business.

This kind of underhanded control is exactly what is happening in this country. Right under our noses, our government, at the mock employ of the people, is stealing our assets and seizing control of our money. The gang of thieves running this country is stealing us blind.

Based on our discussion and some of the stories and examples we have given, obviously we are concerned about, among other things, productive industries and enterprises, including agriculture and food policy. We are strong advocates for agriculture and responsible food and agricultural policy. Without even getting into agricultural sustainability issues that we raised in *Bedrock!* or regulatory-enforcement practices as discussed *in Enough!,* we feel there are several sides to the whole equation—including the government-spending side.

Federal Agricultural Subsidies

For the sake of discussion, let's take a few minutes and look at some of the realities of our federal government's agricultural subsidy programs. First of all, there is the fact that every year our federal government spends over $13 billion on agricultural farm subsidies, much of it in cash payments that keep coming regardless of crop or market conditions.

Let's not pretend that a lot of smart people haven't figured out how to game the system. In a recent conversation with an ambitious "family farmer," he revealed that rather than attempt to be competitive by being a good, effective, efficient operator, he had discovered that the best way to be "profitable" in agriculture was to *work* the crop subsidy and federal crop insurance programs. Consequently, his practice was to plant primarily those crops that were heavily subsidized, regardless of whether they were well-suited for his area or not and regardless of his chance for success. In many cases, he did so haphazardly, hoping that the crops would fail so that he could collect crop insurance. He said this was a much more profitable and lucrative way of doing business than

actually trying to succeed and be competitive and productive in agriculture. Again, what happens when we reward people for not producing?

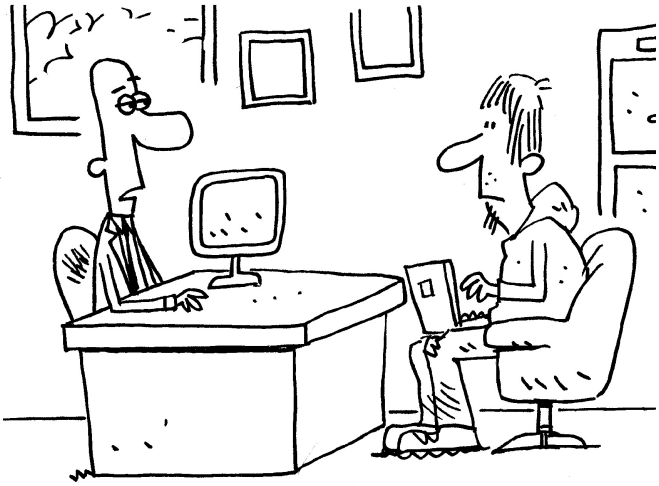
Now let's consider the fact that when a media outlet did some investigation of such crop subsidies, it found that 234 of the people getting subsidies were dead, some for as long as eight years. That group had received a total of almost $10 million since they had died. That's over $42,000 each—paid to dead people!

Worse yet, of those receiving farm subsidies between 2003 and 2006, over 2,700 of them had adjusted gross incomes of more than $2.5 million. Along with big corporate players on the list were the co-owner of a professional sports franchise who hauled in over $200,000 a year as well as wealthy residents of Saudi Arabia, Hong Kong, and the United Kingdom, all of whom are not eligible for U.S. government handouts. In all, these wealthy recipients received approximately $50 million in taxpayer money.

And let's not forget the people who are paid *not* to farm. In the 1950s Congress started approving payments to farmers not to plant and harvest crops on their land. Begun as a temporary program that was supposed to be phased out, more than fifty years later it is still going strong. Every time Congress has reconsidered the Farm Bill, it has renewed the program. Between 2000 and 2006, the government sent over $1.3 billion to people who don't farm.

This is just one example of the kind of absolute nonsense that goes on in Washington, D.C. We've got to ask ourselves, how do crazy programs like this survive, and how does such ineptitude, irresponsibility, and unaccountability continue? The answer is quite simple: lobbyists. Agricultural special interests with more than 1,200 registered lobbyists spend close to $150 million a year to make sure that the money keeps flowing. Consequently, an arguably worthy program conceived during the Great Depression to help struggling American farmers has become a slush fund for corporations and has evolved into one of Washington, D.C.'s, biggest sacred cows, turning farm subsidies into our country's largest corporate welfare program.

In 2008, during the beginning of the Great Recession and amidst calls from all quarters to cut back on agricultural subsidies, agricultural



"Sorry sir, you can't get government subsidies for your Farmville farm."

lobbyists instead convinced federal lawmakers to adopt a five-year $300 billion plan to *increase* farm subsidies. Does this sound familiar? Washington's philosophy seems to be that when money gets tight and is in short supply, spend more.

Obviously, it's not just lobbyists who keep this racket going. At the end of the day, it is our elected lawmakers who have to make the decisions and vote on this stuff. A great example is one senator from a farm state who went to Congress vowing to resign if the federal deficit wasn't brought under control. Now, after over twenty years in the Senate, during which the federal deficit multiplied by at least a factor of seven, he is still in office doing everything in his power to ensure that his agricultural constituents get their farm subsidies, which totaled over $700 million in the past decade and averaged at least $22,000 a year for every farm in the state. In other cases, some of our elected federal lawmakers benefit directly by gladly accepting such farm subsidy payments themselves. Does this make any sense?

Use It or Lose It

As we've stated before, government—at all levels—is notoriously inept at fiscal management. In *Bedrock!,* we discussed the concept of "use it or lose it," as a fundamental principle of the laws of nature. This is a principle that most governmental agencies take very seriously.

As they approach the end of their fiscal year, sometimes governmental agencies, especially fourth branch administrative agencies, actually end up with a budget surplus, and extra money on their hands. Inevitably, when this happens, they scramble to figure out a way to get rid of—spend—it, and get it off their books. The reasoning is, if they don't find a way to use it, even if they have to completely waste it, so that they can show that they used their entire budget, there is a risk that they will experience a budget cut the next year. And the last thing they want is a budget cut. The thought of returning the money or even giving it back to taxpayers never even crosses their minds. Inevitably, two of the driving objectives of most governmental agencies is to grow their budget, and to spend the whole thing. Anyone who has spent much time in or around government knows this is the case.

A very good recent example of this came at the local level—and during the height of the recent financial downturn. For a number of reasons, as the end of the fiscal year approached, a local school district was on track to end up with a $200,000 overage. Rather than pay down debt, put it in a rainy-day fund, reduce taxes or any number of more responsible things, school administrators' sole objective was to spend the money and get it off their books. So, they undertook an otherwise unnecessary landscaping upgrade at one of their schools. The next thing they knew, they ended up spending $500,000 on the unnecessary $200,000 landscape upgrade. This happens in every branch, and at every level of government, over and over again.

Multiple Sets of Cooked Books

And speaking of "books," unbeknownst to many, our federal government and its off-the-operating-budget entities have been buying up

private companies at an alarming rate. Frankly, the main difference between Russia and the United States in that regard is that their media is proud of their government and is reporting it out in the open, while our media looks the other way or even collaborates with government in misleading us, keeping us in the dark about the real abuses being leveled against our rights and our pocketbooks. In fact, we see the vast majority of our media elites acting as giddy about the whole thing as their Russian counterparts have been.

Much of the U.S. government's buying up of the private sector is being done through the fourth, administrative branch of government, with which our media, for the most part, agrees. Here we see complicity and secrecy and a mass of quiet, underhanded contracts—quiet, that is, until the most recent stimulus packages. Suddenly, it's as if the federal government is not bothering with stealth any longer and is boldly saying, "We can't wait any longer! We're taking over! We don't just want to solve the bad economy problem—we want complete control!"

The multiple sets of books our government uses are astonishing. It is remarkable that the same government that sent Enron executives to prison for fraudulent accounting schemes is actually guilty of doing much worse, even at the highest levels. Ironic, isn't it? We can see a pattern here as it relates to white-collar crime being organized and sponsored by our government. It is staggering how many income-statement shortfalls are designed to be covered through taxpayer-backed debt and higher taxes while off-budget transactions that produce income never hit the operating budgets of our governments as income—thereby leaving we the people with all of the risk and losses but no income.

If any of us tried to do the kinds of things our governments are now doing, we would be in prison. If you don't think so, just ask Bernie Madoff, Martha Stewart, or Enron executives.

Chapter 5

What Others Are Saying and Have Said about All This

Much of what we are saying is not new or unique—although we do seem to be about the only ones really focusing on how the fundamental laws of nature and nature's God—and personal responsibility—factor into the whole equation.

