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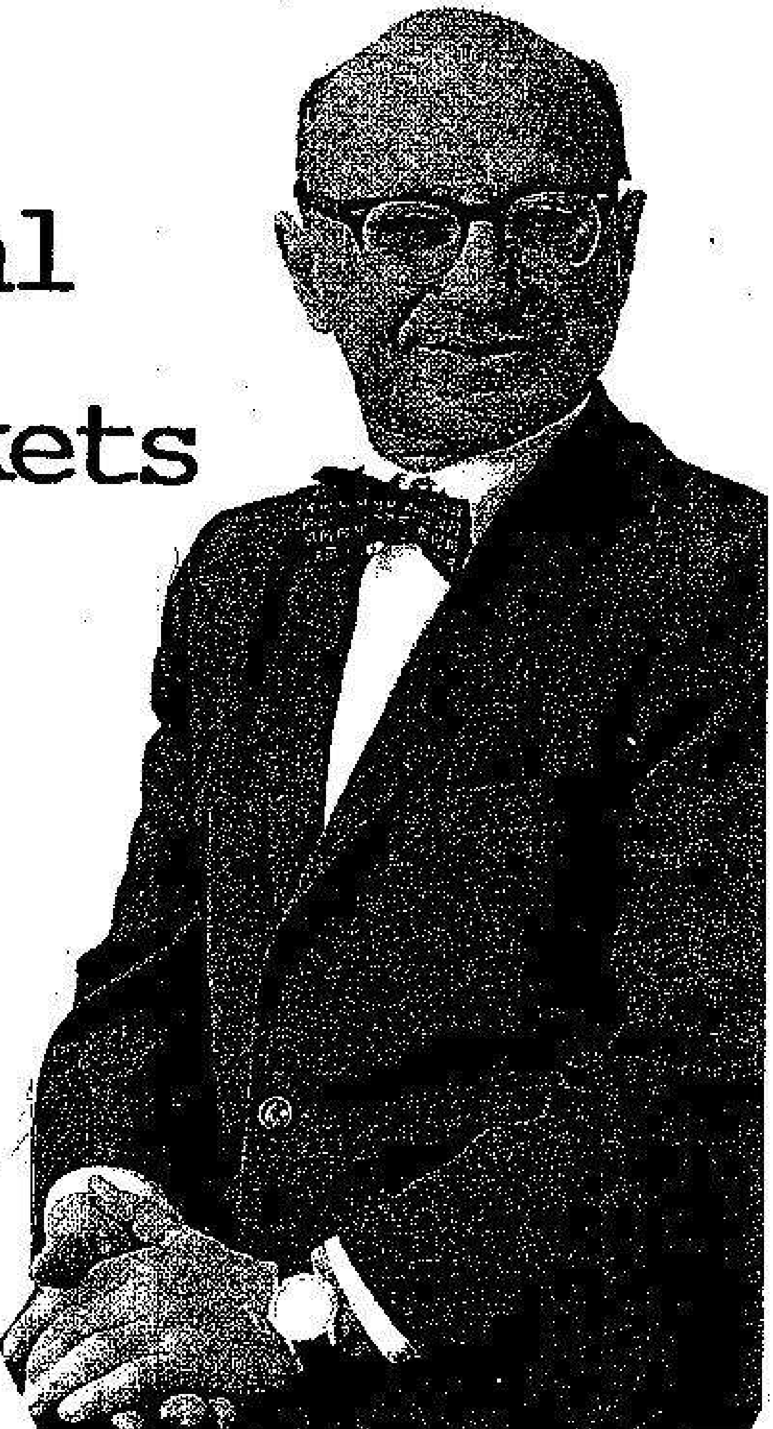
The Irrational Free Markets That are Never Wrong?



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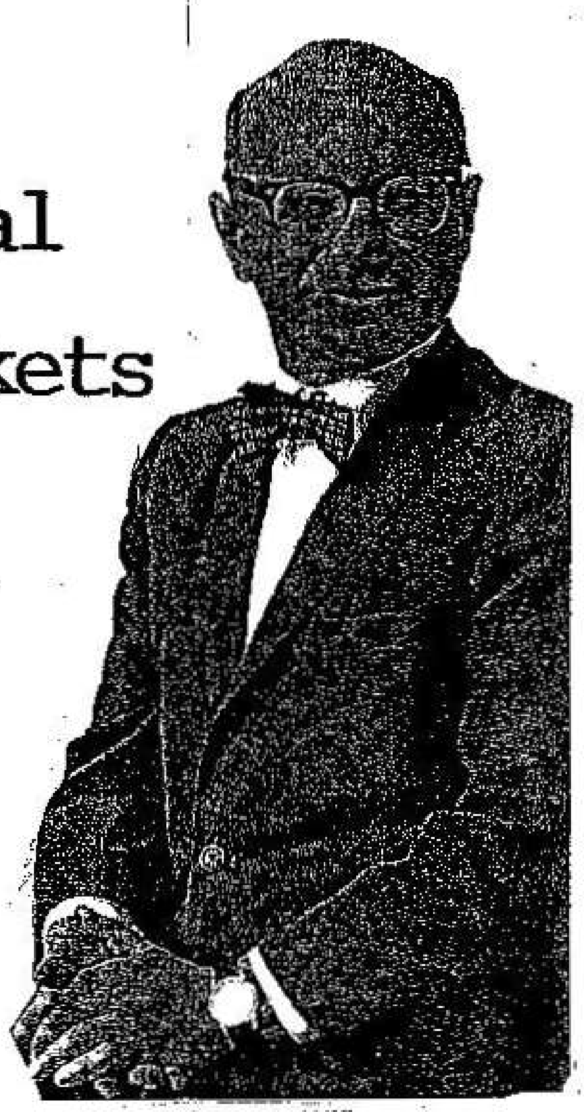
 At a future date, a book will be released **The Geometry of Time.** The charts are often reproductions of an earlier publication from 1986 also to be soon republished The Greatest Bull Market In History covering from 1900 up to the 1980s. Additional updating is underway to complete the Century and into the current time, providing a month to month history of the financial development of Western Society.

The Irrational Free Markets That are Never Wrong?



by: Martin A. Armstrong

Former Chairman of Princeton Economics International, Ltd.
& Foundation for the Study of Cycles

There is a raging war of words where there is a clash based upon the assumption that a belief in **"Free Markets"** means the private sector should be left alone and that the markets will make their own corrections, while the opponents do not want to hear this for it implies that there should be less government power. That is the key word **"power"** not whether the proposition is correct or not. Yet let us make no false assumption. Those who advocate the **"Free Markets"** are by no means advocating that they relinguish political power for themselves. Both sides fail to understand that they are irrelevant, for no matter what they say, they too are part of the system and are subject to the same natural forces of the free markets, just as Communism failed, so will any attempt to alter nature.

At the core of the problem lies a serious fundamental flaw - the wrong assumption that man even has the power to manipulate society in any way, shape, or form, that is meaningful and lasting. The religious right outlawed alcohol to be able to imprison the Irish and Italian immigrants who were Catholic, still fighting the war of Oliver Cromwell and the Puritans. They created prohibition, and the Italian Mafia costing countless lives in this new crime war. How many died making gambling illegal, and then when the state realizes it can profit from this vice, suddenly it become legal.

The same takes place with drugs and make no mistake about it, there are people in jail for life for selling marijuana. Look at the war raging in Mexico. This is the same as the

the result of Prohibition. You can create all the social laws you want outlawing even prostitution, but it will not alter the behavior of the people. It will only drive prices higher making doing business in that area more attractive to those who need the money and nothing is accomplished in the end. We can pretend that we are protecting our children, but that is nonsense. Making things illegal protects nothing for if they want to try it, they may be more attracked because of the status to prove adulthood. A close look at the young black culture illustrates that being charged for some sort of offense is a badge of honor.

We can outlaw sex before marraige, but we are drinking our own bath water to think that it will have any effect. It is like the Religious Right who under George W Bush stopped providing condoms in Africa to help reduce aids replacing it with preaching abstinence. Right!

We Must Be Practical

Economics is no different. If we can't be reasonable and practical, forget it. We can find no example that those who claim that **"free markets"** don't work and we must control all aspects of the economy by the state, are in any way correct. Both China and Russia adopted the same Marxist theory and demonstrated that a centrally planned economy cannot be achieved.

The Marxists today have just changed the labels hoping to give it another shot. They now call themselves **"Progressives"** and think by renaming the pig, it will make it magically a horse.

At three o'clock in the morning, they added a 300 page amendment to the energy bill. Why wait so long? Because they did not want the people to know what they were doing before they acted. That is not what one calls a free democratic state. It is more like an authoritarian dictatorship basking in the glory of its own tyranny and delighting at its own applause.

The Republican **"free market"** advocates use the term, but stay far away from its real meaning. They advocate freedom, but sell it to the highest bidder. It is a true disgrace how Goldman Sachs has controlled the US Treasury and World Bank for so long.

The **neoconservatives** symbolized by Dick Cheney and Bill Kristol, are also now discredited. The Times of London declared "the end of an ideological era in Washington." The Canadian **Toronto Globe and Mail** pronounced that this idelogical branch is "decisively wiped out." Even Kenneth Adelman lamented in the **New York Times Magazine**, "most everything we ever stood for now ... lies in ruins." Yet, here too, the very idea was built upon the false assumption that they can rule the world and fail to comprehend that there is one and simple rule that governs all:

All things collapse from internal structural weakness.

The **neoconservatives** began as Democrats in the 50s but in the 70s they argued against any disarmament in pursuit of peace and they were against affirmative action as well in pursuit of racial equality by force. They viewed that pursuing such polices would undermine the very objectives. Domestic politics thus had attacked the Great Society programs of the 1960s. Eventually, this evolved into a key economic conservative movement that produced Lady Margaret Thatcher whose famous phrase was that **socialism works until you run out of other people's money.** This manifested into the accession of Ronald Reagan in 1981. and indeed the budget was balanced under Bill Clinton who had himself declared "the era of big government is over."

The foreign-policy branch of the original **neoconservatives** eventually followed its own path where the economic conservatives became mainstream, the foreign-policy branch became virtually the nut-jobs. This group was the much more passionate and less likely to listen to anyone on the opposite side. This is the branch steeped in McCarthism and communist witch-hunts. They had zero-tolerance for any communist and destroyed the **First Amendment** trying to make it illegal to even belong to the American Communist Party. As a kid, I remember the drills in grade school of ducking under your desk. These were things that made kids believe they were like the evil witch in the Wizard of Oz. Communists would take you to a gingerbread house and then eat you.

Most of the **neoconservatives** of the foreign-policy wing were hawks (with few exceptions). Where the domestic economic issues if wrongly decided would leave you bankrupt, a miscalculation in the foreign-policy wing would create war. The stakes no doubt were higher, yet there was sill at the core, the failure to understand what **"Free Markets"** really meant.

The **neoconservatives** of the foreign-policy wing became the extremists. They were separate from the **neoconservative** domestic wing that became mainstream, and thus the whole **neoconservative** movement became the power behind George W. Bush and organized by the Dark Lord Dick Cheney who really ran the White House even taking Presidential functions that never before were controlled by any Vice President. His insistance upon still holding press conferences on foreign policy illustrates who was really in charge at the White House.

The **neoconservatives** saw the loss in Vietnam as a product of liberalism. They demonized Communism and believed in <u>zero tolerance</u>. Their attitude was viewed as pure American Imperialism and they became firmly entrenched in the Republican camp following Jimmy Carter who took the position that they possessed an "inordinate fear of Communism."

They managed to influence President Reagan enough to at least have him demonize the Soviet Union as the **"evil empire"** yet he would not adopt their position of such absolutism. The **neoconservatives** became the **"zealots"** and a friend of mine who was the campaign manger for Reagan in Pennsylvania was no **neoconservative**, but believed that they could be tempered and controlled. I, on the other hand, warned that they could not be trusted.

Their loathing of Communism is what drove them. They could see nothing from a pure economic standpoint, nor would they understand that the **"Free Markets"** would seal their own fate. Yes, I knew Bill Kristol and took the back page of his magazine for a long-time to further **economic conservatism**, yet we never agreed on foreign-policy areas.

The **neoconservatives** found Richard Nixon, Gerald Ford as **foreign policy liberals** and they were never pleased with Henry Kissinger, who viewed the Soviets as a great power rather than some sort of a evil empire who would undermine America. The famous kitchen confrontation between Nixon and Nikita Khrushchev symbolized everything feared by the **neoconservatives** and when Khrushchev vowed that Communism would conquer the United States from within, they had that boogeyman and no doubt looked under their bed and in the closet before going to bed.

Yet when Communism fell in 1989, there was no a yelp of victory, but a sense of sheer and total shock. Where was the enemy? Gee, we didn't have to nuke them? It was not their victory. Some tried to claim victory by the **Star Wars Project** that somehow pushed the Russians over the cliff. Now, Putin argues that the fall of Russia was a CIA plot to undermine their economy no different that the Iran government is blaming the riots on the Bitish and Americans. Nobody, not even the **neoconservatives**, will admit that the very core philosophy is just dead wrong.

