Failed Economic Policies

How Greenspan & Wall Street
Mislead Investors

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America's national wealth has been shrinking. Creating personal and corporate wealth is, therefore, increasingly difficult. Sadly, few Americans can define "national wealth". Most citizens have no idea how national wealth is created, many even believe that government creates wealth!

Increasing exports increases national wealth; China is the fastest growing exporter, and their stock market has risen in the past two years. US corporate tax and trade policies have severely weakened the international competitive position of all US companies. Our policies are more the result of rigid ideology rather than the result of logic and evidence. Our policies pose a continuing threat to America's national wealth.

Shrinking exports and increased imports adversely affect every investor, every citizen and every American business.

When US stock prices fall, Americans suffer. Wall Street "theft" is very serious; however, trade and tax policies account for far more past and ongoing losses in national wealth than the value of all the theft that has occurred in the stock market. If we fail to make radical changes in our tax and export policies, our national wealth will continue to decline.

As federal and state governments consume an increasing portion of our nation's wealth, the wealth available to be "won" by US individuals and businesses (those who produce the wealth) shrinks even further. American citizens and businesses are in competition with each other and with third world low-wage exporters, for a smaller piece of a shrinking national wealth base. New trade and tax policies are needed to remedy this conflict.

Investors must critically evaluate Washington's economic and political policies. More than any other (predictable) factors, these policies will determine future business conditions, hence, stock and bond prices, and job opportunities for our children and the value of the US currency.

In 1929, Washington policymakers misinterpreted the root cause of the depression. The failure to grasp its cause led to policies that deepened and lengthened the depression. For a decade, Washington's attempts to restore a vigorous balance between supply and demand failed badly. America remained mired in economic and social chaos until the massive demand created by WWII propelled business activity forward. Today, Japan faces a similar crisis. Over the last decade Japan used massive federal spending programs, like the WPA programs of the 1930s, to stimulate their economy. Japan now has the largest national debt to GDP ratio of all industrialized nations and economic equilibrium has not returned.

America now faces a problem similar to what we faced in the 1930s: businesses cannot make a profit as there is insufficient buying power for their goods and services. US policymakers are focused on policies to "stimulate" our economy. Americans need greater wealth, spending more will not "help" them. If America uses deficit spending as Japan has, and as we did in the 1930s, America will only have more debt and less real wealth. If consumer demand does not increase, the contraction will deepen, we will have a national crisis. This crisis can only be averted if or when foreigners buy more American produced goods. Federal deficit spending and family deficit spending may "stimulate" the economy temporarily; however, such activities only delay the day of our facing the real causes of our economic problems and gravely weakens America in the longer-term.

Two hundred years ago, Thomas Malthus warned that since populations grow geometrically and food production grows arithmetically, some percentage of society would be forced into starvation. He did not foresee the growth in agricultural output. Today, however, we may have (sort of) the opposite problem: American corporations produce goods and services at a far faster rate, than the growth in demand for these goods and services. Our stores are bursting with goods! Our problem has two parts, 1) Americans do not have sufficient incomes and savings to buy more US produced goods, and 2) American businesses have become un-competitive internationally. We will examine some of the reasons this is so as well as some possible remedies.

Today, in America, there is no "natural" allocation of profits and incomes. Tax, minimum wage and income redistribution policies determine the allocation of incomes and profits among classes. A great economic crisis can be averted only if US businesses export far more US produced goods and if American workers obtain higher after-tax wages. Today, the "invisible hand of supply and demand" has symptoms of carpel tunnel syndrome.

Many Americans demand that the government (other citizens) provide them with more services. This will require higher taxes. Higher taxes will dramatically harm US competitiveness, jobs, profits and actual tax revenues. Leaders of the Democratic Party and academics generally, work tirelessly to convince Americans that our government can and must provide more to the "needy" and all federal and state employees. They have half the vote. Republicans talk of reducing the size of government but, in fact, they increase spending just as much as democrats.

America, today, is buying more and borrowing more from abroad. This cannot be sustained. Our trade deficit is a recipe for financial disaster. Real wages are falling. Federal and state spending directly accounts for about 30% of GDP. This level of spending requires a level of taxation that cripples the competitiveness of America.