What follows in this chapter is an assortment of statements that others, including European economists, have made related to these issues, and our response and commentary to their statements. Again, consistent with our practice, because we don't want the messenger to get in the way of the message, as a general rule these statements are cited without reference.

Borrowing and Spending Instead of Saving, Investing, and Producing

Thirty years ago, even American economists believed in saving money. The fundamentals were never questioned. No economist questioned the idea that a nation needs savings. They never questioned that investment is crucial for prosperity. They never questioned that a developed country should have a surplus in its current account. Such things were never a topic of discussion! There are, of course, still a few people in America who are old-fashioned, economically speaking, and who have this basic understanding, but they are becoming an endangered species.

All of a sudden, Americans in general have rewritten economics

because it suits them. Saving money used to be instinctive in people, even without any economic theory, education, or training. But classic economic theory is now absent in America. It does not exist. Deficit spending has become the norm.

We are at an inflection point in our thinking. The big change began in the 1980s. In the 1980s, Americans continued to save, but it was the government that first began to forget how to save. At the time, there was a lively debate among economists about the wisdom and benefits of deficit spending by the government. Today there is no debate. There is no longer any economic discussion. American economists are silent, deeply silent.

Do you know why they are quiet? Because academic America, like all of America, believes that consumer spending, leverage, and deficit spending are the key to prosperity. The high esteem given consumer spending is implanted in every American, including its academics.

Some say that deficit spending by the government is bad. But you virtually never hear them say that deficit spending by the consumer is equally bad, or worse. The American idea that everything good comes from consumer spending is preposterous. And that is one of the key fallacies in American thinking today.

Producing and Manufacturing Versus Trading

In America it is no secret that production, primarily the manufacturing sector, is shrinking. That's *the* big problem. In every economy, the manufacturing sector has the biggest multiplier effect.

Manufacturing is a sector that uses all the intermediate goods. That's part of its multiplying effect. The growth of financial services is fine but not when the manufacturing sector is simultaneously disappearing. When you look at capital goods production in the United States, you can see that what has collapsed is investment. And with the collapse of investment, you have a collapse of employment in the manufacturing sector.

There are two kinds of assets: those you produce and those you trade. In America today, there is an inflated service sector trading inflated assets. The assets traded do not produce any widespread wealth.

They simply produce wealth for the individuals who trade them. The great failure in America is in investment, employment, and income growth—all of which are tied to manufacturing.

We're living in a world where Alan Greenspan and Ben Bernanke and their associates have told the world that all of America's massive imbalances do not matter. But for any economist who has a little something in his head, the structure of the American economy is one of the most alarming of all time. And for a developed economy, it is scandalous and unbelievable. But American economists think it is perfectly acceptable. It's like Ben Bernanke, as the current Fed chairman, blaming the rest of the world for what he calls a "savings glut." This is crazy. Why isn't he, instead, urging Americans to save and invest? Are the Fed governors really as foolish as they appear? Or are they being deliberately stupid.

Liquidity and Consumer Spending

We hear so much about consumer spending and how important it is to our economy. Boy, is someone feeding us a story on that one—one we're taking hook, line, and sinker. The only way consumer spending really does us any good is if it is paid for with cash as opposed to credit and spent on domestic goods produced in this country. But imports are a significant portion of our consumer spending. Crude oil is a prime example. If we were producing all the oil we consume, it would make a difference, but we're not. We currently import about 70 percent of the oil and oil products consumed in this country—up from 24 percent in 1970 and projected to increase to at least 75 percent in the next decade. More important, when we borrow to spend, we're just digging a deeper and deeper hole.

Asset prices are one of the keys to the U.S. economy. As long as asset prices are high, there seems to be ample liquidity in the economy. But as asset prices fall, the liquidity disappears. Americans think they are liquid, but they don't even understand the concept. They aren't liquid. Liquid is a person who has savings. We must realize that the appearance of great liquidity is merely the result of highly leveraged asset prices. And those can collapse. Excess credit is the only thing supporting asset price.

Greenspan recently observed that American consumers had weathered the energy price hikes fairly well. But that's only because they borrowed crazier and crazier. That's not the kind of resilience you should applaud. It's as if he said, "We succeeded in helping the consumer to borrow more and more."

What Americans have done is simply abolish savings. And that means that more and more GDP goes into consumption at the expense of investment and at the expense of the trade balance. What we often hear is that there is a great deal of liquidity in the U.S. economy and in U.S. financial markets. But this liquidity is not from cash. It derives from credit. There is huge liquidity in the asset markets that could turn into a savage deflation tomorrow. This liquidity argument is an illusion. It works as long as the system of inflating asset prices functions. But when it stops, liquidity is gone. If there is a lot of leverage in the market, it can collapse in a heartbeat.

The crucial support for the American financial infrastructure is the massive purchases of U.S. Treasury bonds by foreign central banks. We Americans think this is to our advantage. But this only means we have a longer rope with which to hang ourselves. To have too much credit is never good—not for a company, not for an individual, and not for a nation.

As one well-known economic commentator recently said, "A dollar of consumer spending does not translate into a dollar of domestic production." In fact, the way the Bureau of Economic Analysis (BEA) presents GDP statistics points the public debate in the wrong direction. GDP stands for "gross domestic product"—that is, domestic production. But the breakdown of GDP is into expenditure categories—personal-consumption expenditures, several categories of business spending, government-consumption expenditures, and so forth. So we have grown used to thinking of "spending" as "production"—after all, that's the way it is presented. We need to move toward presenting GDP in terms of production rather than spending. We need a shift from the consumer to the producer as our main unit of analysis. But for now, we need to stop being so obsessed with consumer spending. One has to realize that virtually all the increase in U.S. consumer spending is being done with borrowed money. And much of it was borrowed

against rising house prices. In 2001, Greenspan replaced the bursting stock market bubble with the housing bubble.

America As the Empire of Debt

America has too much international credit—not from private investors but from central banks. Central banks are the marginal key influence. And therefore, when you consider the American fundamentals, among industrialized nations America is certainly the most backward nation in the world.

From a fundamental point of view, the American economy is in incomparably worse condition today than in 2000. Individual income growth is stagnating; it is in fact negative. And there is no appreciable savings going on. America has no reserves to protect itself against the next recession or worse.

The stark reality is that Americans are strapped and trapped. And worse, there will come a point where they will be unable to sell any assets to raise capital, a point where the markets become completely illiquid because there's no buyer left. The buyers of today are all leveraged buyers. They need new credit. But when you get declining prices, there is no buyer left. America's superliquidity all comes from borrowing. Credit has played a major role in all U.S. financial markets.

There are many who say that deficit spending by the government is bad. But they don't say that deficit spending by the consumer is equally bad or worse. The American idea that everything good comes from consumer spending is preposterous. And that is the main fallacy in American financial philosophy today.

But the key question is whether America has finally reached the inflection point where its disastrous economic policies will begin to undermine its prosperity. We think it has. At this point, there is no way out. The excesses are much too big to be treated with conventional methods.

When Europeans attempt to impose fiscal limits on themselves, they have difficulty keeping them under control, which is understandable. But when Americans double and triple their deficits, they believe it is okay because there are no limits. Some say the Americans have two different sets of rules: one for the Europeans and one for themselves. They

think they can do whatever they like. All of a sudden, the virtue of an industrial country is not to export but to overconsume—to save the world through overconsumption.

The normal economic condition for a developed industrial country is to have an export surplus, and this surplus becomes the basis of its capital formation. That was **is** basic macroeconomics.

The European economies, for example, always had investment and export as a key driver of growth. And that is what you would expect from an industrialized economy—that it will invest, produce, and export. But at this point, Americans just borrow and consume.

Because consumption has grown so far out of proportion to production, capitalist America relies on the generosity of communist China. Americans don't even realize how ridiculous and absurd their situation is to much of the rest of the world. It's so absurd we can't believe it. We think this growing dependence is the worst sign we could imagine. It means that net investment is collapsing.

Consumption produces the least desirable kind of growth. And the simple thing to know is that it is unsustainable. It is unsustainable because real incomes are not growing. In America you're having a fiasco in employment and in income growth. The average income of the American middle class is declining in real terms. And the middle class has debts and debts and debts and zero savings or reserves.

Debt Colossus "Ponzi Unit"

American monetary policy is out of control. Greenspan created, and Bernanke has perpetuated a Debt Colossus. This Debt Colossus needs permanent new credit. In an economy that needs four dollars in credit to produce one dollar of GDP, simply reducing credit could be disastrous. Even a slight reduction of credit could create enormous negative repercussions in the asset markets and financial markets. The level of credit excess in America has reached such a level of absurdity that no return to normalcy is possible without a disastrous effect on the economy. America has become what at least one commentator calls a "Ponzi Unit." In other words, there sometimes comes a point where an economic unit

has to rely upon asset sales to satisfy its interest payments and debt repayment. That's America!