The **neoconservatives** needed an enemy. They had a vested philosphy, and with the cold war gone, they needed someone. It was dying and it was not due to its own success, but to a **"Free Market"** success they failed to understand.

They were saved by the Saddam Hussein invasion. The coalition put together and led by President Bush, Sr, was practical and of course diabolically opposed to the voice and policies of the **neoconservatives** who were simply livid - bright red with sheer and utter contempt for stopping shy of taking Baghdad. I personally discussed this issue at the time with former Prime Minister Lady Margaret Thatcher. The position was that Saddam kept the religious nut-jobs in place and provided a buffer that was necessary then against Iran after the Islamic Revolution. The neoconservatives, wanted to wipe out Saddam. They had to win something!

Whether there was ever any genuine deep concern for human rights in the major camp of the **neoconservatives** I personally doubt. Jimmy Carter had taken a position that human rights may be violated regardless of the type or form of government. The **neoconservatives** masked their real goals clothed in the flag of human rights pretending that Communism and dictatorships violate human rights, but not democracy. This much they sold to Reagan, and then in 1984, altered human rights domestically stripped Americans of their right to trial by jury that took until <u>Apprendi v New Jersey</u>, 530 US 466 (2000) in the Supreme Court to admit, yet has still failed to correct.

Former Vice President Dick Cheney

Like the neoconservatives in Germany, once a foreign enemy disappears, they will always turn against their own people. When Reagan came to office, there were only at the time 24,363 prisoners in the Fed system. The image of prison was one of violent and major murderers. Once the cold war was over, by 2002 the reforms they ushered in led by the **Republican Neoconservatives** reached a staggering 163,528 and most were suddenly nonviolent. Even the states followed suit and between 1985 and 2002, the females in prison rose from 19,077 to 76,817. By the time we passed 2000, population rose into the millions. Martha Stewart did time for "lying" to federal agents. She commented that she was shocked to meet nuns in prison for public protests. The number thrown in prison just for taxes is shocking. But now, the neoconservatives have waged war against the American people to such an extent, that also 6% of the entire population will be locked up for something - one in every 20 people. Carter has been proven correct, it does not matter the form of government, for America is either the most corrupt people in the world, or there is something wrong in the rule of law. The United States now has about one-third of all prisoners worldwide.

The **Cheney White House** put the whole **neoconservative** philosophy to the test. It adopted unilateral objectives and would not form real coalitions, adopting a policy of dictatorship to the world for they just knew better. They refused to talk to many states that was insane. If you have a fight with your spouse, do you refuse to ever talk again yet somehow still live together as if you are married? They disagreed with the first Iraq War and manufactured excuses to do what they wanted. They had an agenda to throw Saddam out of power regardless of the fact. When Bush was asked did he first consult with his father? Bush replied: "I consulted with my father above!" If God responded, that says it all for the position of the neoconservatives - they are just as a defiant nut-job as the people they face in Iran.

The search for weapons of mass destruction gave way to we are defending human rights while abandoning that for our own people, and bringing democracy to the Middle East. I fail to see where Russia could not have claimed the same slogan "We are bringing equality and peace to the American people with Communism!" Both seem to be mythical formulae of invocation or incantation of plain bullshit.

The pretense of an ideological democratization of the Middle East is not within American devine power from God or anyone else. As far as the so called War Against **Terrorism**, let us face the facts. We have as much chance of winning such a fictious war as we have in outlawing prostitution and drugs along with premarital sex. It is not a real war insofar as there are two opposing armies or even two countries as the good-old days faced by Russia.

The overwhelming prisoners concerning drugs are not the manufacturers nor even the importors. The feds imprison street sellers for minimum 10 year terms to life. This has had no effect upon the drug trade because street sellers are easily replaced. If you can't stop the production in the fields, you cannot stop the drug trade and you will imprison eventually all the poor since they sell to make a buck.

Terrorists are no different. The leaders do not fly into buildings or blow themselves up in cars or trains. Those who carry out such acts are not the brightest bulb in the box. The ones I have personally met, are religious zealots with no real independent mind. One of the terrorists held at MCC in New York, was tiny and managed to sneak out climbing through a grid to the top of the building about 22 stories high. He was then found praying expecting God to take him into the clouds.

I am personally offended at Mr. Cheney's arrogance that water-boarding is somehow not torture. He has opened the door to justify any other confrontation to torture American soldiers under the same pretense that this will save lives of whoever they are. I would like to see Mr. Cheney demonstrate why it is not torture using himself.

My father served under General Patton in North Africa. When he found people who were going to torture and beat Arabs caught working for the Germans, he put a stop to it. He ordered that they bring in the biggest pig they could find. He then treatened the Arab that if he didn't tell him what he knew about the Germans, then he would kill the pig and then the Arab, he would burry the Arab in the pig, and he would never go to Allah. He told me they never had to touch anyone.

At MCC (Metropolitan Correctional Center) in New York City, one of the terrorists from the first bombing drew a picture on the wall of his cell showing the Twin Towers with planes flying into them more than 1 year before the event. Prison officials took pictures, and obviously nobody checked on anything. So, I'm not convinced that Cheney's policy of torture does anything. All you have to do is look at the criminal justice system. The pleas in a Federal court system are 98.5%, for if they do not plea, they get often twice the time and that is again not "torture" by Cheney's view.

The **neoconservatives** have done more to make America hated where it was once respected and for nothing. It was not the policies of the **neoconservatives** thatended the cold war. It was not the military build-up nor even the threat of **Star Wars**. None of that has had any effect upon North Korea.

The credit goes to **"Free Markets"** that is something a lot more than merely reducing the regulation that the **Democratic Progressives** now rale about relentlessly. They hate to listen to anyone talk about **"Free Markets"** because they see this as vehemently the pure enemy for to them it restrains their personal power to dictate to the economy what shall be done no different than the **neoconservatives** have imprisoned so many Americans for non-violent offenses that never existed before and have exercised under Cheney in foreign policy.

The Real Free Market

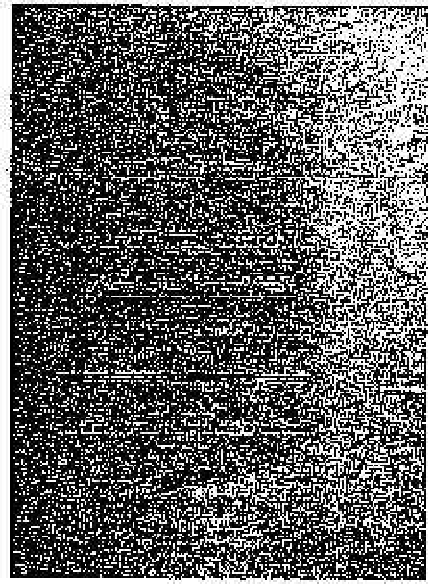
Smith's Invisible Hand

Free Markets is a term often thrown about, but I have not seen any real description of what it means. Just to use the term invites danger, for it comes with a lot of baggage. It is the very essence of life itself and is not in the least a political theory that should invoke such distain among Democrats for if you honestly care about our nation, our people, and our posterity, then you must put aside the politics and listen just for once.

Before there were political parties and there were simply monarchs, the concept of economics was forming from observation. By the early 1800s, the term **Laissez-faire** emerged to express that the state should not interfer in the economic affairs of men, and thus to adopt the minimum necessary restraint to maintain peace and property rights.

KARL MARX

The person largely responsible for the complete break-down in our world economy and in human rights, is none other that the infamous **Karl Marx** (1818-1883) who built on utopian theories to assume that government could manipulate the behavior of mankind.



Adam Smith The Wealth of Nations 1776
The First True Glimpse of the Complexity of The Economy

Countless people have read Smith, but countless fail to comprehend what he was saying. For anyone to claim that "Free Markets" don't work, have somehow been discredited by the current economic decline, or some other excuse as to justify how they know better than everyone else with absolutely no sense of reason, history or the consequences if they are wrong, reveal their own pure stupidity as well as their arrogance. Smith had an opponent, the Physiocrats who like the idiots now, based their entire reasoning upon current events and dare not comprehend how to walk after tying their shoes. The French Physiocrats had argued that land was money and thus a man who made a plow and sold it to a farmer was a economic parasite who created no wealth, but lived off of the farmer who was the only member of society to create wealth. We must understand, the Physiocrats observed a old world of feudalism based upon land and could see not beyond those shores. Hence, the title **Wealth of Nations** demonstrated that the economy was far more complex than this very simple one-dimensional view of the world. Smith through observation, saw that a man who made a plow and sold it to a Frenchman and an English farmer sold his crop to a Frechman, both came back with gold in hand and both contributed to the wealth of a nation.

Smith observed without explaining, the true vast complexity of the economy. He explained that each individual acts in his/her self-interest and that is what is the essence of why the economy is far too complex to fool with. For this **Invisible Hand** described by Smith goes much beyond his own observations. They extend not just to the rich and the poor, but it extends into the corporate/group behavior, into the political structure (which is why the Democrats say free markets don't work for it goes against their plans), and then it rises to the national level forming the competition between nations.

Smith saw a glimpse of the origin of the economy, but he was at the very front of the line and unable to see how events would evolve. This was the beginning of the **Industrial Revolution** that would begin to shift labor requirement from agriculture to commerce. We must keep in mind that even by the American Civil War in the 1860s, we were still composed of a work force that was 70% agrarian. By 1929, this declined only to about 40% and finally post-World War II, the expansion in agricultural technology made it possible to reduce that work force down to 3% by 1980. So you see, Smith still did not see the whole future, yet he went a long way.

the Origin of Communism

Sir Thomas More
(Feb. 7th, 1477 -
July 6th, 1535

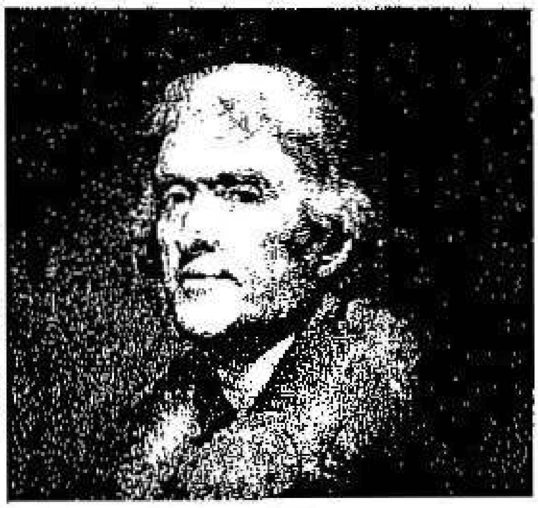
There might be shock to most, but the very idea of communism was not purely arising from the dark places within the mind of **Karl Marx.** The origin of this notion comes from a source predominatly overlooked. To my astonishment, whenever I would be engaged in an interview for a job as an analyst, I would run down a list of economists and ask what their view was of his theory. When I came to Marx, the vast majority would look at me with surprise. They were unaware that Marx was even an economist and most certainly did not discuss his ideas economically. There were only a handful of schools who ever seem to address Marx in economics. Of even greater shock you might find that the origin of Marx's ideas can be traced to **Sir Thomas More** who disagreed with the King Henry VIII, was sentenced for treason to be "drawn, hanged, and quartered" (torn apart), but was given a downward departure and simply beheaded. It was **Thomas More's** writing that was known as the **"golden little book"** published in December 1516 that forms the epic center of our troubles. The title was **"Utopia"** that was a Greek name he coined from the Greek **ou-topos** meaning **"no place"** that was a pun on the Greek **eu-topos** that means **"good place." More's** famous book was a best seller and thus his **"Utopia"** meaning "no place" is written in contrast to what he observed. This fictional place is a pegan land and a communist city-state in which the institutions and the policies of the government are all based upon reason!

More's **Utopia** was a response to what he observed in Christian Europe that was divided into states all bent upon self-interest and greed for both power and wealth that he in fact describes vividly in Book I. He writes the book as a novel through the mouth of a traveller Raphael Hythloday. His argument unveils his conclusion that a communistic state is the only cure against this unbound egoism that has consumed public and private life.

More speaks of a mitigation of evil rather than a cure, and accepts that human nature is indeed fallible. **Utopia** deals with penology, state-controlled education, divorce and women's rights, and religious pluralism. It was this work that gathered a reputation as being a **"Humanist"** for **Utopia** was even translated into most European languages. It was this **Utopia** that created a whole new line of philosophy. By the time we come to **Marx** about 300 years later, this **Utopian** philosophy becomes not a mitigation, but the cure for everything.

