

Part One

LEVERAGE AND ITS ABUSES IN THE ECONOMY

COPYRIGHTED MATERIAL

Chapter 1

An Economic Future for America

Through the ages, the principle of financial leverage has been both used by the many and abused by the wealthy and powerful in society. The seduction of leverage is strong, in that it makes the difficult appear easy and the impossible seem to be within reach. It brings the illusion of equality between the wealthy man and the common laborer in the land of finance.

You can think of leverage as a drug, and an addictive one at that. Like many drugs, leverage is perfectly acceptable when used in moderation. But as with all addictive things, leverage has a lure that is indescribable once it is tasted. Who among us who has bought a house doesn't remember the first time we inserted the key in our new-to-us home and walked through the front door? The house is devoid of furniture and fashion, a box into which we would load our lives, and we quickly forget that we don't really own the house since a bank has the legal right to our title. The new car smell is likewise one that

people consider a rite of passage, even though that smell is probably a derivative of formaldehyde and rather unhealthy!

The seduction of having a little plastic card in your wallet that can buy the equivalent of a car in seconds with no money in the bank is powerful. Many have walked into a shopping mall and an hour or two later emerged with thousands of dollars' worth of clothing, jewelry, perfumes, and baubles that they have no idea how they're going to pay for. Indeed, how many of us didn't chuckle to some degree at the comedy *Confessions of a Shopaholic* on the silver screen and failed to identify, in some small way, with the pithy phrase "Really declined."

In the financial panic of 2007 to 2009, who could fail to note that certain wealthy and powerful people seem to have not only escaped the wrath of contraction in the economy and credit but also profited tremendously from these events? Others of apparent wealth and many of modest means have been rendered destitute. Millions of jobs disappeared, salaries and wages were slashed, and as of early 2011, more than a million homes have been lost to foreclosure.

Some have put forward the theory that certain people of money and influence have the ability to sway events to their liking through various forms of bribery, whether legal or not, with regulators and members of government. Still others believe that luck is responsible for the difference in outcomes. Neither view is correct.

Some wealthy people do indeed use their influence with government officials and even resort to actions that could be called extortion when the economy turns downward. Influence peddling, bribery, and threats are as old as politics itself, and it should not surprise anyone that the rich and powerful are at the center of these activities when their wealth is threatened.

To stop the abuses of leverage in our financial markets, we must first identify the fundamental nature of leverage and how structures are set up to disadvantage the general public. The abuse of these structures requires that the average person be ignorant of the fundamental nature of capital. They must not understand how capital and leverage, otherwise known as debt, are fungible, and how certain mathematical facts guarantee outcomes over time in the economy as a whole. This lack of knowledge among the populace is then exploited by the few in positions of power to set up edifices that strip the general popula-

tion of their wealth, much like a whale is flensed after being harpooned, leaving the public in debt peonage. Eventually these artificial structures always collapse, exactly as they did during the California Gold Rush. The collapse leaves wealthy only those who exploited the bubble to skim off a piece of the activity via selling blue jeans, picks, and shovels, while the majority of others who engaged in the Ponzi scheme are bereft of both a job and their allegedly accumulated wealth.

Only through an understanding of history, along with the fundamental nature of leverage in the economy, can we change the economic system to end these abuses. While there are many who argue that the market is efficient and left to its own devices will govern these matters on its own, the presence of governments and thus the inevitable corruption that comes with them makes this option entirely unsatisfactory. There are choices available to us, and we as a body politic can choose to demand their implementation.

Should we fail to address these imbalances, there will be dire consequences for the United States and indeed the entire world economic system. We can no longer pretend that the Federal Reserve holds the power to address what's wrong with an economy that is structurally defective, just as we cannot fix a collapsing bridge by painting new lines to divide the lanes of traffic and claim that the structure has been rehabilitated.



Consider America's future, where your children and grandchildren will live their lives. What will it look like from an economic perspective?

If you look at the U.S. labor market today, you see more than 30 years of exporting manufacturing jobs overseas. The first exodus was to Japan, which destroyed the U.S. television and automobile industries. The second was to China, which destroyed large swaths of high-tech manufacturing and assembly. While the United States has maintained manufacturing output, it has come almost exclusively through mechanization and productivity gains; manufacturing employment has plunged by half since 1979 and stands at roughly 11.5 million as of March 2011, despite the population increasing by almost 50 percent

during the same time period.¹ The alleged economic recovery from 2009 onward has come with more than three-quarters of all the jobs created paying below \$15 an hour, well under the national average hourly wage of \$22.50.

In 2011, we have crushing levels of federal, state, and local debt, and more than a third of all so-called wage income is paid by some form of entitlement program, whether it be Social Security, welfare, Section 8 housing, or food stamps. One in six households cannot afford to buy food in America, a 58 percent increase in three years' time.² Our civilian population employment rate, the percentage of adults who are in the workforce, is back to where it was before women joined the workforce en masse in the 1970s. Contrary to economic projections in 2000 that the federal government would be debt-free by 2010, our federal debt more than doubled from \$5.7 trillion to nearly \$15 trillion, and the unfunded mandates in Social Security, Medicare, and Medicaid total approximately \$100 trillion. Our total indebtedness and obligations are roughly seven times the total economic output of the United States. In April 2011, Secretary of the Treasury Timothy Geithner threatened to raid federal employee retirement funds if Congress refused to allow the Treasury to borrow even more money.³

The future one can see ahead on the path we currently walk is bleak.