Economic commentators have identified three distinct income-debt relations for economic units: hedge, speculative, and Ponzi finance:

1. Hedge economic units are able to fulfill all of their contractual payment obligations by their cash flow.

2. Speculative economic units can meet the interest bill on their liabilities from their income but are unable to repay the principal out of cash flow from operations. They need to constantly roll over their liabilities.

3. Ponzi economic units are unable to fulfill repayment of principal and to pay the interest due on outstanding debts by their cash flow from operations. They depend on borrowing or selling assets even to meet their interest obligations.

It is a reasonable conclusion that the U.S. economy and its financial system on the whole have become one huge Ponzi financing unit.

The Good News . . . As Long As It Lasts

The important goal for now should be a healthy economy, and some claim there have been signs that the economy has been improving. Corporate profits were surprisingly strong in early 2010, and early second-quarter reports are encouraging.

At this point, though, the Left wants to downplay any positive economic news so that it can justify more economic stimulus. At the same time, the Right wants to tout any negative economic news as proof that President Obama and the Democrats are doing a bad job, which it hopes will lead to large Republican gains in November.

The bigger question for the long haul should be: Where does the U.S. government fit in the spectrum of governments that will not be able to pay their bills? So far, despite its challenges and based on past comparisons, the United States is on more solid footing than most countries. This should be one of the lessons learned from the near default this year of the Greek government. Government finances are important, but in the end it is private sector economic strength that matters most. Those

who focus solely on government fiscal policy may be missing important things. Spain appeared to be in fine shape, with government surpluses, before the recession hit. Now Spain is being downgraded and has soaring deficits.

To quote one insightful economic observer: "Academics and market practitioners have not had an impressive record of predicting serious financial downturns or of providing adequate early warnings of impending sovereign economic and financial problems.

"One can learn a great deal about sovereign risk by analyzing the health and aggregate default risk of a nation's private corporate sector, a type of bottom-up analysis."

Looking at corporate strength does a better job of forecasting debt problems than do traditional macroeconomic indicators, such as growth of gross domestic product and debt levels relative to GDP.

This thinking and analysis is sharply at odds with much current political discourse, which focuses on debt-to-GDP levels and purports to see disaster looming for both Britain and the United States if something is not done immediately to restore fiscal discipline.

It may seem odd to talk of businesses bailing out governments, when the reverse is what appears to have been happening over the past couple of years. But this would in fact be a better practice, and government credit, in the end, is based on its ability to collect taxes. A healthy private sector will provide the taxes and the means, if they are to be provided at all, to support a government.

That is something the bond rating agencies understand, but it is also the opposite of the traditional ratings practice, which has been to treat a country's debt rating as a ceiling for the ratings of companies from that country. In fact, the reverse has something to be said for it.

The old ceiling view did make sense under some circumstances. Defaulting governments have sometimes required companies to default as well as a way of protecting dwindling foreign currency reserves at a time of crisis.

The overseas debt of most countries is denominated in currencies the governments cannot print and its citizens do not use, which is one reason crises can sneak up on traditional analyses. Argentina's debt-to-GDP ratio was about 50 percent shortly before the nation defaulted in

the 1990s. The currency collapsed, and the debt-to-GDP ratio tripled overnight.

That distinction is one that has gained less attention than it should. In practice, it means that a crisis such as Argentina experienced, or as Thailand did a few years later, cannot sneak up on such nations as Britain, which borrows pounds, or the United States, which borrows dollars—because they are capable of printing the currencies they are borrowing.

Greece did not face that risk, either, because it borrows Euros (even though it does not print the currency), but new credit could dry up. It was that threat that forced the crisis.

Now, turning attention to the United States and its situation, federal debt, as reported, has skyrocketed during the Obama administration. But a large part of that stems from decisions made years before most Americans knew who Barack Obama was and certainly before he had any power. Some of those decisions were made by the private sector. Many were made by banks and brokers. They were made by Fannie Mae and Freddie Mac when they were not under direct government control. Federal debt has also come from efforts to keep the economy from collapsing under the weight of the proof that those earlier decisions were horrendously bad ones.

This goes hand in hand with another lesson from the recent Greek financial crisis that should be understood. The obligations of a country's financial sector eventually become contingent obligations of the government. Allowing the financial system to collapse is simply not an acceptable alternative.

The economic debate now should be focused on keeping the U.S. federal government from someday becoming like Greece's, with both a bloated government and a weak private sector from which to collect taxes to meet government obligations.

In the near term, the U.S. government can simply rely on the Federal Reserve to print more dollars to avoid default. It can also continue to borrow at low rates because investors around the world still trust it. But to keep that trust in the long term, the U.S. economy must continue to grow.

Demonstrable signs that the recovery has slowed can be found in two prominent areas—housing and cars—where stimulus programs artificially spurred growth on a temporary basis. It should have been obvious that there would be declines once those programs were discontinued.

Although the American economy is doing better than it would sound from the rhetoric on both sides of the political spectrum, pessimism remains intense. There was talk of depression just before the latest stock market rally began. Surveys of investors show levels of bearishness normally seen only after years of market declines, but in reality, the market is up sharply from early 2009 and about 20 percent above where it was in 2009.

At this point, everyone seems to be holding their breath and crossing their fingers.

The Foundation of Fiscal Responsibility

As we said in *Bedrock!,* all practical, sustainable solutions work from the foundation—the bottom—up. That means in order to get this country's financial house in order, we've got to get our own individual financial houses in order. It all starts with we the people.

Shifting gears from government fiscal policy to personal finance for a minute, and before looking at structural financial solutions, let's look at reality from the ground up.

The reality is that if we want to turn things around and become a truly prosperous country individually and collectively on a sustainable basis, we need to stop acting—just because we've had a few good years—as though we're endlessly wealthy, with an ample supply of money in the bank, and instead begin living beneath, or at least *within,* our means.

History and the laws of nature show that frugality is one of the keys to true wealth. And this is a trait that starts not with the government but in the home. It is a virtue that parents pass on to their children. Wealthy parents tend to be not only frugal but also well-disciplined. Most millionaires today came from middle-class backgrounds. Their parents were not wealthy but somewhat comfortable. Most millionaires say they never feel embarrassed by where they live or the type of home

they have. To a considerable degree, it is the uniquely American upward socioeconomic mobility that fuels much of the hyperconsuming engine of the market for luxury goods, prestige products, upscale brands, expensive homes, and so on. It is the home and neighborhood environment that most explains one's ability to accumulate wealth. It may be useful for people to understand that there are 1,138,070 millionaire households in homes valued under $300,000. This is far more than the 403,211 who live in homes valued at $1 million or more.

The glittering rich make up less than 1 percent of the household population. They have a minimum annual household income of seven figures and a net worth of eight figures and more. They are extremely wealthy people, and they spend accordingly. No matter what they spend their money on, it is just a fraction of their overall net worth. In other words, even the glittering rich spend below their means.

On the other hand, the "income-statement affluent" are those with high incomes and relatively low levels of net worth. They are not very productive in transforming their incomes into wealth. Many of the people in this category are highly compensated professionals—physicians, attorneys, and executives. Many are driven to hyperconsume by their need to display high social status. Most farmers, on the other hand, are found in high concentrations among the segment referred to as "balance-sheet affluent." The balance-sheet affluent are highly productive at transforming their income into wealth. Among the most productive of this group, in addition to farmers, are educators, engineers, and owners of small businesses.

Status products and homes are more likely purchased by people who have higher incomes. Look at three socioeconomic measures: net worth or wealth, household income, and the market value of a home. Which of these variables is best at predicting consumption? The value of a home ranks first, income ranks second, and wealth ranks third. Again, though it is true that the people at the upper level of these measures have a higher propensity to consume prestige products, they are not necessarily the most significant market. For example, most prestige makes of cars—86 percent—are driven by nonmillionaires. Yes, people with high incomes and high levels of wealth are more likely to drive status

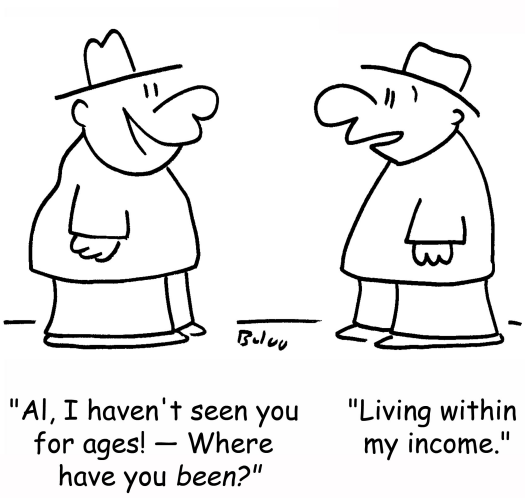
automobiles. But in sheer numbers, the largest consumer segment for pricey cars, vodkas, and homes is not the millionaire population. It is the *aspirationals.* These are people who think they are acting rich via their adoption of prestige brands, but in most cases they are only acting like each other.