Although **Utopia** is a pegan land, any punishment for a claimed crime is limited to reason that essentially is embodied within the Biblical code for crimes - **an-eye-for-an-eye.** What that really means it is against the law of God to inflict a punishment greater than the harm. In other words, one would not be sentenced to death for disagreeing with a king or taking an apple because your family is starving. Government always violates the laws of God and inflicts punishments that are far beyond proportional reason. Just as both America and Australia were penal colonies, the state would punish you for the most minor offense, even steeling an apple, by selling you as an indentured servant to a distant land for several years, and when you were free, there was no one to take you back to England. Even today, the **neoconservatives** have removed all the restrictions upon such power created by the Constitution and have increased the prison population by nearly 1000% since 1987, for nonviolent alleged crimes including taxes. So it is not hard to see **More's** sheer lack of respect for those in Government. They did just kill him for disagreeing.

Revolution was in the wind and began in 1600s that was based primarily upon the Puritan religious views that became very Spartan rejecting luxuries, wealth, and evolved as a derivative of Utopianism. What More set in motion was a whole concept of a new land that could be created. We must realize that it was this book on Utopia that perhaps instigated even Martin Luther by illustrating what was ethical. The impact of More's Utopia cannot be under-estimated. By 1687, we find the emergence of a **unitarianism** where one believes that the deity exists only in one person and that this belief also stresses that individuals have the freedom of belief that is the freedom of reason even in religion, and that there should be a united world community with liberal social action that can be expressed as a advocate of unity and/or a unitary system.



Thomas Jefferson
(1743–1826)

Declaration of Independence [1776]

When in the Course of human events, it becomes necessary for one people to dissolve the political bands which have connected them with another, and to assume among the powers of the earth, the separate and equal station to which the Laws of Nature and of Nature's God entitle them, a decent respect to the opinions of mankind requires that they should declare the causes which impel them to the separation.—We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.—That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed,—That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its foundation on such principles and organizing its powers in such form, as to them shall seem most likely to effect their Safety and Happiness.

About 100 years later, we find the American Revolution giving birth to equality by freedom, not by force. **Thomas Jefferson** expresses the belief in the most eloquent words possible in his remarkable **Declaration of Independence**. The concept that indeed "all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness" is not coextensive with Socialism.

I have written before, that today it is very hard to comprehend the true meaning of these words that they neither advocate communism or forced means of socialism, sumptuary laws to impose the will of the state, nor do they justify the tyranny of any neoconservatist that wishes to impose a dictatorship of sheer intolerance. We lost so much in our struggle to be free, that one wonders if it is ever truly possible. At the time when those words were written, you were merely the **property** of a king who could not be in any way punished for a crime in another land. That monarch sent you back in chains to your king who owned you to be justly punished. **Jefferson** argued that we were revolting against the concept of a monarch and thus anyone traveling to America, was subject to our laws and was not to be sent back to his king in chains. This was a fundamental difference and was the true meaning of "**Freedom!**" Today, thanks to the greed More saw in government, sanctioned by Marxism, you are once again the property of the state. Whatever you earn anywhere is the property of the United States and if you do not produce it or hide it offshore, you will be hunted down and thrown in prison for you have no rights. – Marxism took them all again.

This rising wind of Revolution swept most of the world between the mid 1600s to the late 1700s. This was a turmoil against the arrogance and corruption of monarchy. Yet we must not forget that it was the **Black Death** that put an end to feudalism in the 1300s, and as kings began to see wages earned, it demanded its pound of flesh. The **first tax revolt** appeared 1381 in England led by Wat Tyler. This is a period where we are witnessing the rebirth of not capitalism as implied by Socialists to implicate a sense of greed, but individualism and the idea of inalienable rights that **Jefferson** captures.

By the 1700s, we are developing world trade and by 1720 we have the first bubble of speculation with the South Sea and the Mississippi ventures. This is followed by the **Industrial Revolution** and we begin to see the migration of labor away from farms and into factories. The entire world as it was once known, is turned upside-down.

In order to understand how these key ideas emerged and are still depriving us of **Freedom** and **Liberty** today, we must realize the economic evolution that was taking place between 1300 an 1900. We were emerging from the **Dark Ages** created by the collapse of Rome in 476AD. The rise in debt and taxes that began during the 3rd Century of Rome, set in motion the suburbanization of civilization where people migrated away from the cities. This eventually gave way to **Feudalism** as taxation consumed virtually all wealth of the individual. People sold themselves and their families to "landlords" and Europe fell into a new age of agrarianism. The rise of the Arabs cut off all trade by the control of the Southern European ports and the sea. The Vikings kept pressure from the North and thus Europe became landlocked. It was this isolation from world trade that had created the Dark Age.

The **Concentration of Capital** was thus exterminated for the working population had been reduced to serfdom where their wage was in kind - about 20% of the food they had produced. Indeed, when the monetary system of Rome collapsed between 252-260AD, the value of money had fallen to about 1/50th of its former purchasing ability due to the debasement of the coinage (inflation) to such a point, that taxes even began to be collected in kind, meaning that the state would just seize livestock, grain, or whatever else you had to pay what it claimed you owed. To keep track of taxpayers, the state invented both birth records and passports to restrict movement to collect taxes.

From this background, by the time we reach the 1300s and the **Black Death**, the loss in population made labor scarce and suddenly wages come back and with them the greed of the state - taxation. We then have competition arising between these feudal states that are emerging back to empires that begin with **Charlemagne (742-814AD)**. We begin to see the reverse of the suburbanization that was a migration from taxation under Rome and with this we are are fueling the beliefs of the Physiocrats who believed that land was the source of all wealth. So here we have the competition an self-interest observed by More and we have a changing new world of specialized commerce and manufacture and trades that Smith sees to be on a equal footing with agriculture insofar as producing wealth.

So we have **More** observing the self-interest of monarchy and lords rising based upon a desire to increase wealth and their power. We have the **Physiocrats** led by a french group including **Francois Quesnay (1694-1774)** who is confronted by **Adam Smith (1723-1790)** who observes that it is the raw self-interest that drives the economy in a complex manner with individuals competing for wealth creating innovation between them. This is what Smith argues creates the wealth of a nation, **all** productive forces.

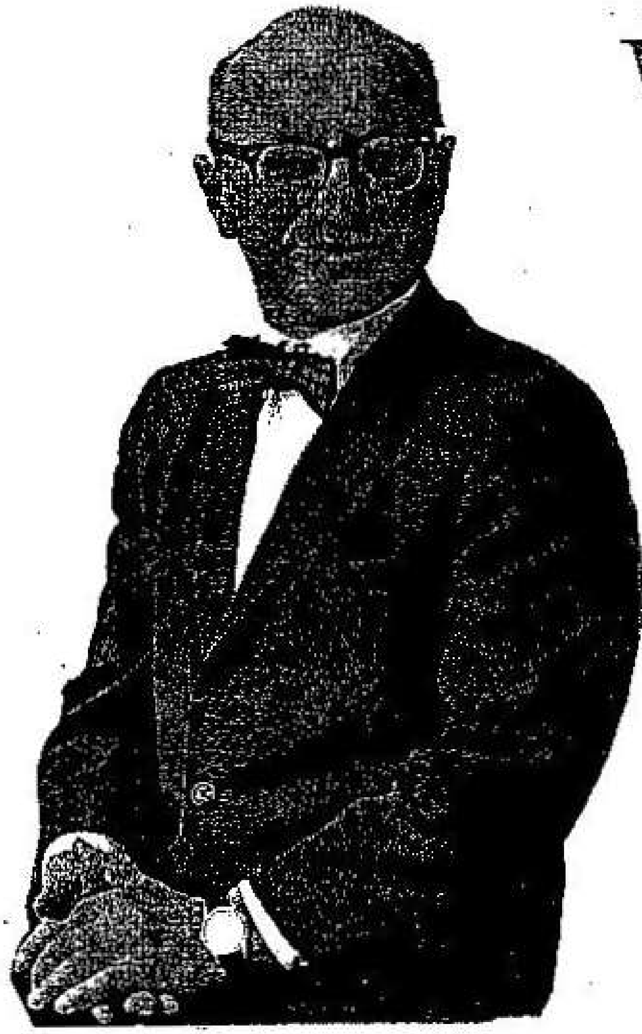
Karl Marx (1818-1883) comes into this mix observing the self-interest of both Smith and More, and pictures this against the backdrop of the birth of the **Industrial Revolution**, where he sees the exploitation of labor from his perspective as industry is still trying to figure out how to even create work-shops. Marx sees the **Long Lease** that still prevails in downtown London where land is rented for 100 years and then returns to the next generation of landholders. He sees this a means of preventing the shift of wealth among the classes.

All of these ideas that have created the mix-bag of economic theories we are now forced to live with, are still depriving us of our **Freedom**, **Liberty**, and the pursuit of individual **Happiness**.

The taxation of government has transversed all levels of government and people can no longer look forward to simply retire in their home for even if it is paid-off, the taxes continue to rise forcing them to leave causing flight to Florida.

The **Marxist** theory has created a major change in society. To pretend that the state can prevent economic declines that it can no more do than decree weekends shall be rain free, they have created a power base that is so expensive, it depletes the national wealth and lowers the living standard of the whole. They are indeed **public servants** for they do not contribute anything to the creation of national wealth, they consume it.

The economy was evolving throughout this period between 1300 and 1900. While it is still evolving and the **Internet** has become the highway to deliver product worldwide, this is changing labor needs and people will fight change, because they do not understand its role in the progress of mankind.



Milton Friedman

What we do not grasp, is that the economy is no different than any other complex system. It can be easily predicted from a long-term perspective that the present course of events will unquestionably lead to the destruction of the United States and Western economies from excessive debt, declining real growth, and rising costs of government that set in motion the same collapse of Rome and just about every other empire.

Nevertheless, with each economic recession and depression, this is how the economy evolves. People will not change voluntarily. They must always be forced. Margaret Thatcher was correct: Socialism works until you run out of other people's money! I am not a neoconservative who believes in world dominance and just handing control to Goldman Sachs.

The Great Depression forces farmers to learn how to become skilled labor. By 1980, we fell from 40% agrarian to just 3% as measured by the labor force. It is true that those who yelled the loudest did more than make noise. They furthered Marxism in ways no one understood. The whole nonsense of creating the dollar as the world reserve currency based on the fact that we had 76% of the world gold reserves in 1944, was matched by our stupidity to fix gold at $35 per ounce while failing to limit the quantity of dollars. A 5 year old could predict such a system is going to go bust. The boom and bust cycle creates the waves of economic innovation, progress, an eliminates all excess while rewarding innovation itself.

I did not begin seeking to be any sort of an academic. I was a analyst, trader, and a global fixer-upper. I was not trained by any particular school of philosphy, but by our clients. Having offices around the world and coming into the birth of the floating exchange rate system in 1971, I stepped into an evolving field of global foreign exchange. Running around the world, I seemed to be called in to just about every major financial crisis imaginable. I was called into the turmoil in oil in the middle east and was involved in just about everything from the Greek shippers to the tycons of Europe and Australia, and was even called upon by China in the midst of the Asian Currency Crisis. What I saw was from the front-lines, not from text books. I saw Smith's Invisible Hand at work globally. I was forced to run studies in all currencies because every client would measure profits and losses only in their home currency. Currency became a language of global economics.

I would give lectures around the world to the movers and shakers. Central Banks had purchased blocks of seats. Major corporations came from around the world. Our Conference held in Princeton in 1985 for 3 days, was a mini-United Nations. The audience was perhaps the first gathering of investors/businessmen from around the world in one place.

At one of my lectures, a small man of stature attended who came up after I was finished to introduce himself. It was Milton Friedman. Perhaps until that moment, I had not really thought too much about contributing to economic theory. I was a man of the real world. Milton had advocated a floating exchange rate system in 1953. What he saw in me, was his theories coming alive. I had witnessed the Invisible Hand on a global scale that unless you had clients around the globe, you would never see. Milton's theories of Free Markets being so complex that intervention is dangerous, I lived such moments globally.

Why The Free Markets Will Always Win!

The cannot be wrong!

Thomas Jefferson wrote his beliefs that the United States would not last. He believed that **Revolutions** were a natural course of events and that the **Tree of Liberty** had to be refreshed with the blood of both tyrants and patriots. **Jefferson** saw cycles in history and did not expect that the United States would last much beyond the year 1900.