What if you were to learn that there is a path forward that will produce a better tomorrow? Would you insist on changes today that would bring prosperity back to the United States, even if those changes would produce severe short-term economic discomfort?

We can have a nation and economy that manufactures most of what we consume at home. The United States can have abundant and stable energy supplies. We can have a stable, sound banking system that matches lenders and borrowers, along with clearing payments, but does not encourage speculation. We can have sound money with no inflation over decades-long periods of time. We can have a college system where your children can afford to put themselves through school working part-time, taking on no debt, with only a small contribution from you as their parents. And we can have medical care that delivers excellent outcomes without bankrupting you, your employer, and our society as a whole.

With a labor force that is vibrant and earns wages in the United States producing cars, televisions, computers, and more, our middle class can afford to buy the goods and services they produce. Credit will be uncommonly used in the population, reserved for true emergencies and extraordinary events instead of being a staple of everyday life. Interest payments will be small and uncommon. Speculators will be free to place their bets, but they won't be able to demand handouts when they lose in the Wall Street casino. You will be able to save 10 percent of your gross income during your working years and, coupled with a Social Security system that remains solvent, live out your life without having to speculate in the stock market. A house will be a place where you hang your hat instead of a get-rich-quick scheme that blows up in your face and results in foreclosure, eviction, and financial destitution.

Some Americans will choose to start businesses and employ others. Those who do will not fear having their product's design ripped off in China and sold without compensation or fear that their competitor will utilize slave labor and environmental pollution as a strategy to put them out of business. The rest of the United States, who work for someone else, will compete against other first-world nations and their citizens for jobs rather than against near-literal slave labor being paid \$2 a day.



We hear constantly about income inequality in the United States, but there are two forms of income inequality, and one of them is positive for the nation. The rich person who becomes wealthy by inventing a new process or widget brings wealth to everyone. Henry Ford made possible ownership of an automobile by virtually every man who worked for him on the assembly line. To deny him the wealth that flowed from his innovation would be to prevent the production of the Model T, and America would have been much poorer. But some people become wealthy by finding ways to effectively screw the public, putting in place legal and business systems that skim off funds without providing anything of real value in return. Our focus should be not on flattening income inequality but rather on getting rid of the economic and legal structures that allow and protect theft while

encouraging competition and entrepreneurship. We should encourage many Henry Fords and Thomas Edisons in our society rather than those who use financial trickery as a means of enriching themselves at the expense of the public.

Tax systems that are designed for social agendas provide a convenient foil for those who would demagogue political issues for their own ends, and the United States suffers greatly for it. Our tax code has become part of an intentionally convoluted economic structure that is designed to consign the common man to debt peonage and poverty. Why else would we tax long-term capital gains, the fruit of a successful investment that employs others, while at the same time allowing a tax deduction for interest on consumed capital goods, particularly housing, which can only make you poorer?

The United States emerged from World War II as an economic powerhouse unequalled before in the world. Where we produced tanks and aircraft for war, we turned to peaceful production of automobiles and airliners. Where we produced radar screens, we changed those factories over to produce televisions. Where we produced nuclear weapons that ended the war, we turned our ability toward peaceful nuclear power and currently obtain 20 percent of our electricity from exploitation of the atom.

We can return to our former status as an economic powerhouse without equal. America lost its way not because there are other nations with a better political structure, a smarter population, or more resources than we possess. We stumbled and fell through a common path of corruption called leverage that has played out time and time again through history. The salve found in leverage is much like alcohol; the first drink does no harm and makes you feel good. The tenth has you in the bathroom hugging porcelain. If you do not learn from your mistakes and continue to increase your consumption, rather than choosing to be a teetotaler, you will eventually suffer liver cancer or alcohol poisoning and die.



You have taken the first step on the path of understanding how the United States, like so many other nations, lost its way. But unlike many

other books through the years, here you will also find how we can regain the path of prosperity.

The choices before us are not simple ones, but they are necessary. Our path toward destruction did not happen in an afternoon, a month, or a year. We have been destroying our nation through debt alcoholism for more than three decades, and recovery will take time. There will be setbacks and pain, as there always is when breaking an addiction. Our focus as a nation must be not on the binge of today but rather on how we sustain our economy and people through both today's generation and tomorrow's.

Every journey to set right what has been wrong begins with a first step. Before we embark on our journey of reconstruction, we must understand how we both broke our nation and became broke so we can avoid the traps that were intentionally set by those who corrupted our future. Without understanding the foibles of the past, we have no hope of avoiding them tomorrow. Those who profit mightily from the current economic structure in which we find ourselves trapped will not easily give up the privilege they have won through decades of trickery and deceit. It is only through understanding why the alleged solutions they put forward cannot work that we, the people of this nation, can challenge and depose their bankrupt economic prescriptions, replacing them with sound alternatives.

America's future down one road is dark and foreboding, while down the other, it is vibrant and exciting. We stand at a fork in the road, and our challenge is to choose the path that looks rockier at the outset, but leads onward and upward toward sunshine and a warm summer's breeze rather than downward to ruin.