So why do these people act this way? In large part, they are trying to imitate economically successful people. They take their cues from Hollywood and the advertising industry. The problem is that most *aspirationals* know few, if any, really wealthy people to emulate. Would they still continue to drive prestige makes of cars if they knew that the top make of automobile among millionaires is Toyota? Along these lines, would they still crave to live in a $1 million home when they find out that nearly three times more millionaires live in homes valued at under $300,000 than live in those valued at $1 million or more?

America is often referred to as the land of the free. But most people in this country are not really free. They are tied to debt and a treadmill existence in terms of earning a living.

At this moment, our federal government has promised future social benefits in excess of $50 trillion. That figure is approximately the same amount of the total personal wealth held by all Americans. In the future, it is likely that the government will not be able to provide the promised social benefits to our seniors. The typical household in the United States has a net worth of just over $90,000. That is about the same as the annual cost of a decent quality nursing home. Also, if home equity and equity in motor vehicles is netted out of the $90,000, then the typical household's net worth drops to about $30,000. That is only about 60 percent of the typical household's annual income. Therefore, it should be everyone's goal to provide for an economic future by being fiscally responsible at a personal level. Otherwise, what will happen when millions of seniors are no longer able to work and have little or no wealth accumulated? Many of them will become completely dependent upon their adult children, or they will become destitute. The money they spent on the trappings of wealth yesterday (the house in a tony suburb or a European sports car) will not pay for tomorrow's food, clothing, shelter, and, possibly, nursing home.

The simplest and best way to get ahead is to simply live below our means. The typical couple should be able to put away 5 percent of their annual income when they are in their thirties, 10 percent when they are in their forties, and 20 percent when they are in their fifties. Frugality is related to overall life satisfaction. There is a highly significant correlation between satisfaction in life and living in a home and neighborhood that are easily affordable. What is a good rule if you are determined to become wealthy? The market value of the home you purchase should cost less than three times your household's total annual realized income. Also, if you are not yet wealthy but want to be wealthy someday, never purchase a home that requires a mortgage that is more than twice your household's annual realized income.



The bottom line is that we are a nation of hyperconsumers. We encourage our children to major in consumption and minor in frugality! The smartest people in the world are in the marketing and advertising industries in this country. How else can you explain that 300 different brands of vodka coexist in our domestic market? In 2009, about 2.3 million American seniors passed away. What did they do with the more than $2 trillion in income they earned in their lifetimes?

It is estimated that only 2.3 percent of Americans will leave behind a gross estate (all assets included) of $1 million or more. What do the

other 97.7 percent do with all of their income? If they do not save their income, invest it, or allocate it to things that appreciate, where does their money go? Beyond the basic necessities, an awful lot of it is spent on *things,* many of which eventually reside in landfills and thrift shops. Unfortunately, we are now, and until something drastic changes, will continue to be a culture of hyperconsumption.

Chapter 6

Bucking the Trends—Success Stories and Examples of Government Fiscal Responsibility

Much of the subject matter of this essay is depressing in many ways, but we want to add balance to the discussion by including some success stories and examples of fiscal responsibility—at every level of government.

The Million-Dollar Sculpture

Our first story comes from a city council. In *Bedrock!,* we introduced Matt James. After previous struggles, at this point Matt is actively involved in many good causes and gets to know a lot of people. This story is about Matt's observations of a mayor he has worked with and the city council the mayor leads.

This mayor, whom we'll call Mayor Jones, was making a big push for the acquisition of a majestic sculpture to be installed to beautify one of the city's parks. At a cost of just over $1 million, the sculpture would commemorate an important anniversary for the city and would be a handsome addition to the grounds. Despite the recession in 2009, the mayor had about 25 percent of the needed funding and intended to pursue grants and other fund-raising efforts to secure the rest.

One challenge associated with the sculpture was that the dealer selling it had other interested parties and was unwilling to hold the sculpture until the city could raise the rest of the money to pay cash for it. If the city wanted the sculpture, it would have to give the dealer the $250,000 already in hand and sign a contract to pay the rest in annual

installments of $250,000, plus interest, over the next three years. The sellers would retain a security interest in the sculpture, which meant that if the city should miss any payments, the sellers could take it back.

The mayor was still adamant about moving forward with the project, to have the sculpture in place for the big anniversary. At a city council meeting, city officials were to decide what to do. Matt and a friend watched with interest as the mayor pled his case to the council. At first, the tentative vote was in favor, but as the project was further debated, the table began to turn. A councilwoman who typically supported the mayor's initiatives finally said, "I'm changing my position. In our house, we pay cash. If we want a new car, we save the money first. We pay as we go, not buy now and pay later. That approach has worked well for our family, and I believe it is the correct approach for the city. I love the sculpture, but I can't support its purchase on these terms."

What she said made a difference. When just one council member changed her mind and decided not to go along just to get along, she caused another council member to change his vote as well, and the measure ultimately failed.

The mayor was stunned; this project was near and dear to his heart. He left the meeting dejected.

"Keep your chin up, Mayor," Matt told him as they were leaving the meeting. "Maybe there's something the private sector can do."

"I don't know that we're in a position to help out," Matt's friend later told him. "But the private sector is the only sector that ought to be doing stuff like that. First of all, it's not the proper role of government, and second, it's definitely something that government should never do on credit."

The ready response to a story like this might be, "Why shouldn't our city government put a nice sculpture in the park? Everyone else is doing it." Or, "How can we pass up the opportunity—we can get free grants for 75 percent, so how can we turn that down?" Or, "If we don't beautify, we won't be able to compete for growth and business."

Just like most of us, governments seem to struggle to understand the distinction between needs and wants. Moreover, this kind of expenditure is outside the proper role of government. Let us not forget that

monies spent by government *do not belong to government!* The people have agreed to give government their property (money) only for specific, limited purposes and *nothing else.* Living within our means—even as a city, state, or nation—is one of many fundamental laws of nature to which we must return. According to our friend Worth, "When it comes to spoiled kids and government spending, the most powerful word in the human language is NO."

When it comes to unnecessary spending, our governments need much more practice saying this word. With more government agencies, programs, red tape, and intrusion into our lives than ever before, we also need to learn to say no. When it comes to acquiring unnecessary debt, our elected leaders need to learn to say no. And as citizens—constituents—we need to hold our leaders accountable and be clear regarding what we expect. The council members who voted against the sculpture should have received flowers from their constituents or at least a thank-you note! They did the right thing.

As a general rule, in our essays we try to avoid getting too personal and letting personalities or messengers potentially get in the way of the message. But as in this next instance, that is not always possible. There are only a handful of states in this country that are true examples of fiscal responsibility, and they and their leaders deserve to be held up as beacons to the rest of the country.

Old Dominion

Just one hundred miles from Washington, D.C., the government spending capital of the world, is one of the few centers of fiscal responsibility in the United States: Richmond, Virginia, capital of the Commonwealth of Virginia—one of the thirteen original colonies. Considered to be part of the South, Virginia joined the Confederacy during the Civil War, during which Richmond was the Confederate capital and the state of West Virginia separated from the rest of the state.

Virginia is nicknamed Old Dominion and sometimes called the Mother of Presidents because it is the birthplace of eight U.S. presidents. Although the state is traditionally conservative and historically

part of the South, both major political parties are competitive in modern Virginia. Virginia currently has a Republican governor, Democrats hold a majority in the state senate, and Republicans hold a majority in the house. In Congress, Virginia is represented by two Democrat senators, six Democrat representatives, and five Republican representatives.

The Virginia General Assembly is the oldest legislature in the Americas. The state government has been repeatedly ranked most effective by the Pew Center on the States. It is unique in how it treats cities and counties equally, manages local roads, and prohibits its governors from serving consecutive terms. Virginia's economy has many sectors: agriculture in places such as the Shenandoah Valley; federal agencies in northern Virginia, including the headquarters of the Department of Defense and CIA; and military facilities in Hampton Roads, the site of the region's main seaport. The growth of the media and technology sectors have made computer chips the state's leading export, with the industry based on the strength of Virginia's public schools and universities. On the other hand (and this may be a sign), Virginia does not have a single major professional sports franchise.