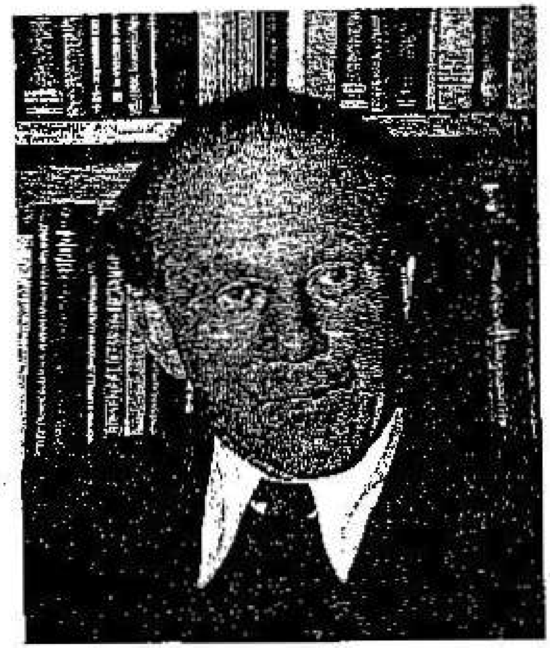
The loud cry of the new **Progressive Democrats** who shed the labels of "liberal" or "Marxist" replacing it with this new and better version of the same old bullshit, that the theory of **"Free Markets"** is dead as demonstrated by the current economic decline, are indeed drinking their own bath water. They are clearly ignorant or perhaps voluntarily blind to history, but they can no more defeat the **"Free Markets"** that is best portrayed as Smith's **"Invisible Hand"** today, than they were in China, Russia, or at any point in history.

They fail to even comprehend how the system works and the Republicans have just let the Investment Banks run the Treasury, Courts, IMF, and World Bank. That is not a **"Free Market"** when they gather together to manipulate markets to gain an unfair advantage. That is <u>**not**</u> what the **"Free Markets"** represent any more than the Taliban by force fulfill the will of God.

"Free Markets" means there exists the most complex system of billions of plain variables that are interconnected in such a way, that we cannot manipulate the whole for we do not even comprehend component parts. As a society we are standing on the threshold of a completely new horizon, yet we are so blinded by our bias, hate and prejudice we cannot see what exists. One day like Neo in the Matrix, our eyes will open and we will be able to see the code that lies beneath.

HEISENBERG

"Uncertanty Principle"



Werner Heisenberg
(1901 - 1976)

No matter what we are looking at be it the Universe, our Earth, our real world facts and events, or the microscopic world, there is a **Grand Unified Theory** that all systems larges and small function based upon the set structural design. Just as we have a heart that pumps blood carrying oxygen to vital organs, so does a dog, rat, and a goat. The structural design is the same and the fact that life exists based upon certain design structures is evidence that there is some master plan just as DNA is a code shared by us as well as dinosaurs.

We understand that the Earth revolves around the sun creating the four seasons as we have night and day, and the gravity even pulls upon the ocean to the create high and low tide. We look out at the Universe and see that everything follows the same model and we are spinning within the Universe that takes about 26,000 years to complete just one revolution.

When we look at the microscopic world, we see within an atom, the same structure with objects rotating around the center.

What we are looking at is a structural design upon which all systems are based. There may be variations, but at the core, each is the same fundamental design.

Smith **Invisible Hand** was a glimpse of a complex system that has been termed the **"Free Markets"** in that there is a natural inherent system that flushes excess and creates new opportunities that drives the engine of innovation.

In 1925, Werner Heisenberg proposed a complete new foundation in physics that was so radically different in its core concepts as distinguished from the classical Newton formulation. His vision has been accepted as being applicable to all physcial systems no matter what size they might be. For this very reason, we must realize that we are also only a physical system and we also may not escape from these basic concepts.

Classical Mechanics

Quantum Mechanics

Heisenberg's idea can be demonstrated mathematically where only macroscopic systems are involved, the predictions of **quantum mechanics** differ from those of **classical mechanics** by amounts which are far too small to even measure. The **classical mechanics** involve systems of real world size that are mathematically simplistic in comparison. Yet where there are systems of atomic dimensions involved, the predictions of **quantum mechanics** differ substantially from those in the **classical mechanics**.

You may be asking what the hell does this have to do with **"Free Markets"** and the **Invisible Hand?** Well the consequence of Heisenber's theory is known as the famous **"uncertainty principle"** that he formulated in 1927. This is perhaps one of the most profound and far-reaching concepts within science, it is amazing that it has been just ignored by economists and politicians alike.

The **"uncertainty principle"** confines us to a large extent by specifying definitive theoretical limitations to our ability to make even scientific measurements. If the fundamental laws of physics prevents any scientist even under perfect ideal conditions, from obtaining accurate knowledge of the key system under investigation, consequently, it becomes obvious that the system that he is attempting to investigate cannot completely be predicted. Heisenberg thus established that pursuant to the **"uncertainty principle"** no improvements will ever overcome this core problem.

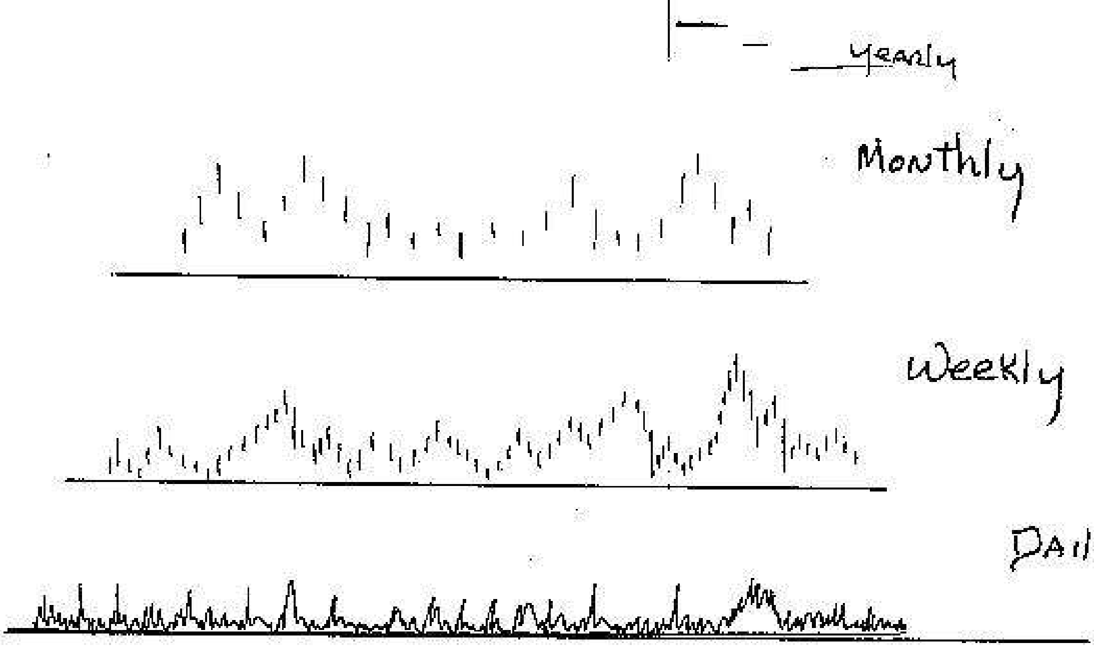
This **"uncertainty principle"** makes it clear that within the very nature of all things, we are limited to a statistical type of prediction. This means we may be able to predict that say out of 10 trillion atoms of radium, there will be 1 billion that will emit gamma rays within 24 hours. However, we are unable to predict whether any indivudual radium atom will emit a gamma ray!.

This is a profound realization that is applied within the complex global economy. We can predict a economic decline will take place even at a particular time, but since there are billions of individuals (atoms) the best we can do is predict the overall trend while the individual retains the free will to react or not (emit a gamma ray).

Einstein himself when he realized the significance of this limitation, commented "I cannot believe that God plays dice with the universe." That is an example of the sheer complexity that we face also in the field of economics.

If we consider that everything that in fact moves, every market, every sector both within commerce and industry running parallel to the productive forces, combine within each region, state, nation and geographical area, which is then combined with the forces of nature both earthly (volcanic/earth quakes) as well as weather, we can end up with such a vast overwhelming array of complexity that one begins to see Heisenberg's "uncertainty principle."

When chaos theory began to emerge, it was noticed that the slightest variance in a event could ripple through and create a major different trend at the end result. This was first expressed that if a butterfly flaps its wings at the right moment, it can have a subtle cascade effect that alters the weather patterns. While perhaps a long-shot, what we are dealing with economically is the same observation that was made by Heisenberg.



The assumption that everyone has made ever since Marx, with the sole exception of **Friedman**, has been that we even have the raw power to manipulate the economy. What if that very idea is dead wrong? What if the complex nature is indeed too vast? We may end up just importing one spieces to solve one problem as they did in Australia, that ends up killing off native species disrupting the entire ecology.

Man has learned he cannot transport one animal to a region to solve an isolated problem. The eco-system is far too complex and we will destroy our environment by such a careless behaviour. Why do we have such a high degree of arrogance that we can do as we like to the economy?

The answer to this question is that the observer alters the system by his very presence. Stranglely enough. the new Progressive-Democratic-Marxists have their own self-interest and no matter what we say, they will not listen. The Invisible Hand is hard at work, for it does not preclude suicide. What we are about to witness is the destruction of our economy under the pretense of trying to fix it.

Don't get me wrong. The Republicans are no better. Their idea of "Free Markets" is to hand out contract to their friends and let Gold Sachs run the finances. The $700 billion bailout orchestrated by Paulson trying to slip in a get-out-of-jail-free card for his Investment Banker friends, was a national disgrace of utter corruption. And as for the **neoconservatives**, they want to dominate the world just like Putin. That is their self-interest - raw power.

All we can do is mitigate the decline, we cannot cure it. We have to stop this plain insanity and try to make that next step in the evolution of economics. STop the same old bullshit about creating Utopia. It does not exist and More used it as a pun meaning "no place."

We are in the middle of no place, with nowhere to go. We are still caught in this battle of words and self-interest that can only lead to war, bankruptcy, and sheer disaster.

Socialism ceases to work once you run out of other people's money. To whom will we sell bonds to to keep fund trillion dollar deficits? The game will come to an end just as Bretton Woods came to an end because the politicians are plain stupid. If you fix the gold at $35 per ounce but allow the supply of dollars to expand without limit, don't you think someday you will not have enough gold at $35 to back the unlimited supply that you create? Come on. Can we really be that stupid again?

Long-term trends are easy to see. At the sub-atomic level, we find that the degrees of movement are greater than the mass of the objects making it impossible to predict where they will appear. Moving up in scale, we find that the same degrees in movement become just insignificant when the object is thousands of times greater in size.

We cannot predict with certainty the close of the Dow every day. That does not mean we cannot predict the broader trends and when they will change. We are on the verge of a major change in trend economically. Watch gold, for it will explode with uncertainty.

The New Practical "Laws" of Global Economics

Why Taxes are the only tool remaining!

by Martin A. Armstrong
former Chairman of Princeton Economics Int'l, Ltd.

One of the highlights of my early career was Milton Friedman attending one of my lectures. At first I was surprised that such a great mind would take the time to come listen to what I had to say. I was not an academic. I was a global analyst and fixer-upper. But then I remembered that back in 1953, Milton had argued for a floating exchange rate system rather than a fixed exchange rate system designed at Bretton Woods during 1944. Milton had seen the free market forces adding the checks and balance to keep governments in line. As our conversation progressed, I realized I was doing what Milton had proposed and I was in the front lines. Indeed, in 1997, I testified before the House Ways & Means Committee on global taxation at the request of then Chairman Bill Archer. When you testify before Congress, they group you into panels with like persons. I was placed on a panel with other economists who were pure academics. Bill apologized for the grouping because there was just no one quite in my field. I was not theory, but practice.

I never met John Maynard Keynes. Nevertheless, as the hands-on-guy who just did not fit into that ivory tower model, I had to deal with real-world effects of the floating exchange rate system that was born in 1971 through a mere trade dispute unlike Bretton Woods. I became a globe-trotter rushing around from one crisis to another. I would meet with central bankers and even lectured before them in meetings such as in Paris or in Toronto, and was asked to fly to Beijing in 1997 to meet with the Central Bank of China during the Asian Currency Crisis. So what I had to offer was a front row seat that few ever achieved. Milton helped me appreciate the unique position I ended up in - the Bird's Eye view of the world.

There was a fierce battle between the theories of Keynes and Friedman. In effect, Keynes had advocated that government could steer the economy through the economic turmoil by manipulating interest rates and taxes whereas Friedman argued government could never steer the car and at best the key resided in the quantity of money. This battle raged between the 1950s through the 1970s. Milton was joined by Karl Brunner and Allan Meltzer, who became known as the "monetarists" that were at first treated with disdain. But the core of the monetarists theory was deeply rooted in the theories of John Locke (1632-1704), David Hume (1711-1776), John Stuart Mill (1806-1873), and David Ricardo (1772-1823). Eventually, during the Carter Administration of the late 1970s, Congress ordered the Federal Reserve to take the monetarist arguments seriously.