When Governor Bob McDonnell took office in January 2010, the state of Virginia, like many others, was facing a big revenue shortfall. What follows is McDonnell's story:

"On January 18, two days after taking the oath of office, I delivered my first address to the Joint Houses of the Virginia General Assembly. Waiting for our administration was a Virginia budget with an unprecedented $4.2 billion deficit, a politically divided General Assembly and the toughest economy in modern Virginia history.

"In my address, I made it clear this administration would be dedicated to bipartisan cooperation in the pursuit of job creation and economic growth. I also made it clear that on one key issue I would not budge.

"We would not balance Virginia's budget by making it harder for Virginia families and business owners to balance their own. I said, 'If you pass a bill in this recession that raises taxes on the hardworking families of Virginia, I will veto it. And if you pass a budget embedded with those same tax increases, I will not approve it.'

"To many observers this was a recipe for an extended and contentious legislative session. Instead, the parameters set in that speech brought all the parties involved to the table. Through hard work and without raising taxes we closed the largest budget shortfall in Virginia history. We set priorities, reduced state spending to 2006 levels, and laid the foundation for a future budget surplus.

"Virginia is a unique state. Our odd-year gubernatorial election cycle makes us an object of national political attention. It also leads to a tough budget calendar. We run for governor in odd-numbered years, we budget in even-numbered ones, and we do not allow our chief executives to serve consecutive terms. This arrangement leads to a situation where once every four years an outgoing governor introduces a two-year budget that will be ultimately signed into law by his successor. Even in transitions of power within the same party, this handoff is awkward at best. When it comes to transitions of power between different parties, the potential is certainly there for a flat-out fumble. In our case, it involved a transition between two different philosophies as to how government should be run and how it should operate in difficult fiscal times.

"My predecessor proposed to close the budget gap with $2 billion in cuts and a $2 billion-a-year increase in the state income tax. He would also phase out car tax relief for Virginians, with an offer to localities to use the proceeds from his income tax increase to continue that tax relief if they wished. I fundamentally disagreed with his proposal to enact the largest tax increase in Virginia history during one of the worst economic downturns in memory. I objected to any effort to take away car tax relief from Virginians.

"My priorities for this budget were straightforward. We would eliminate the proposed increase in the income tax by identifying an additional $2.2 billion in budgetary savings. We would protect car tax relief for our citizens. At the same time, we would put in place significant new tools for job creation and economic development to foster future growth.

"It is evident to most Americans that federal spending driving the debt to $13 trillion and growing is just not acceptable. During the past decade, state spending in Virginia had also been increasing dramatically.

"According to Virginia's watchdog agency JLARC, the total state operating budget grew 73.4 percent from 2000 to 2009. After adjusting for population and inflation, it still grew by 28 percent. In good times, we had put in place rates of spending that could not be maintained in bad ones. This was the time to responsibly reverse that trend, just as families and businesses were doing with their budgets.

"Forging consensus across party lines, we found the spending reductions necessary to balance our budget. And on March 14, just one day later than scheduled, the General Assembly adjourned with passage of a new biennial budget that contained no tax increases, kept car tax relief in place and made Virginia's government smaller and more efficient while adding major new tools to attract job-creating businesses to the state. There was no deadlock, no overtime session and no government shutdown. There was simply frank discussion and bipartisan cooperation to get state spending under control in a responsible fashion during a difficult economic period.

"The passage of this budget has positioned Virginia for economic growth and job creation in the years ahead. As one of the few states to budget already for Fiscal Year 2012, we were one of the first to have to prepare for the end of federal stimulus dollars. And while many other states turned to higher taxes on their citizens to navigate the difficult present, we did not, making Virginia a more attractive location for businesses and families in the future. Remarkably, even in these tough times, we will likely realize a small budget surplus at the end of this fiscal year. This is a Virginia success story. Promoting fiscal discipline, strengthening free enterprise and bringing new ideas and entrepreneurship to government are the keys to our future economic vitality as a state and as a nation."

At this point, the McDonnell administration is expected to tell legislators that Virginia—despite the recession and its aftershocks—is finishing the spending year with even more money than expected. McDonnell's administration had earlier projected a surplus of approximately $220 million. Now, they are projecting a surplus of closer to $400 million.

The only place we can fault Virginia is in its willingness to add to the national deficit by taking economic stimulus money to help balance its

budget. But it's still doing a much better job than the vast majority of the states.

Can this be done at a national level? Why not—it's all a matter of choice. Let's look at Australia.

Australia

Australia is a shining example among modern developed nations when it comes to fiscal responsibility. Just for the sake of comparison, the Commonwealth of Australia occupies a landmass roughly the size of the continental United States. Much of it is sparsely inhabited but still requires governance and some level of services. With 22 million people, Australia has a population just less than 8 percent of the U.S. population. It has only a fraction of the natural resource development of the United States. In addition to its isolated location, much of the country is subject to seemingly perpetual drought and other climate extremes. Australia has some real challenges, but it seems to make the most of its situation.

With a GDP right around $1 trillion a year, Australia's diverse economy, with a very strong production component, is the thirteenth largest in the world, well ahead of a number of countries that are better situated geographically, with bigger populations and much greater economic advantages. Despite the recent global recession, Australia's unemployment rate has hovered around 5 percent, and Australia has a foreign trade balance, with imports totaling roughly $161 billion and exports totaling approximately $161.5 billion.

Australia's currency is one of the strongest and most stable in the world. The Australian dollar is and has for some time been the fifth-most-traded currency in world foreign exchange markets behind the U.S. dollar, the Euro, the Yen, and the British Pound Sterling. The Australian dollar is popular with currency traders because of comparatively high interest rates in Australia, the relative freedom of the foreign exchange market from government intervention, the general stability of Australia's economic and political systems, and the prevailing view that the Australian dollar offers diversification benefits in a portfolio

containing major world currencies, especially because of its greater exposure to Asian economies and the commodities cycle.

Most remarkably, and of particular note for this discussion, is the fact that Australia has one of the lowest levels of government debt to GDP of all developed nations in the world. Although Australia does have a current deficit of roughly $19 billion (remember that the State of Virginia started out the year with a $4.2 billion shortfall), it has done a remarkable job of implementing sound fiscal principles and keeping public debt to a minimum.

Another stark difference between Australia and the United States is that its central bank, the Reserve Bank of Australia, governed by a board of governors much like our own Federal Reserve, operates on a fully transparent basis, is regularly audited, and is fully accountable for its actions. As a nation, Australia is a shining island in a sea of global economic bleakness.

As heartwarming and hope-instilling as these stories and examples are, unfortunately, they are rare exceptions to the rule. But they do show what is possible.

DURING HARD TIMES:

Chapter 7

The Bottom Line

Despite our history and greatness as a nation and the success stories and rare examples of fiscal responsibility shared above, with the track we're on as a country, the United States has many substantive issues and problems. From economic woes, including excessive debt and high unemployment to underproduction and overconsumption; from runaway spending and unbalanced, heavy-handed, out-of-control government; to lack of personal responsibility and a wide variety of dependencies, we've got plenty of financial problems.

As we mentioned in *Bedrock!,* according to an old Chinese proverb, "Lots of food, lots of problems; no food, one problem." In today's world and economy, the concept of food is essentially interchangeable with money or financial resources—lots of money, lots of problems; no money, one problem. In this country (and indeed, in much of the developed world), despite all our other problems but primarily because of personal and governmental fiscal irresponsibility and the use of inflation and deflation as described and predicted by Thomas Jefferson, we are currently on course to experience this one problem.

We often hear people, especially among the older generation, talk about the *prosperity* of the past fifty years. As a country, we have become so consumed with maintaining our purported prosperity that we have mortgaged *at least* the next three generations to pay for our current and past excesses. At this point, essentially the only thing we are doing as a country to address our financial crisis is looking for something else to leverage, something else to mortgage—primarily the future generations of this nation and what's left of our inalienable rights.

At this point, if we were to view our country as a chronically ill patient (which it is from a financial perspective), suffering from a variety of life-threatening ailments, including massive internal hemorrhaging, the first thing we would need to do is stop the bleeding. Mixing metaphors, the first thing we need to do to get out of this hole we've gotten ourselves into is STOP DIGGING!

Regardless of the applicable metaphors and analogies, the situation is serious. We are at a unique crossroad in our nation's history. We have serious substantive issues and problems, and time is of the essence, requiring high priority attention. Consequently, we have no choice but to engage in intensive care. At this point, timing may be more critical than getting everything perfect, but effective strategy is very important.

Though many people seem to be able to see and identify many of the issues and problems—almost anyone can see and identify symptoms as they appear on the surface—few seem to have the ability to see the internal bleeding and genuinely understand the core causes of that bleeding. Fewer yet seem to have the ability to see what needs to be done to address the core issues and causes. And even fewer seem to have the skills, ability, vision, inclination, resources, and determination to provide the necessary leadership and actually take action to do something about the core issues and causes.

"The Government thinks it can spend our money better than we can!"

"Well, they've had a lot more practice!"

Chapter 8

Solutions—What We Can Do to Fix the Financial Problems

We have heard the stories and we have discussed the problems. In *Bedrock!* even imagined some of the possibilities for a better vision and a better future. But where do we go from here? We've been drunk on our federal-dominion port and financial irresponsibility for such a long time. It's time to wake up, shake off the hangover, and get to work. But once the discussion closes, where do we start?

Though it is important to acknowledge where we are, it is even more important to get where we need to go. One of our well-known founding fathers said, "Any fool can criticize, condemn, and complain, and most fools do." Though we haven't been shy about talking about problems, we aren't interested in focusing on the complaints. These essays are not about problems. The reason for writing them is to generate solutions.

The reason we wrote and published *Bedrock!* first is that it outlines the foundational steps that must be taken to straighten out some of the fundamental issues and problems we face in this country. The discussion in *Bedrock!* focuses on the foundational, personal level; for any solution must start at the foundation. The only change that will really work is from the bottom up. As we discussed in *Bedrock!,* these core principles include using our fundamental freedom of choice—liberty—to exercise personal responsibility, prioritize production rather than consumption, and learn to live within our means.

Beyond that, as we move from the foundation on up the structure, we need to make some important changes to the structure of our financial

system, including government's role in how it operates. One of the first things we need to do is create a new financial system that is backed by something other than paper and thin air.

Inevitably, there is some overlap between our essays, but in *Enough!* we focus primarily on general governmental, political system, and policy *structural* reforms. In this essay, we focus on structural policy and governmental reforms, particularly as they relate to economics, our financial system, and governmental financial structure.

Fundamental Structural Financial Reforms

Through the Constitution, we the people and the states have a contract with our government. Under that contract, we have a responsibility to provide the financial support necessary to run our government. Our government has a corresponding duty to protect our rights. The reason we created this government—its essential purpose—is to protect and defend our fundamental, inalienable rights to life, liberty, and property.

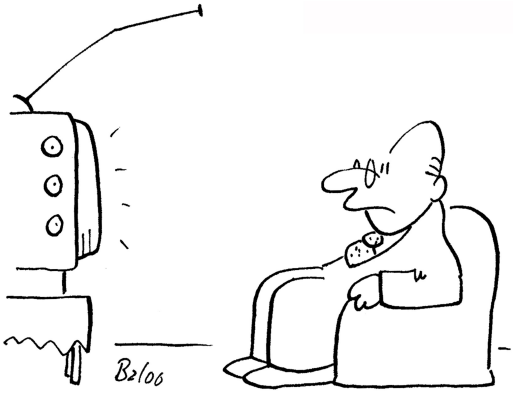
But our government has an insatiable appetite for power. It seeks to invade every aspect of our lives and has become very high maintenance. Protecting and defending our basic rights is no longer its priority. In fact, rather than act as guardian of our rights and freedoms, our government (at all levels) has become the biggest infringer upon our basic rights—and we're paying our government to do it!

1. Address the Federal Reserve System

After talking about the importance of starting at the foundation, we move right to the top in terms of needed fundamental structural changes in our governmental and financial system: the Federal Reserve. It may not be the place to start, but after moving from the foundation, we feel that it heads the list in terms of structural changes that need to happen in order to properly address the issues.

Thomas Jefferson said: "I believe that banking institutions—and particularly a private central bank issuing the public currency—are more

dangerous to our liberties than standing armies. . . . If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that will grow up around [the banks] will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered. The issuing power should be taken from the banks and restored to the people, to whom it properly belongs. . . . We must not let our rulers load us with perpetual debt."



"The Fed decided today not to raise or lower interest rates, but instead just moved them sideways a little."

In the Constitution, we the people and the states delegated power over our national currency and money supply to the federal government. It doesn't say anywhere that the states can't do it, but it says that the federal government has the authority to coin money and regulate our currency. With so much in our world dependent upon money and finance, that is arguably a proper role of government. But in 1913, contrary to Jefferson's advice, Congress abdicated that role and delegated it to the Federal Reserve, a private, for-profit entity that we the people have no oversight or control over whatsoever.

As previously stated, contrary to many popular misconceptions, the *Federal* Reserve is not a branch or department of government, federal or

otherwise, and has no real accountability whatsoever to any branch of government or to we the people. The Federal Reserve and its influence in this country are the absolute epitome of Mayer Amschel Rothschild's statement in 1838: "Give me control of a nation's money supply and I care not who makes its laws." The United States has become living proof of this statement.

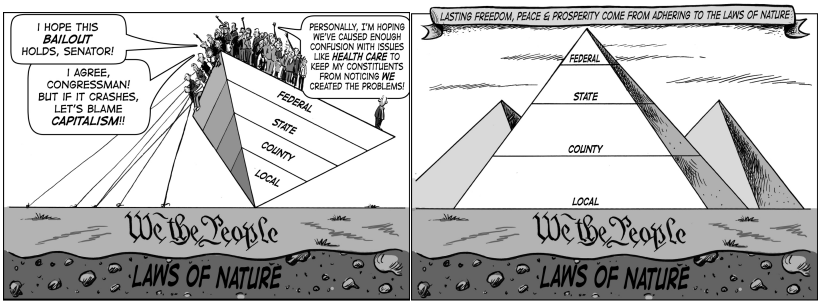
While we agree completely that the collusive association between the federal government and the Federal Reserve needs to be severed, unfortunately, detailed treatment of that issue is much too large a task for this book, so we'll save such a treatment for another day. For purposes of this discussion, we have a longer and more specific list of much-needed governmental financial reforms.

But the bottom line is that the federal government should take direct responsibility for our currency and money supply on a non-profit basis, see that our money is backed by something other than paper and thin air, and end its collusive relationship with the Federal Reserve as it relates to our currency, money supply, and monetary policy.

2. Straighten Out Our Governmental Financial System

One of the single most important things we can do in terms of fundamental government financial reform is to *straighten out* our governmental financial *system.* What does this mean? To understand, we must first recognize and understand that our current governmental financial system is completely backward and contrary to the laws of nature and sound principles of organizational structure. It is the epitome of the upside-down pyramid we introduced in *Bedrock!.* This is a huge, systemic problem that must be addressed in order to correct many of the governmental financial issues in this country.

The bottom line is that all taxes, including income taxes, are best assessed, collected, and spent at the lowest possible level. Currently, the vast majority of taxes in this country are collected at the federal level through the Department of Treasury via the Internal Revenue Service. And guess how they are spent? The federal government *wastes* the vast majority of that revenue on the unconstitutional, administrative fourth



branch of government; wasteful overhead; discretionary spending programs; bailouts; and loans that give part of the revenue "back" to state and local governments.

Instead, all taxes should be assessed and collected at the state and local levels. And that is where the vast majority of tax revenue should remain and be spent. The states should pass on some of the revenue to the federal government only for essential—constitutional—federal government functions, such as national defense, international relations, a postal system, a federal justice system, and other discreet and limited functions specifically enumerated in Article I, Section 8, of the U.S. Constitution. Let's not forget that the states formed the federal government as a cost-sharing venture for the above-referenced, limited tasks only. Tax revenue should be collected at the lowest possible level, with a certain portion being passed up the chain rather than passed down, as is currently the case.

Some people will inevitably say that this will never work because, at this point, many of the states have proven to be such poor financial managers as well. We recognize that this is a legitimate concern; as we have stated on several occasions, government is notoriously inept at management, including financial management. As a general rule, however, as bad as some of the states may be at financial management, the federal government has proven that it is much worse. The only way the federal government masks this is by endless borrowing, printing money through its collusive relationship with the Federal Reserve and its multiple sets of cooked books. The reality is that the federal government has created and mismanages the biggest Ponzi schemes in history.

To squarely address this issue, the states obviously need to start saying no to Washington, D.C. Unfortunately, at this point even many of the states that do buck Washington on some fronts have their hand outstretched for financial handouts at the same time. The state of Texas is a good example. It has typically been vocal about federal intrusion, yet it had borrowed more than $1.7 billion in unemployment funds from the federal government as of the end of February 2010. Texas is just one of thirty states borrowing unemployment funds, and another eight states are expected to join them at the trough by the end of 2010—thirty-eight states borrowing from the federal government to fund unemployment! Something is seriously wrong with that picture.