I did not set out with a burning desire to be an academic. Nor did I seek a journey to change the laws of economics. I was an analyst seeking only practical answers to be able to cope with the world and understand investment. Before fax machines, the analysis I produced was delivered by Western Union via telex and in the early 1980s, sending just one telex on one market cost $50 to the middle east. Every day, each market was covered in the financial group including precious metals, stock indexes, and all major currencies. The cost to take all the subscriptions could exceed $200,000 just in telex fees that adjusted for inflation in 2006 dollars would be $1.6 - $2 million. So the audience just happened to be the major institutions and government around the world. By sheer chance, what emerged was a incredible opportunity to see like Adam Smith the real movers and shakers. Finally, in 1985, I decided to open our first office outside of the United States in London. The reasoning was that if I could send just one telex to London and then allow them to redistribute from that point, the costs would decline and we could expand our client base into the lessor middle class of corporations. I met with the head of a major Swiss bank in Geneva. We had become friends and I trusted his advice. I asked him what name to use. I was assuming something European. He asked me to name one European analyst. I was embarrassed. I could not. He said that was his point. He said everyone turned to me because I was American, and Americans could care less if their currency rose or fell. But Europeans were trapped in their analysis by their patriotism. The British were always bullish the pound; the German the mark, and the French the franc.

The fundamental problems with economic theories is just that. They are theories. I did not seek to establish any new theory no less create "laws" that are fixed and unyielding. But we sometimes travel down a road and get hungry. We search for a place to eat and on that rare occasion, we stumble upon a new discovery - a great restaurant that brings a smile to our face upon remembering.

The economy is like a child, it grows and matures. We may expect one child to end up in one profession, only to discover they explore an entirely different path. The problem with economists is they have perhaps not seen what I have seen, such as the vast pool of funds that runs around the world altering the course of nations and destroying the best plans of men and politicians.

Why do we need the "New Practical 'Laws' of Global Economics" today more than ever? The reason is we are flying in a jet but are still acting as if we have a prop-plane. Many of the pilots could not make the transition to a jet because they were unable to respond quickly to consider the dramatic increase in speed. We have the same problem in managing the economy.

The theories that prevail today bounce back and forth between Keynes and Friedman with a little Marx thrown in for flavor. Do we increase money supply, lower interest rates and taxes, or just regulate everything that moves and pretend we are not taking the toys away from the kids as Marx advocated? Do we ignore the Invisible Hand of Smith to the point that we are blind to the self-interest of Government that cannot sleep at night unless it feels in complete control of our lives?

When gold was money, the capital flowed between nations only because there was, as David Ricardo explained , a comparative advantage. This was the key to international trade - their desire to purchase something one could not obtain locally or was at a significant lessor price allowing for "arbitrage" that gave birth to insurance to cover the risk of long voyages. This "arbitrage" still exists today just in the form of electronic trading on a global scale. We need a new understanding of capital and how it moves because we're not in Oz anymore Dorothy!

Most theories in economics are not practical because they are based upon assumptions that are not real. The same problem has wiped out the Investment Bankers because (1) they create models by young students who do not understand market dynamics, and (2) they assume there is always a market and fail to map those pesty periods when the model would fail such as the Great Depression. This is akin to making the assumption that we will live forever. It is the old difference between the optimist and the pessimist who both are blown off the top of the Empire State Building. The Pessimist says immediately - "Oh my God I am going to die!" The optimist can be heard while passing the 4th floor - "Well so far so good!"

LAW #1 - Capital Moves To Avoid Danger Globally

This law would seem to be self-evident. We have all heard of the "flight to quality" where in a domestic economic decline, capital flees stocks and private assets moving to the best quality that may be Government short-term paper.

However, capital reacts the same way globally and those reasons are not always apparent domestically.

(1) capital will flee a war or threat of war. During World War I and II, the capital flowed to the United States. By the end of World War II, the United States had 76% of the world gold reserves. During the Suez Canal crisis, the dollar rose on capital fleeing Europe as they once again perceived a risk, although it was very brief. Yet during the Cuba Missile Crisis, capital fled the opposite to Europe. The same was true for capital began to flee in advance of various middle east wars.

(2) capital takes flight when it fears unstable economic conditions that can be caused by inflation, taxation, nationalization, geopolitical, or negative perceptions in politics and the economy altering confidence.

EXAMPLE:

The Great Depression was made far worse by politicians who did not understand global capital flows to quality. In Herbert Hoover's Memoirs, he has all of the documentation that revealed World War II began with the financial markets in the 1930s that led to nations attacking their bond markets that led to the wholesale collapse of European debt. Even Britain went into a moratorium on its debt suspending all payments. These defaults sent capital fleeing to the United States causing the dollar to rise and interest rates to fall irrespective of Fed policy. Politicans only viewed the rise in the dollar and responded with protectionism - Smoot-Hawley in June 1930 destroying international trade and sending the economy back into a feudal state of economic dark ages. Had there been the understanding of the "flight to quality" that can emerge for a host of international reasons that swamp the domestic conditions, perhaps there may have been some hope.

The 1987 Crash was caused by the formation of the G-5 in 1985 and the persistent talk about lowering the value of the dollar by 40% to reduce the trade deficit. The Japanese, who had bought up to 33% or so of the national debt and loads of real estate like Rockefeller Plaza in New York, were being told indirectly that whatever investments they made were going to be devalued by 40%. The 1987 crash took place with everyone befuddled because there was no change in the domestic fundamental conditions of the economy or corporate earnings. The flight of capital by the Japanese caused by the G-5, led to the capital concentration in Japan with foreign investors looking at a rising yen & assets creating the 1989 high.

Another example is a mind twister. Between 1980 and 1985 I was giving lectures throughout Europe. The number one question I was asked; What was my opinion of the United States adopting a two-tier currency system? I understood the question only because I studied money globally and had also clients from South Africa when there was the Rand and the "Financial Rand." One currency is used domestically, but it cannot be used for any purchase of goods & services outside the country. The rand would need to be converted to the "Financial Rand" that was allowed to be used externally creating the two-tier system. The Euro-Dollar market had hit $1 trillion nearly in 1980 as did the US national debt. Europeans were convinced the way to escape the debt was for the US to create a two-tier currency. This led them to move their Euro-Dollar deposits into onshore domestic dollar deposits. They had assumed that the Euro-dollars would be new "blue" dollars worth less than the domestic "green" dollars. The more convinced the risk was perceived, the more capital flowed. The Euro-Dollar deposits declined sharply and this drove the dollar to record highs in 1985. The more bearish Europeans became, the more bullish the dollar trend. This was amazing to see. Government misunderstood creating the G-5 in 1985 announcing they wanted to see the dollar decline by 40%. The Japanese began to sell US investments taking capital back causing the yen to rise attracting others creating a bubble top.

Law #2 - Capital Moves Globally For Comparative Advantages in Currency

The traditional Ricardo model of comparative advantage was built upon a world when gold was money. We must realize that prior to 1971 with only brief exceptions, the capital flowed only because of a comparative advantage reflected in investment rates of return, to gain goods that were not available in the domestic economy, or for arbitrage insofar as the same produce available in one nation was cheaper when compared to domestic prices, then trade internationally would take place exploiting those differentials that was an early form of global arbitrage.

However, we are no longer in a world of a gold standard where money is the same relative internationally. Gold might buy more goods in one nation than another, but it is the differential in the price of goods relative to the same amount of gold that fluctuates due to other external factors - labor & transportation costs. Today, a floating exchange rate system has altered that time honored tradition and this affects every economic theory rendering them irrelevant.

(1) capital may now move according to the old principles of trade and seek an arbitrage to purchase the same goods cheaper in another land that has a comparative advantage such as lower labor costs, little or no tax rates, or on some occasions deliberate pricing below cost to gain market share (rare event).

(2) capital may also move solely because of currency fluctuations, or differentials in interest rates such as the capital outflows from Japan to gain the higher rates of interest in dollars, where no such comparative advantage exists solely due to trade, but the capital flows due to currency may in fact alter the trade balance.

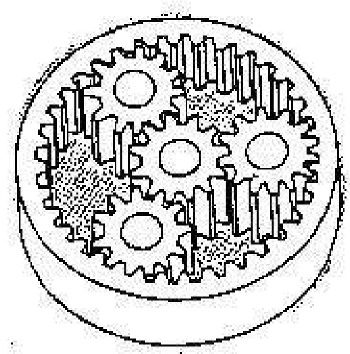
Where under our first Law capital flows to avoid global risk, here we find in the calm of the storm, capital will flow purely according to the arbitrage it sees in values. This is what Milton Friedman advocated back in 1953. He saw that this natural flow would place a check and balance upon governments. In reality, this is the manner in which capital also votes relative to the politics of a nation. We are no longer in Oz. Capital will flow not because of solely the comparative advantage in trade, but in the value of money itself. They can at times both be arbitrage.

The New Practical "Laws" of Global Economics

There are other "Laws" that now exist also within our new Global Economy. However, let us stick to these first two Laws for they alone alter every theory in economics to date. The "practical" side of these two realizations is that the entire field of economics changes much like what Galileo did to dogma. If the planets revolve around the sun rather than the sun around the planet, then where is up and where is down? Translate this into heaven and hell, and you can see why he was imprisoned for life.

Suddenly, how we manage our economy is no longer autonomous. The theory of chaos you might recall was explained that the flap of the wings of a butterfly in Asia could set in motion changes to the winds in the Americas. Although extreme, the principle remains the same - kind of like a sci-fi movie - "We are not alone!" Indeed, the actions of one will have an impact upon all others. We cannot escape the consequences of our own actions. It is just impossible.

In my globe-trotting running between nations and getting to see first hand what was taking place, my eyes opened like never before. This is what Milton perhaps saw in me before I myself realized the full scope of what I had fallen into. They did not teach global capital flows in school. They did not even teach hedging and floating exchange rates. This was a field that just emerged more akin to being an apprentice. But what I observed globally was the grand Invisible Hand of Adam Smith (1723-1790), yet on an international level. The image in my mind was each nation formed a gear in one giant machine we call the economy of nations. Turn one, and there will be an effect in all others. We are all connected.



How do we create a practical theory? Karl Marx (1818-1883) saw the collapse in capitalism as a class struggle between labor and employer assuming the later would exploit labor to the point they could no longer consume. He ignored Smith and paid no mind to money supply and the boom bust economic cycle. He destroyed (1) personal liberty placing it in the hands of government for the greater-good, and (2) ignored the self-interest of the state to also expand its personal power. It was Ivan IV (1533-84) "the Terrible" who seized land of his enemies and gave it to his supporters yet realized if the workers left, the land became worthless. He enacted a law that the workers (serfs) could not leave laying the seeds for the Russian revolution in 1917. Clearly, other rulers saw the problem, but did nothing to correct it. Alexander I (1777-1825) came to power in 1801 and spoke about reform, but then Napoleon invaded putting an end to that possibility. So Marx was wrong. It was not limited to employers, but could also be the state that in fact exploited the people. Handing all the assets to the state and destroying the liberty of individuals, was not the answer. To fix what is wrong, requires a clear working knowledge of what we are trying to fix. Bad theories and assumptions have led to the deaths of millions. We need "practical" economics - not theories.

In Times Like The Present
Should we Follow Keynes or Friedman?
Or Do We Need a New Theory Altogether?

Understanding Keynes and Friedman may mean the difference between survival or economic destruction that leads always to war. The Monetarists accused Keynes of ignoring money. This is truly a critical point that must be understood. By advocating two tools interest rates and taxes, Keynes is approaching the economy indirectly. In other words, to stop some behavior the government does not like in you, it is directly attacking your wife in hopes she will cause a change in your behavior. Japan was in a very bad economic depression. It lowered interest rates to a tenth-of-one percent (0.1%), it was virtually zero. All this did was cause capital to seek interest rate profits elsewhere and did nothing to relieve the economic downturn in Japan. The final low may come in 2009 after the 1989 high. Waiting for a possible low 20 years later, is not acceptable fiscal policy. Economic declines can be very prolonged. From the 1873 Panic in the United States, the economic decline lasted overall until 1896 - 23 years later. That is a waste of generally 1/3rd of everyone's lifetime.