Fixing this serious systemic issue is one of the single biggest things we can and must do to rein in our out-of-control federal government and undertake much-needed financial reforms. It will undoubtedly require one or more constitutional amendments, which we will discuss in more detail later.

3. Balance Government Budgets and End Deficit Spending through Use of Debt

As Thomas Jefferson said, "We must not let our rulers load us with perpetual debt." Interestingly, Jefferson's quote assumed that it would be private banks (such as the Federal Reserve) that would do this. How fearful would he have been for his country had he known that ultimately the federal government itself would perpetuate the very element he feared?

At some point, as part of fixing the foundation, we need to amend the U.S. Constitution to require that the federal budget be balanced on an annual basis except in cases of properly declared war, which would be financed with the issuance of war bonds. These war bonds should also be the only way our federal government is allowed to use debt to balance the budget. No more hiding the true cost of programs and indebting future generations to satiate the greedy appetites of today.

4. Drastically Reduce the Administrative Fourth Branch of Government

As more fully described and addressed in *Enough!,* the administrative fourth branch of government is completely out of control. If government isn't competing with private business, it's regulating it to death. The fourth branch, with all its parasitic agencies, needs to be pared down to size. The vast majority of excessive and wasteful federal spending is in the fourth branch of government. One of the first places to start is by eliminating all duplication among agencies—in both federal and state governments. When government starts adhering to the laws of nature, allows individuals to take personal responsibility, and quits acting like a nanny state, the fourth branch of government can be reduced to a fraction of its current size and its spending correspondingly curtailed.

5. Understand and Control *Discretionary* Spending

An interesting phenomenon about our government—and indeed our country—is that we have changed the definition of *mandatory* spending to *discretionary* spending and vice versa. Constitutionally mandated spending for defense, funding our embassies and court systems, and even paying the light bill for the Capitol is now called discretionary spending, while we allow lawmakers to secure enormous extras because—like any shopaholic—they tell us they are *needs* by simply calling them mandatory. We need to be saying no! There is a big difference between needs and wants. Let's fix this system and our money problems by first getting our definitions straight! Entitlement programs, fourth-branch-of-government expenditures, and bailouts are not mandatory spending. They are extras. They are discretionary. They are the additions to the nice home that has turned it into an overbuilt monstrosity.

More than just bribing the states or being coconspirators with state legislators in their own efforts to get around their state constitutional limits, our ill-behaved federal child (see *Enough!*) has also been manipulating the electorate by being reticent about the true cost of entitlements. The funding actually required to run this country—the truly

mandatory spending—is borrowed. If the media was interested in probing deeper, a reporter might ask, "How secure are we if we are borrowing from places such as China 100 percent of the money we need to fund our defense? What happens if no one buys our debt generated by war or national disaster? Could we defend ourselves? Could our court systems stay open? Could we even keep the Capitol Hill lights on?"

Recently, the city of Colorado Springs turned off the lights, cutting basic services throughout the city. The city had reached the end of its financial rope. Will the same scenario be repeated throughout the country and in Washington, D.C.?

The issue of entitlement spending should have been addressed long before it grew to 100 percent of revenues. The federal government has already raised the debt ceiling several times over the past year; how is raising the limit another $1.9 trillion, as was done in early 2010, or another several trillion next year or the year after, going to solve the actual cash flow problem? This is like making our credit card payment by applying for a new card and simply transferring the balance to the new card, thereby increasing our overall balance and payment due, with the corresponding fees, while not paying off a dime. These indefensible actions are making us all *poorer!* Will Congress please stop digging? Entitlement spending has long been positioned ahead of the spending requirements for which our federal government was created: defense of life, liberty, and the pursuit of happiness (property) through a strong national defense, blind justice system, and international relations. Where have those original directives gone?

Our massive debt load comes at a tremendous cost to future generations, but for what? Not for continued freedom, peace, and prosperity; those come from adhering to the laws of nature. Remember, if you spend more than you make, you are broke and are going to lose something. As one of our greatest Founding Fathers said, "I say the Earth belongs to each of these generations during its course, fully and in its own right, the second generation receives it clear of the debts and encumbrances of the first, the third of the second and so on. For if the first could charge it with debt then the Earth would belong to the dead and not the living generation, then no generation can contract debts greater than may be paid during the course of its own existence."

We must stop this generational theft and slavery! In the near future, we will have to start making our debt payments rather than charging the annual debt obligation by increasing the debt limit. This annual debt payment, just as entitlement spending, will soon exceed the federal government's annual revenues. If we don't stop our selfish, irresponsible binge, we will drive our children and ourselves off the proverbial cliff. We have to sober up. Though it may be difficult, and the withdrawals may bring pain, we will be better off for owning up to our Progressive governmental addictions and overcoming them. Will it be worth struggling through the difficulties of readjusting without bailout systems? Will it be worth the work of rebuilding an ailing economy without safety nets? Will it be worth the effort to put safeguards in place through constitutional protections? The answer to these questions is a resounding *yes!*

6. Eliminate Collusion and Get Government *Out* of Private Business

Again, we discuss collusion between the public and private sectors in much more detail in *Enough!* But in no sector does this collusion have greater implications, particularly in recent years, than in our financial system. Based on these collusive relationships between big business and government, our governments have proactively engaged in the process of picking winners and losers and treating businesses accordingly. This flies in the face of the free enterprise and free market principles of capitalism and is wrong at every level.

We're not talking here about government regulation of private sector business, which needs to be drastically reduced as well. We're talking instead about getting government *out* of private-sector business. From a financial perspective, one of the ways we can further eliminate such collusion is by following a keep-it-simple principle: no more public-private partnerships. No more nonessential services being owned or run by government. It's time to sell off or trade all private business interests and quasi-public assets: Amtrak, Fannie Mae, Freddie Mac, and a variety of other equity interests acquired as a result of all the recent

bailout programs as well as the vast majority of federal lands, assets, and natural resources that the federal government mismanages at taxpayer expense. Private sector businesses should not have to compete with the government or government-subsidized enterprises.

When it comes to any remaining roles government *does* have as it relates to the private sector, it must exercise such roles impartially. Government has got to quit favoring one business over another and picking and choosing winners and losers. This especially applies to the Federal Reserve.

This action would get the government out of the mismanagement business and significantly dismantle the fourth branch as well as lower taxes and virtually eliminate the need for lobbyists. Power, money, and greed would be segregated. This would also help other governments do their jobs better. It is hardly right for governments to try to act as referees while also trying to be players in the game. After all, no man can serve two masters. But because lawmakers are not willing to enact these kinds of reforms on their own, direct citizen legislation and constitutional amendments may be required.

7. End Government Financial Support to Political Parties and Campaigns

Governments at all levels need to stop picking winners and losers—in business, private enterprise, and politics. Consequently, there should be no public- or taxpayer-funded support of political parties, candidates, or campaigns. It is time to end all government collusion between the parties, and that especially means taxpayer-funded campaigns. *No federal or tax dollars of any kind should be going to political parties, PACS, advocacy groups, candidates, or campaigns.*

8. Require General Consent for General Obligations

In many states, the law requires consent of the people before the state can generally obligate the people for new sales taxes, projects, or expenditures, especially when such financial obligations benefit less than

the entire population. This happens with sales-tax-increase elections, school-construction bonds, and other bond elections at local and state levels. Most state and local lawmakers do not have unfettered discretion to generally obligate the public—especially for specific projects that do not benefit everyone—without consent (a vote) to do so.

Why should the whole country, without consent, be required to pay for things that benefit only a small portion of the population? You want a bridge to nowhere in Wasilla? Fine. No problem. Those who receive a direct benefit from such expenditures should pay for it—if they choose to—following an election. Why should the rest of the country be generally obligated to pay for special, limited-benefit projects without its consent when it derives no general or specific benefit? If our federal government thinks it has a blank check, it will spend as much as it can while obligating us without our permission.

The federal government was never meant to have license to create stimulus bills, earmarks, and emergency relief, or to create special deals for one congressional district over another in order to buy votes (healthcare reform anyone?) or spend on credit. The founders could not foresee that government would ultimately attempt to usurp power to this degree—and if they had imagined that possibility, they must have been convinced that the states would stop it. Instead, the states have allowed the federal government—or rather have been bribed to allow the federal government—to usurp their power, with no consent and no accountability. In fact, many states have become dependent and now use the federal government's own lack of required protections for us—we the people—in this area so that they can avoid following their own state constitutions and applicable state laws, requiring them to hold special obligation elections. They do this by having the federal government fund projects within their states rather than seek consent from taxpayers via required elections.