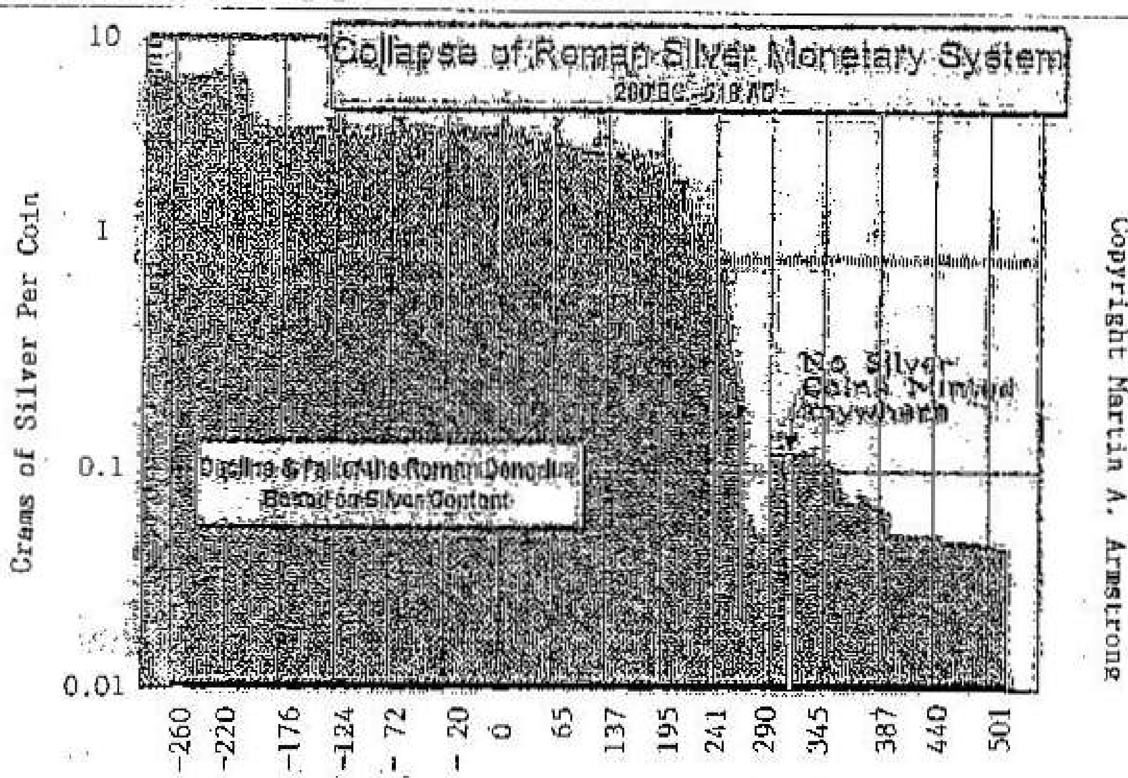
The Monetarists' approach is to increase the money supply, not use indirect means that hope will change events. If we simply gave everyone $1,000, there is no guarantee that they would spend it. If their confidence is still distrusting, they may just pocket the money waiting for a rainy day. This would not increase the money supply for that we measure truly in terms of velocity. If we collectively add up the economy in what we call the Gross Domestic Product ("GDP"), and we divide that by the money supply, we achieve what is known as the turnover rate (Velocity). If the money supply divided into GDP creates a velocity rate of 6:1, this means the "float" or holding period before spending is about 2 months. If we increase that rate to 12:1 the time period drops to 1 month. We define M1 money supply as:

(1) the amount of currency held outside banks
(2) the checking accounts at commercial banks (demand deposits)

This is a very narrow view of money. It does not include stocks, bonds, and real estate - three major areas where capital can reside and is considered to be "wealth" by every rational person. Where problems also enter is the assumption of a perfect-world. If the velocity is constant, then if the central bank can truly manipulate the money supply (velocity), they would have a direct tool that is far better than interest rates and taxes. However, if the velocity can fluctuate widely according to the "confidence" of the people, then manipulating the money supply would also be reduced to an indirect tool. Here is where the forces of Keynes and Friedman clash. Keynes argues that the velocity is unstable, whereas Friedman would take the opposite position.

The debate about money may be the third oldest profession. Prior to about 600 BC, money traded in clumps of silver and gold and in some areas of Italy it took the form of cattle and later bronze. Every time there was a transaction, the metal had to be tested and weighted. King Croesus of Lydia (ca 560-546 BC)(Turkey) came up with the idea that he would pre-test and pre-weigh gold creating the first coinage. Other kings quickly caught on and it became a sweeping new trend of a show of power and wealth. Economically speaking, it was a step toward making commerce efficient and thus increased progress and the velocity of money. Trade expanded and the age of empire building followed shortly thereafter. It was Money in the form of a standard unit of exchange that furthered international trade. The reference to Jesus overthrowing the tables at the Temple states they were the tables of the "money changers" John 2:15, who were the ancient foreign exchange dealers.

The invention of money brought with it the natural consequence of the inevitable counterfeiting. However, counterfeiting has never resulted in widespread inflation even when used for the military purpose of undermining the currency of one's opponent used by England against the American colonies during the Revolution as well as during WW II. The single greatest threat to the money supply has always come from the issuing government itself.



The above chart illustrates the metal content of the Roman Monetary System. It was the steady debasement of the silver content of the Roman Denarius that finally led to an all out collapse during the Third Century AD. For centuries, governments have sought to expand their money supply by debasing the currency. In other words, reducing the content of precious metals to enable the same amount of gold and silver to create more coinage. The economic advisor to Queen Elizabeth I correctly observed the response to such practices among the population. It was one of the earliest Economic Laws established - Bad money drives good money out of circulation - Sir Thomas Gresham (1519-1579 AD). The economic hardships that Elizabeth faced during her reign between 1533 and 1603 including the defeat of the Spanish Armada, put great economic pressure that was seen in the debasement of coinage. Indeed, Gresham's Law proved to be correct during the 1960s when silver was taken out of modern coinage being replaced with nickel and copper. The silver coins quickly disappeared and were worth a premium to the "bad" money that entered the world economies.

The notion about watching the money has been around for a long time - far longer than Keynesian theory. The famous economist of the Great Depression era Irving Fisher (1867-1947) derived a formula in 1911 inspired by John Stuart Mill's analysis creating the "quantity theory" of money being MV = PQ. The "V" is the velocity of "M" money supply where the "PQ" represents GDP ("P" being the price level, and "Q" being the quantity of goods & services produced). This equation can be reduced to explain the Monetarist theory in its most simplistic form, that a manipulation of "M" (money supply) will create a direct effect in "P" (prices) that we instinctively view as "inflation" defined as (too much money chasing too few goods). Historically, it was always the supply of money and its quality that had the impact upon the economy of mankind.

.. The Monetarists maintain that an increase in government spending will not directly affect prices unless the money supply also changes!. This is a very critcal point to keep in mind. People generally assume that a deficit in spending will be directly inflationary. We must realize that the gold standard is dead. What we even define as "money" within M1 effects our entire concept of how to manage the economy as a whole. If bonds are not part of the money supply nor stocks, then neither would derivatives on such products. These ideas are obviously wrong in the face of our current crisis. Under M1, derivatives do not exist.

We do not live in a purely Keynesian world. The Federal Reserve does in fact seek to manipulate the money supply as part of its tools. First, there is the discount rate where it lends money to the banks that in turn lend money into the economy in normal conditions when not covering losses in a crisis. If the Fed raises or lowers the rate of interest, it will in theory affect the lending of the banks by reducing their borrowings by raising rates higher. But if the debt crisis is causing a collapse, then people will pay higher rates to stay afloat. Therefore, we must be cautious about making too many assumptions based upon the perfect world. This can directly increase or decrease the money supply through the lending to banks, but it is not a limitation upon the borrowing that is being employed as the tool, it is the indirect effort to affect demand by interest rates.

Second, the money supply is more directly manipulated by the buying and selling of Government bonds. The Fed can increase the money supply as defined by M1 through buying Government bonds from the public injecting therefore cash. It can reduce money supply by selling Government bonds into the market taking in excess cash.

These assumptions are what were taught in school, but guess what? They are wrong! This entire model is based upon the assumption of a gold standard and a relatively closed economy. Let us say that the Fed desires to stimulate the economy so it increases the money supply in theory by buying Government bonds. This would work assuming the seller to the Fed is a local resident. If China decided to sell US bonds it holds because it suddenly needs cash, the Fed purchase will not then stimulate the domestic economy at all for the money injected into the system is headed to China. Hence, an increase in money supply is not always inflationary!

Our definition of money is far too narrow in a Floating Exchange Rate System. If we look at a piece of real estate that changes hands for $1 billion and one American sells it to another, the net effect in the money supply is zero. However, if Japan enters and buys that same piece of real estate, they bring yen, convert it to dollars, and now one American has $1 billion in his pocket that did not exist previously! Milton may not have witnessed what I have seen first hand, but he saw that the possibility existed where changes in the supply of money did not effect merely prices in the inflationary model, but economic activity. That has come back to haunt us in a Floating Exchange Rate System that goes far beyond what Milton envisioned back in 1953.

The Monetarists assumed that velocity was stable and thus an increase in money supply would result in greater spending of the extra cash on goods and services causing GDP to rise. The Fed could slow the growth rate by selling bonds taking cash out of the system. But these assumptions are not real, for the velocity can and will change depending upon "confidence" and in a Floating Exchange Rate System the Fed cannot directly be sure it is putting money into or taking out of the system when there are foreign holders of debt. The model begins to decompose under our new dynamic global economic system.

Keynes disagreed with the Monetarist's view that money supply was the key. Keynes actually began with a focus upon money supply and evolved into the policy theory of interest rates and tax manipulation, whereby Milton began with the Keynesian model and reverted back to study money supply concluding that Keynes would create massive new spending that would only lead to inflation. Was he correct?

Keynes bought into the money supply model after viewing the hyper inflation of the German Weimar Republic between 1921 and 1924. Keynes viewed in his Tract on Monetary Reform that it was the increase in the quantity of money that caused the population to spend money faster that in turn led to escalating price adanvances. However, Keynes flipped positions after the Great Depression in his General Theory he believed it was a collapse in demand rather than money supply, that led him to his tools of interest rates and taxes. Keynes saw no reason why the velocity of money would remain stable. Keynes was not sure that a mere increase in money supply would translate into more spending of excess cash. He recognized that an increase in money supply may not produce an increase in velocity for people could stuff it in their mattresses, and thus the decline in velocity would negate the increase in money supply. Keynes also argued that others may hoard cash to also speculate in stocks or bonds. Keynes thus saw that interest rates could effect the speculative demand and in his mind had a more direct effect than money supply concluding that a increase in money supply might be offset by a increase in hoarding. Keynes thus took the anti-Monetarist position in a letter advising President Franklin D. Roosevelt:

> "Some people seem to infer ... that output and income can be raised by increasing the quantity of money. But this is like trying to get fat by buying a larger belt. In the United States today your belt is plenty big enough for your belly."

The Collected Writings of John Maynard Keynes (Vol XXI, p294)
London: Macmillan/St. Martin's Press for the Royal Economic Society 1973

Roosevelt took the money approach by (1) confiscating all gold, and (2) he then devalued the dollar offically increasing the supply of money relative to gold by revising the system from $20 for an ounce of gold to $35. This did not have the widespread effect that he perhaps secretly believed. Roosevelt also made it illegal for Americans to own gold. That was not overruled until 1975. It was presumed that if the public could still hoard gold, they would do so, and defeat the best efforts to inflate. There was something lurking in the bushes that was also the silver lining in the dark clouds of the Great Depression. It was nature and her 7 year drought of Biblical proportions as in the story of Joeseph. The Great Depression forced a new age of progress by necessity - the new age of skilled labor fulfilling the culmination of the Industrial Revolution.

Keynes thus viewed the world entirely differently. Keynes saw that the economic forces of production were motivated through interest rates and investment rather than consumption. Keynes was perhaps too deeply involved in his personal world of investment to see the other side of the street. Keynes believed that to get GDP to rise, interest rates had to be lowered that would stimulate borrowing from banks to buy the goods and services. Thus, he saw the Great Depression as a collapse in this demand.

Keynesian economics has been proven to be false just looking at the decline in Japan. The interest rates that fell to nearly zero did nothing to restart demand and because of the Floating Exchange Rate System, there was an escape value - the ability to borrow yen for next to nothing and invest it overseas earning 600% more and that would have no effect upon stimulating domestic demand. By the 1950s, Milton had moved away from Keynesian ideas he harbored in the 1940s viewing that ignoring the money supply was a serious error.

Milton broadened his view to support the idea that the demand for money and velocity was stable by turning to the long-term factors of education, health and income of the family or individual over decades - the saving for retirement approach. Milton also attacked Keynesian ideas that consumption rose and fell along with the short-term income. Milton argued that people took a longer-term view to their life and finances. Milton was correct, for there would be no market for Life Insurance if the view of the individual or family was extremely short-term. Milton then also viewed that consumption would be also stable for the long-term expectations of the family or individual.

If we look at the events of the Great Depression, it is hard to see how Keynesian economics would have really worked. Interest rates collapsed for three primary reasons with no economic effect; (1) the Fed did lower rates, (2) there was a flight to quality forcing short-term rates to near zero as we have seen recently, and (3) there was capital flight from Europe during the early stages due to the widespread defaults of European government debt that also impacted domestic policy forcing interest rates lower even if the Fed did not want to see such a decline. The Fed could not lower interest rates to stimulate the economy. That will only help during bull markets where there is "confidence" to invest for a profit in any event. Lowering taxes did not really matter because there was no payroll tax until after World War II and the rich were losing money profusely. I find it hard after just reading the memiors of Herbert Hoover and the serious documentation available to prove to me that Keynes would have helped. The massive runs on banks took place on rumors that FDR was going to confiscate gold. He denied that as absurd the night of the election. But the rumor persisted and led to massive bank runs. Hoover could not stop it for it was not a "credit" crisis as much as it was a sheer flight to quality. The majority of banks failed after the election of FDR and his inauguration. Hoover wrote letters to FDR pleading with him to reassure the people he had no such plan. But FDR remained silent. Had the Fed provided cash loans to the banks, it would have been fruitless.

Milton viewed the Great Depression from a money perspective. He was correct, the fears and uncertainty of the times led to hoarding of gold. This no doubt contributed to what Milton saw as a collapse of one-third of the money supply during the Great Depression. It is hard to imagine promising to lower taxes and interest rates would have much impact when the world seems to be ending.

I believe it was Abe Lincoln who argued that you can fool some of the people some of the time, but you cannot fool all of the people all of the time. This is clearly a lesson politicians need to learn. The people do look to the future and will spend more of their income if they "feel" that their home is rising in value. When housing prices decline, savings rise, because people do in fact respond to their longer-term expectations. This brings us to the question of tax cuts and do they even work? In 1964, a tax cut was made and this was viewed as a permanent cut in payroll taxes. The economy exploded and there was the great boom in mutual funds that led to wild speculation with the high in 1966. By the time we see the collapse, there was fear about inflation due to the spending for the Vietnam War. In 1968 Congress passed what it marketed as a temporary tax surcharge to stop inflation. True, consumers spent less, but they drew down savings to maintain their consumption. In 1975, there was then a temporary tax rebate to stimulate the economy going into the steep decline for 1976. None of these changes in temporary taxes did anything significant. Where the 1964 payroll tax cut took place and was perceived as permanent, there we find a surge of investment planning for the long-term as Friedman expected.

The empirical evidence suggests that one-time rebates will not stimulate the economy because the people are quite frankly - not stupid! The only historical evidence of a tax cut stimulating the economy is a permanent change not one-offs!

We are not concerned with the absurd arguments that the average person does not weigh the budget deficit when he is buying eggs. These sorts of criticisms malign the intuitive nature of the people as a whole. For example, when Paul Volker raised interest rates to unheard of levels to fight inflation in the early 1980s, my mother and her sister ran out and bought CDs for 10 years at banks with interest rates of about 15 percent. She did not ask me any advice. She instinctively knew this was a deal of a lifetime. For the next decade, they made a fortune. Did they weigh inflation relative to the interest rate? Perhaps. But they clearly did not see inflation as rising faster than the rate of interest or they would have hesitated as was the case during the German Hyperinflation. Did they have a model? No! Did they make some instinctive decision based upon personal observation without empirical data? Absolutely. Sorry, trying to impute knowledge that must be somehow quantitative on a professional level to the general public, makes no sense. Sometimes we forget, that if enough little old ladies run out and shift their demand deposits to long-term fixed rates, they do cause a contraction in M1 as we calculate our world.

Milton was correct. Keynesian models promote inflation with no objective. They are indirect and may assume that an increase in government spending will be inflationary, but this is just not always true, if there are external factors that are offsetting the spending such as a capital withdrawal from outside the domestic economy. The assumption that even within a closed economy that an increase in spending will create economic growth of a tangible nature is also false - just look at the German Hyperinflation. We saw the period of the 1878 start of inflation deliberately created and targeted to increase the money supply by overvaluing silver relative to gold, failed to produce the expected result for gold was being drained by foreign investors replacing it with silver until the entire experiment led to J.P Morgan having to bailout the nation lending the US Treasury gold. The deliberate creation of money that was cheaper than the world standard, led not to economic growth, but economic decline in a similar fashion to the German Hyperinflation of the 1920s, but to a much less extent.

Law #3 (Gresham's Law) BAD Money Drives Out Good

While Gresham's Law was based upon a Gold Standard and that by debasing the precious metal content causes the hoarding of higher content coinage, in a floating exchange rate system, it still works by driving real wealth out of a nation fleeing to another currency by creating excess currency.

Law #4 Only Permanent Reductions in Taxes Produce Economic Stimulation

The average person may not understand fancy statistics, but they will also not be induced by false statistics. The average person reacts according to their own personal view of the economy, which is why one-off tax reductions will not have an economic impact but will be hoarded for the rainy day unless the average person "sees" and "expects" economic changes.

Interest Rates - Taxes - Money Supply So is that the Best We have Got?

As much as I respect Milton Friedman, I must be honest. There are no plain assumptions that we can tolerate. We cannot assume that velocity will remain a constant because people will hoard and fear spending in times of economic decline. Likewise, let us not kid ourselves that raising and lowering interest rates will have any meaningful effect upon the economy or the behavior of its participants.

Setting aside the accolades, the government could not help but lower interest rates during an economic decline. Capital will flee to government debt as long as it perceives the risk to be in the private sector. Hence, capital will move to the government debt bidding higher in price forcing yields (interest rates) to decline. So Keynesian theory does not work. It is assuming government has some effect when it is not in the driver seat. If it keeps interest rates so artificially high, private economic commerce will collapse and government expenditures would rise sharply due solely to interest rates causing both the money supply and economy to collapse. Lowering interest rates below world levels as did Japan in the 1990s, fuels capital flight to higher yields preventing domestic increases in money supply defeating any intended stimulation package.

Likewise, if money supply is just increased assuming it matters not how it is increased or spent, this sort of untargeted wholesale spending will promote inflation causing capital flight to other lands. Currently, there are proposals to spend money on infrastructure. This is a throw back to Roosevelt and the WPA. But this demonstrates how a little-bit of knowledge can be dangerous. The WPA worked because unemployment rose to 25% during the Great Depression when we were still 40% agrarian when there was a 7 year drought known as the Dust Bowl. Government was still quite small. The federal reserve was created only in 1913 and there was the Interstate Commerce Commission. There was no payroll tax and no social security. Today, the growth in government state and federal has become nearly that 40% level. More government programs may kill the entire goose bringing back the good-old days and the complaints against Constantine the Great (306-337AD) that there were more people collecting taxes than paying them. For unemployment today to reach 25%, it would require a collapse in governments throughout the states and municipalities. This becomes possible because we have the federal income tax competing for revenue against the state and local entities causing the tax base to collapse.

In our modern-day economy, the king has no clothes, but no one will tell him. Money is created by velocity. This is agreed upon by all persons. The leverage in the banks they created with their unregulated derivatives markets between themselves is at least 30:1. Our definition of money is far too narrow today. It cannot be limited to demand deposits and cash. It must include bonds, stocks, and all such financial instruments from money-market funds to derivatives. If we stop ignoring reality, just maybe we can figure out the rules. If derivatives are not money, then what were we so stressed about bailing out bankers? It is not real! Right? Poof! It's not there as a magic trick. We have to stop defining money so narrowly if we rush to bailout housing, banks, and manufacture but none of that we consider money. So how do we fix what we do not even define properly?

Once we accept reality and ask the average person if his house is part of his assets he considers wealth, then we will realize that the true picture of money is what people believe it to be - not what economists claim. This is why we are bailing out ~~the~~ mortgage-derivative crisis, because it is money. Hence, if the electronic money created by the private sector through velocity includes the 30:1 leverage, we can see that increasing the money supply to compensate for the decline in the velocity that was effected by the 30:1 leverage, brings into focus the problem of money supply. There is no way to increase the government spending by 30 times to offset the decline in velocity. Even if we look at a 10 fold increase, it is still far beyond what could be absorbed. This type of an increase in money supply would be hyperinlationary to say the least. It would be wide spread that everyone would be influenced and capital would then run to tangible assets and flee government debt forcing that also to go into default or just be monetized.

Because we are in a global economy, if the Fed buys bonds to inject capital into the economy, those bonds may be held by foreign investors who take the money home. If we lower interest rates so far, capital will flee to other lands to get the higher yield as what took place in Japan. We live in a whole new world.

The Last Tool Standing

Obviously, we cannot just create vast amounts of cash and just spend it wildly without creating a wave of inflation that would cause real capital and wealth to flee to other lands. We cannot artificially raise or lower interest rates against the natural trend without either causing a competing force that attracts capital or fuels the asset inflation. Nor can we drop interest rates or raise them arbitrary to world levels without causing capital to flee for higher yields or foreign capital to arrive taking interest earnings home draining domestic resources. Interest rates & money supply are subject to global trends.

This is why we have the New Practical "Laws" of Global Economics. We are not alone and whatever we do with money supply or interest rates can attrack or repell both domestic and foreign capital. We cannot continue under false assumptions. We must face reality. Why did Milton come listen to me? Because where we may have disagreed on the presumption that the velocity of money was stable, we agreed on one point that stands behind these "Laws" of economics. Milton saw that a floating exchange rate system back in 1953 would act as a check and balance upon the governments of the world. Many criticized Milton and thought he was nuts. But he was correct. He saw in theory in 1953 what I have witnessed in practice. This is were theory and observation have met. Whatever we do, we will effect the world just as the world will effect what we do. This is perhaps implicit in the "contagion" that people see as the debt crisis spread around the globe like the latest strain of flu.

The money supply and interest rates are truly created not by the man sitting behind the curtain in Oz. They are created by the interaction of the people and how they respond to both private and public events that impact their long-term and short-term financial expectations. This is the essence of the "flight to quality" dictated by the Invisible Hand of Adam Smith, who wrote "it is not from the benevolence of the butcher ... that we expect our diner, but from [his] regard to [his] own interest." Wealth of Nations, Vol I, p26-27 (Oxford: Clarendon ed. 1976).

As already explained, both money supply and interest rates cannot be confined to purely domestic impact. We cannot count on the "benevolence" of foreign investors or states to simply buy our debt to stimulate our economy contrary to their own self-interests. We have to respect international capital flows or we will send our own economy back into the stone age. We cannot stimulate domestic issues exclusively by using purely interest rates or money supply theory by government spending.

The last domestic tool standing is taxes. Here too, we can raise taxes and send capital fleeing taking with it jobs. But we can lower taxes to create jobs domestically as well. Taxation is a barbaric relic of the past to increase the money supply of the state (king) like war. We are no longer on the Gold Standard so there is no need to tax or wage war for profit when money is electronic anyway. We must distinguish that state & local government need taxation because they lack the power to create it. They must learn to be competitive to attract jobs, but the Feds no longer need income taxes. Money can be created in a disciplined manner. Milton even suggested a negative tax rate that was an automatic payment to lower income that enabled a steady increase in money supply. The payroll tax merely borrows from the poorest interest free and then hands back a refund as if it were Christmas. The 1964 tax cut was a permanent cut and that sparked economic growth. One-off tax cuts in troubled times never worked because when confidence is low, people will save rather than spend for the future.

The only viable tool we have is the federal income tax. The only way to spark a economic boom and create jobs, is to eliminate it and make American labor competitive. The jobs would pour back just as Hong Kong grew because it had only a 15% tax rate that was lower than the rest of the world. There are those who would assume that if government printed the money it needed that that would be inflationary. This is a matter of definition. They forget that we issue trillions of dollars through our borrowing in the form of bonds. However, if bonds, stocks, real estate and derivatives are outside of our definition of money, then this 18th century thinking makes sense. Sorry. In the real world a bond is still money.

Between 1986 and 2006, the national debt rose from about $2.1 trillion to $8.5 trillion. This took place not in printing money, but in bonds. In fact, we were forced to issue more debt just to pay the interest on debt. The interest payments for this 20 year period was $6.141 trillion. Had we printed the deficit between taxation and spending (excluding interest), that would have amounted to only $259 billion a far cry from the bailouts. If we are already committing billions if not beyond 1 trillion for rescue, we cannot afford to borrow on top of this.

The very idea that we borrow money rather than print it is somehow less inflationary is absurd and a throw-back to the Gold Standard when nature controlled the quantity of money. Spain borrowed heavily on the gold it expected from America. When its treasure ships didn't show up and it lost the Spanish Armada against England, the default destroyed the bankers in Venice and relegated both Spain and Italy to almost third world status. The Spanish Inquisition merely caused the jews to flee to Holland transferring banking to Northern Europe. We cannot afford the same mistakes. Borrowing is a ancient tradition when there was no other choice.

The Gold Standard & Cronic Shortage of Money

They say history is biased - for it is written by the victor. But we can also remember things of days long since past with rose-colored glasses. Some see gold as almost a religion - the savior that will deliver us from the evil of inflation. That is just not true. The boom-bust cycle existed in ancient times as well and always we find no matter what system is in place, there is someone who always spends too much.

The Gold Standard was a world that was not so simplistic. In ancient times, it provided the incentive for war - the best way to increase money supply. In fact, one of the reasons there are so many ancient coins that have survived is there was the practice of burying the payroll before battle so that the other side was denied the spoils of war.

The Gold Standard also meant that the way to create more money was through reducing the metal content - debasing the quality of the metal. Those who were looking to be dishonest had two options - (1) counterfeiting, or (2) clipping. Take a coin out of your pocket and you will see reeding on the edges of an American dime or quarter for example. This was an old anti-clipping device that was to prevent those who would shave a little off of every coin collecting a pile of scrap metal. This gave rise to banks issuing notes to at first guarantee the payment in the proper amount of precious metals of good currency meaning unclipped coinage.