Many of the same founders who framed the U.S. Constitution wrote, or were involved in writing, many of the state constitutions as well. Many of these states have constitutional limitations that prevent legislators from indebting the general public with massive debt without the people's consent. In such scenarios where a limited group of people

want a project done, states and local governments have ways of isolating those who receive a direct benefit to ensure that they pay for it.

What the federal government has done with economic stimulus and many other spending bills and earmarks is no different than a person taking a neighbor's credit card, charging it up without permission, and sending the cardholder the bill. We find ironic the guileless, surprised expressions of current and past presidential administrations when people act bothered and disgusted by their actions to obligate each of us and our unborn children, grandchildren, and great-grandchildren to debt that neither they nor we have agreed to. It is as if they didn't consider the fact that they stole money that we haven't even earned yet—and we are supposed to be okay with this!

If it is theft for us to steal from our neighbors, it should certainly be illegal for politicians and governments to steal from our neighbors and us. It is time to apply the same type of constitutional protections at a higher level. We must fix this on our watch. How can we face our posterity with this bondage we have created for *them?* How can we justify mortgaging the next several generations? If our children and our children's children forsake us in our old age, so enslaved they can barely take care of themselves, how could we blame them? Sadly, this trend is already developing with recent changes in healthcare and age-dependent treatment options. What will it be like in a decade or two? We must stop this now! *Enough* with the federal government's ability to generally obligate us without our consent!

9. Implement Nullification and Referenda of Unacceptable Federal Legislation

The next principle we want to discuss is treated in more detail in *Enough!* It is the concept that when there is sufficient consensus among the states that the federal government has done something that violates the Constitution or is contrary to the will of a supermajority of the people, there should be a process by which the states can nullify or reject what our elected representatives in the federal government have done—especially when it comes to spending *our* money!

A prime example of this would be recent healthcare legislation. A supermajority of the states should have the power to nullify such legislation altogether, and individual states should have the right to opt out on an individual basis.

Although, like the Founding Fathers, we firmly believe in a constitutional republic, we also believe there is a proper time and place for the people and the states to hold our federal representatives accountable when they go too far, spend too much, and act contrary to the will of the people and the best interests of our nation.

We know that direct citizen legislation, including initiatives and referenda, sticks in the craw of many conservatives, who are concerned (just as we are) about mob-rule democracy. But given the current state of things, particularly when it comes to federal spending, we believe that tools need to be in place to address what is happening in Washington, D.C. And with so many career politicians, as discussed in *Enough!,* calling the shots, simply electing new representatives is not always an effective solution.

Based on the collusion that has come to exist between big business and the legislative and executive branches, we need this tool because many laws are now passed that are not in the best interests of the American people. Therefore, when bad laws are passed, voters should have a right and a mechanism to veto such laws.

This just makes sense. When local governments want to spend money over and above their budget and normal tax revenue, etc., they have to hold a bond election. General obligation requires general consent. Why don't we do that at the federal level, as most of the states and cities do and as was recently done in Iceland, with respect to the vote on whether or not to bail out its financial system? Why shouldn't we the people be able to vote on general financial obligations, particularly those that only benefit certain, limited interest groups? One argument against this is that our federal government moves so slowly. But over the course of the last several years, we have seen government move at breathtaking speed, spending money so fast it makes our heads spin, in numbers and terms so large they no longer have any relevance. What's a billion? What's a trillion? What's a quadrillion? And what's the problem with that? *It's our money, our children's money, and our grandchildren's*

money they're spending. We need a mechanism to hold lawmakers accountable and do something about it.

Again, we realize that this would require amendment(s) to the Constitution, which we will talk about next.

10. Pass Constitutional Amendments

The main substance of our discussion of constitutional amendments, including the process, is likewise found in our essay *Enough!* But by the time you have read this far, it should come as no surprise that we believe the U.S. Constitution needs to be amended in some important ways, particularly as it relates to the way our government does business financially and spends money.

Based on the structural reforms we have described and advocated above with respect to government financial reform, we believe there is a strong need for—and we wholeheartedly advocate—the following constitutional amendments:

- A balanced budget amendment requiring the federal government to balance its budget on an annual basis and live within its means without being dependent on deficit spending and debt.
- An amendment straightening out the government financial system by clarifying that all taxes should be assessed and collected at the lowest level possible, including state and local governments, with a certain percentage of tax revenues passed on to the federal government as part of an appropriate cost-sharing arrangement with the states.
- An amendment requiring special consent and essentially a bond election to approve special obligations that don't benefit the entire population.
- An amendment creating a new national banking system to create currency and govern the monetary system, severing the collusive relationship between the federal government and the Federal Reserve, or at least requiring that the Federal Reserve be audited on a regular basis and held fully accountable.

It is our position that such amendments would greatly benefit and be in the best interest of our country.

As Amended

Chapter 9

Restoring Prosperity!

As our friend Worth and others like to say, "If it ain't broke, don't try to fix it." Unfortunately, that saying does not apply to the U.S. financial system and the way our government spends money. Despite success stories and other exceptions to the rule, the system is plumb busted and in serious need of an overhaul. Fundamental changes are a long-term project and will take steady work over a number of years—well beyond 2010.

Although cycles, including economic cycles, are normal and natural, a little blip in an otherwise normal cycle, which will continue upward and onward forever, is not what is going on in our nation at this point. We are approaching the end of a major, once-in-a-century, once-in-a-lifetime (and possibly longer) financial cycle. As we've stated before in this essay, our current financial system was not designed or built to last forever. Under no circumstances is it possible for growth and expansion to continue forever. That's where cycles come into play. Instead of running in a straight line or even in a jagged line with little ups and downs, everything goes in cycles. When one cycle ends, another begins. And that's where we're at in this country. We're approaching the end of a cycle. At this point, it's not a matter of *if* the cycle is going to end but rather *when.* But predicting timing with such things has always been a big challenge.

We don't want to kid anyone. Ending this cycle and starting the next one, with all the uncertainly that such transitions always entail, won't be easy. And it won't be painless. Cycles of death and birth seldom are, but they are necessary. It's also not going to happen overnight. It took

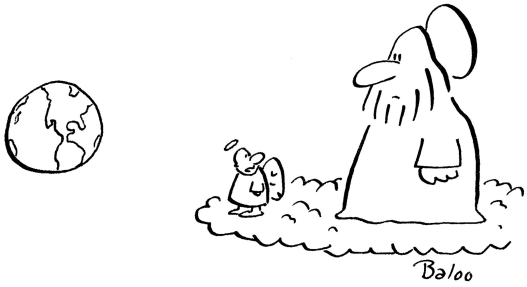
decades to get to this point, and it's probably going to take decades to turn it around. It's going to take a lot of work, effort, and proactive steps, but the pain we will experience will be a fraction of the pain and carnage we will face if we don't start taking substantive steps to address these issues now and begin to prescribe a course of action to return our nation to financial health and true prosperity.

If we want to experience true prosperity again, we're going to have to start a new cycle and create a new system based on new paradigms and lessons learned from past mistakes. And if we want the next cycle to yield lasting, sustainable prosperity, we're going to have to do things differently this time. We can experience lasting sustainable prosperity but not on the same scale as the purported prosperity of the past.

Maximum yields and corresponding prosperity, though impressive on a temporary, short-term basis, are never sustainable for the long haul. Mortgaging future generations to pay for the excesses of today is not something that can go on forever. Voluntarily enslaving ourselves and giving up our fundamental rights, liberties, and freedoms as a people is something that we should never allow. What we should be seeking is *lasting prosperity!* But it must be based on optimal, sustained production and living within our means in accordance with the laws of nature.

Finally, we have reached a point in this country where we're going to need help—divine help—to turn things around. Just as our forefathers relied on divine intervention to accomplish the impossible and win independence from the British during the Revolutionary War, we need that help now, and we will need it even more in the future. While some may not recognize the true gravity of our situation, eventually they will. And just as George Washington and his army were reduced to utmost humility and the pit of despair at Valley Forge before the tide turned, in all likelihood, we will face similar experiences. And just as with General Washington and his troops and Matt James and others, in the end such experiences will be for our good. As it relates to such things, an old adage says that in order to qualify for the divine help we need, we must work as though the solution were entirely up to us but pray as though it were entirely up to God! At this point, we would be well advised to take heed and begin that process.

We affirm that lasting freedom, peace, and *prosperity* come from adhering to the laws of nature and nature's God!



"They are fun to watch, but wouldn't a bowl of goldfish have been just as good?"