However, the greatest problem with the Gold Standard was the inability to create money other than war, altering contents, or changing the ratio of silver to gold as the Silver Democrats tried in the late 1800s. The money supply was in the hands of nature and thus was subject to boom and bust cycles based also upon the discovery of metal. The California Gold Rush of 1849 contributed to the economic boom that led to the Panic of 1857.

The disadvantage of the Gold Standard was the inability to create a steady new supply of money to keep pace with the growth in population and economic needs. Going back to the Gold Standard is <u>not</u> the answer to long-term economic growth nor would it solve the current economic crisis. In fact, it would create an economic contraction that would end flexibility to even deal with the problem.

This is separate and distinct insofar as gold providing a private source of ~~wealth that remains a store of value. The reason gold emerged as money because it~~ was a valued commodity and recognizable in all lands. They use gold for jewelry in India and China the same way they use it in Russia, Europe, or the Americas. It is a scarce commodity that there would not be enough of if every person in the world wanted just 1 ounce for themselves. Whether or not gold is the "official" monetary unit or the check against fiscal irresponsibility is of no importance. In the spirit of liberty, allowing gold to remain as the private store of wealth is far better. That was the very issue that Roosevelt sought to eliminate - the ability to hoard gold as a hedge against government. This is also why Roosevelt confiscated gold so he could devalue the dollar relative to gold thereby any such profit would default to the government - not the individual hoarding the gold.

All the problems with the Gold Standard emerged from the inability to create money when needed. Milton argued that the deficit spending advocated by Keynes would lead to only inflation rather than economic growth. Ineed, Keynes himself did not advocate perpetual deficit spending year after year. Once the government received his blessing, they just ran with the ball, but the goal-post was past decades ago. Looking at the Federal budget since 1936, the <u>only</u> years in which there was <u>not</u> a deficit were far and few between:

1947, 1948, 1949, 1951, 1956, 1957, 1960, 1969, 1998, 1999, 2000, 2001

During the 72 years between 1936 and 2008, there were only 11 years that produced a budget surplus. This is not a very good record for Keynesian economics. Once the concept of deficit spending was introduced by Keynes, it was seriously abused. But the problem was not so much the deficit, but the fact that at the same time there was the pretense of maintaining a Gold Standard at a fixed quantity of dollars to an ounce of gold while the supply of dollars was being increased and the gold supply was declining. This culminated in the first break with the two-tier Gold Standard whereas gold began to trade on the London exchanges freely, that was followed by the closing of the gold window in 1971 when there were more dollars than gold to redeem them. The reality of perpetual deficit spending under the Gold Standard came home with shocking force.

<u>The Bottom Line</u>

Arbitrary spending even on infrastructure will do nothing but create perceived inflation before it even hits the economy. The work programs of the Great Depression made sense only because there was a natural disaster in the form of the Dust Bowl that lasted 7 years. It is true that unemployment rose to 25%. However, it was only 8.9% in 1930 deep into the start of the Depression. It reached above 20% only when the Dust Bowl destroyed jobs given we were still 40% agrarian in our work force. Unemployment began to decline with the WPA, 1935 20.3%, 1936 16.9%, 1937 14.3%, 1938 19% and 1939 17.2%, but as you can see, we have a selected memory for what really worked and what did not. Unemployment in 1940 stood at 14.6% and at the end of World War II, it was 1.9%. It was not the WPA that changed the economy, it was the war. This has led to some claiming also selectively that war is good for the economy. We began the first peacetime draft in 1940 that was approved on September 14, 1940 but it was Pearl Harbor on December 7th, 1941 that officially started the war for Americans then declared war against Japan on December 8th followed by a declaration against Germany and Italy on December 11th, 1941.

The WPA was instituted May 6th, 1935. It provided a vital role in creating jobs not lost by the credit crisis in the financial markets, but by the Dust Bowl. The collapse of the Austrian Credit-Anstalt in May 1931, began a credit crisis contagion that swept the world creating a wave of business failures as we are seeing today with General Motors. Unemployment was the worst in Germany hitting 5.6 million in 1932 while Britain was 2.7 million. These were the conditions that not merely led to the election of Roosevelt in 1933, but Adolf Hitler also in 1933. From the September sanction of Germany in 1938 by Britain and France, it was but only about 3.141 years later to Pearl Harbor. The US had declared its neutrality in Europe on September 5th, 1939 when Germany invaded Poland. It was the war and not our participation that ended the depression, but we became the arms and food dealers for Europe. By the end of the war, the US stood with 76% of world gold reserves. That created American wealth - not policy or even peacetime trade.

Today, if we wage war, we spend our resources and the economy declines much as what took place in Europe. War is good for the economy, only when you are the arms dealer, not the aggressor. Today, the work force is nearly 150 million. If we subtract the agricultural sector from the Great Depression, unemployment hit at about 10%. Since 1995, the US unemployment rate is between 4%-6%. But this is also not a fair view of the economy. As of 2005, federal government civil employment is about 2.7 million. The military personnel is about 500,000 (Army), 54,000 (Navy), 353,000 (Air Force, and 20,000 (Marines) with about 41,000 (Coast Guard). This brings the federal government consumption of labor to about 3.7 million or about 2.4% of the civil work force. Outside the Great Depression, the worst bout of unemployment came in 1975 when it hit 8.5% and did not drop below 7% until 1987. The peak during the economic decline between 1980 and 1985 took place in 1985 at about 7.2%. We did see 7.5% for 1992 that led to a brief popular movement for Ross Perot and the victory of Bill Clinton in the Presidential elections. To reach 25% today, we would see sweeping political changes and massive political unrest. It would be impossible without the collapse of state and local governments since we see that agriculture accounts only for about 3% currently.

The US Gross Domestic Product ("GDP") is now about $15 trillion annually. If we assume the high side of a budget for one year will be $3 trillion, the total federal tax collected stands at about 17% of the GDP. If we spent that same amount of money on infrastructure, by the time that filters into the economy, the effect would be too-little-too-late. We would need another layer of oversight and costs to even administer such a project. If we simply eliminate the federal tax collection, that would be an immediate shot in the arm. But this too would fall short unless the people see this as a permanent reduction. Companies would not relocate for a mere one-off reduction. What we need is a three-punch solution.

We already know that interest rates and wholesale increases in the money supply will not be limited in scope to the domestic economy. Whatever we do to relieve the economic pressure (lower interest rates - or - increase spending), is more likely to cause foreign capital to flee. This will further contract the domestic money supply and would most likely prolong the economic depression.

We must consider what seems to be the most radical solution, but in 21st Century economics instead of 18th Century, it is far more targeted and practical. If we eliminate the federal income tax and stop the borrowing, we can jump start the economy and provide that boost to confidence that the permanent tax cut did in 1964 compared to the unsuccessful one-off tax cuts that went more to increase savings than spending.

We cannot lose sight of the fact that the federal government is now also competing for tax dollars against the states and cities who are now in trouble and cannot create money as the federal government can do. Unless we now consider a 21st Century definition & solution, then the 18th Century theories will cover the speculative losses for investment banks, not Wall Street, and create only work programs for stock brokers and programmers to learn how to fix bridges and roads. That seems one way to lower skills opposite of the policy of the WPA in 1935.

I.) ~~Eliminating Federal Income Tax~~

(1) Will signal a permanent and immediate change to the public restoring "confidence" in the future and will result in immediate economic relief.

(2) Will shift the tax to make domestic labor cheaper whereby corporations who move offshore would then be subject to tariffs and excise taxes but not on domestic labor depending upon what nation they moved to.

(3) Eliminate the competition with the states & local government that will only be petitioning for bailouts of their own, for as real estate prices decline, the tax base will implode creating a contraction in revenues forcing the states and local government to layoff workers.

(4) Eliminate the high costs of collecting taxes we do not need due to the evolution of what we define as money.

(5) Eliminate the cost and delay in creating a new administration to oversee some sort of program that would take years to actually produce any economic effect, whereas simply returning what was received in income taxes (not social security) is a clean way to jump-start the economy - immediately!

a.) To those who will argue Marx's philosophy that the rich will get more, well they also paid more, and it is the concentration of capital that creates the pool of funds that banks then lend that will eliminate the credit crunch. If someone has $1 billion in cash and he is now enticed to deposit it with a bank because we also will eliminate the $100,000 FDIC limitation that prevents big money from being lent out and merely insure all deposits because we install better regulation to prevent gaps with unprecedented leverage, then we should have no problem securing all deposits, that will suddenly attract capital from around the world as well. This will benefit the average wage earner and stop the Marxism that caused both Russia and China to see the light that we remain blind preferring to live in the dark.

II.) Eliminate the National Debt By Monetization

(1) FDR confiscated gold so he could devalue the dollar. This was limited to the times because we were still on a Gold Standard. By monetizing the debt, we would not create a dramatic change in inflation because in the real world, when we issue bonds, we may not define that as "money" in terms of M1, but in the practical perspective, we look at how much we owe and judge that as money issued regardless of what we call it.

(2) Between 1986 and 2006, the interest expenditures to keep the debt in place accounted for almost 72% of the increase in the debt. We are funding our mortgage with a Visa card.

(3) Those who believe that this would be inflationary are just misguided for the marketplace already sees the same amount of dollars held as assets in the form of bonds and replacing that same amount with dollars will save as we have seen 72% of the overall growth in debt that we could never repay in any event, and no government actually believes they will in fact pay off their debt for that would be a contraction of money supply unprecedented to date.

(A) Eliminating the Insurance Limitation at the FDIC

(1) There is no reason why we should not insure all deposits in commercial banks, for this would replace government debt and make vast sources of cash available for lending and would eliminate the credit crunch overnight.

(2) If we insure all commercial bank deposits, this will also attract foreign capital increasing the capital reserves for lending.

(3) Investment Banks should be excluded for they are higher risk and not part of the "real" commerical network with local branches that service the community. Those who wish to deal with such banks should also suffer the higher risk for higher yield

a.) There must be a single regulatory body with no gaps in the regulation where the greatest danger has historically been the leverage.

b.) There must be transparency and only openly regulated exchanges where counter-parties must have the asset to support the position, not mere reputation.

(B) Social Security Reform

(1) By eliminating the borrowing and taxation at the federal level considering the income tax (direct taxation), this will also automatically rehabilitate the Social Security program and make this into a real savings plan that would then invest the funds becoming a national wealth fund to also enable it to face the entitlements coming sooner than later where the public also have lost faith in ever seeing a real dollar.

(2) Once freed from the investment in government bonds, this fund can create tremendous economic progress for the future by even allocating 3% for venture capital in sizable new innovations that will greatly advance medicine, science, and technology.

III.) National Health-Care Program

(1) We need to establish a national health-care program for all that will relieve the coming crisis in pension funds of cities, states, federal government, and corporate America. The costs are so steep, even service jobs are leaving for a salaried employee costing $50,000, ends up costing on average $125,000 between taxes and health-care along with pension costs.

(2) We must face the facts, that the purpose of society is the cooperative efforts of society to seek lower costs and security, not much different why people were willing to be a serf so that when danger came, they got to run behind the wall of the castle.

(3) A national heath-care program is vital to our survival for the costs are rising so rapidly, corporates are passing those costs on to employees and the quality of life is collapsing.

(4) We must stop the nonsense, pass tort-reform, stop the crazy lawsuits, and the costs will come back in line to where they once were 20 years ago when small companies handed out health-care that covered the whole family of every worker. The lawyers will find another area to exploit, or perhaps they too have to tighten their belt for the good of the nation before we don't have one anymore.

(5) Eliminate trade barriers to cheaper drugs from Canada and force them back in line as well. This is our future we are talking about, we have seen what the investment bankers did to the economy with their outrageous leverage and unregulated shadow markets, let us not wait until hospitals close because people can no longer afford health-care.

(6) We need urgent attention for as unemployment rises, children will now die for the "greed" of this industry is destroying the very thing they claim to be protecting.

S U M M A T I O N

This three-punch solution is critical to our survival. We must respect that there are just sometimes in history that we have a choice to make a real effort to change the trend, or to bullshit our way around the facts only to postpone the reality. No one expects the national debt to ever be paid. We can continue to live in our 18th Century world and pretend that if we print the money it will be some how more inflationary than printing bonds and spending 72% more to keep them going when there is no plan to ever retire them anyway.

It is time to create a control burn before we explode from our own nonsense. It is not to late to save the day. But we have to start to make realistic plans and address the honest issues. The Investment Bankers have blown-up their world as they always do. They have never got it right even once! They create models that ignore the big events because they thought they don't happen that often. Well it happened and now they are begging to cover their losses. Healthcare and the wave of entitlements is going to hit shore like a tsunami. Are we going to just once plan for the future, or is democracy the worst kind of government because there is too much talk and no action?

Just for once, let use update our definition of what is money and we will see that printing dollars or bonds is really the same thing except bonds are the gift that we keep having to pay for generation after generation. End the stupid borrowing. We are not in Oz anymore. Gold is not money. Let us start understanding the modern world we live in today.

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