This article reviews recent market history and addresses some crucial questions prudent investors must consider:

- Who Wall Street serves, and how Washington created the money and the rules;
- Washington's role in solving economic problems, and a few ideas on building national wealth.

WALL STREET FABRICATED THE BULL MARKET

Wall Street operators knew the one vital ingredient to increase their wealth; they had to get a bull market stampeding. That alone could draw in the masses of investors. They knew what monetary and regulatory policies best favored sustaining a bull market. They knew how to influence Washington policymakers to get what they needed. They got what they needed. Today, average Americans are left with more debt and less equity.

Salomon Smith Barney and other Wall Street firms are sometimes fined for their "mistakes". SSB was recently fined a mere $5 million for issuing "misleading research reports". They made billions of dollars by "misleading" the public. Is this justice? The fines are set by the NASD, a "self-regulatory organization" established by the SEC. The SEC and the NASD are both comprised exclusively of Wall Street insiders. Wall Street is always "bullish". To sell, they have to be and their only job is to sell. They focus on matters that will put people in a "buyer's mood". Financial salesmen care little about the relationship between international trade policies, macro-economic trends, Washington's policies and stock market prices. They know these discussions dampen investor (buyer) confidence. The mission of Wall Street is to convince investors to hand over US currency (cash money) in exchange for stock certificates, paper that Wall Street prints for about $1000 per ton of certificates. The primary role of Wall Street is to generate commissions for them-selves. Wall Street operators, today, are far richer today than they were prior to the bull market. They stayed on their plan. If you lost money it was because you confused your mission to be their mission; you trusted the wrong people and the wrong institutions.

To rationally evaluate market risks and opportunities, in addition to having many years of experience, one must have considerable financial sophistication. The financial planners (salesmen) who work with (sell) investors are paid to make sales, not to interpret financial statements, economic trends and market history. However, the study and analysis of these matters is at the heart of analyzing investment risks and returns. These issues must be carefully considered to create a rational investment strategy. Investors must see (value) the trees (stocks) in the context of the forest (the economy). Even an examination of dozens of stocks will fail to reveal the dangers and opportunities in the economy and our markets. A rational assessment of the risks and opportunities in the market and the economy can be made only after an independent evaluation of the domestic and international economic and political trends. Individual stock analysis and selection follows this process. The overall goal of this process is to reduce risk and uncover the best business sectors in which to invest. But that is not what Wall Street sells, they sell bull.

THE SEVEN MOST COSTLY WALL STREET MISREPRESENTATIONS:

1. That "national wealth" and solvency are reflected in higher stock prices and an increasing gross domestic product,

2. That the US economy was healthy and that demand for US produced goods would continue unabated,

3. That technological innovation always produces sustained economic growth,

4. That the American high-tech industry has a competitive price structure,

5. That the balance sheets of US corporations were healthy and profitable,

6. That increasing federal and state expenditures would not impede US competitiveness and prosperity, and

7. That Wall Street conduct (sales practices) with its customers is ethical and professional.

The market had to fall - why it rose is equally instructive. We address this subject more fully in another article but it has a rightful place here.

Wall Street wrote (almost) every line in the script of the stock market's performance. They raised hundreds of billions, from average Americans, to give to new companies. The evidence is conclusive: this money created no long term value for "new" investors. In April of 1999, 32 internet companies had a combined market value of $2.8 TRILLION. By 2000, most insiders had cashed out. Today, these companies are worth nothing. The demand for their products is but a tiny fraction of the submissions made by their Wall Street financiers and promoters. Wall Street's Harvard, Princeton, and Yale MBA's did not make "miscalculations". Their calculations served their interests very well. How could they possibly have made more money, for themselves?

The billions that were spent on research, development and marketing created an illusion of wealth. The spirited activities of so many bright youth-filled new companies exhilarated Americans. The markets rise mesmerized investors. The managements of these high technology companies consorted with Wall Street to create brilliant stock promotions. While the business plans of these companies were spurious, at best, their stock promotions were executed with laser precision. Wall Street convinced most Americans that these technology companies would be a source of great shareholder wealth and propel America into a new age! Stocks that were most heavily promoted were dumped by corporate and Wall Street insiders, at the same time.

Wall Street doesn't care about the policies that create national prosperity and national decline. Their only concern is to influence policymakers to implement policies that favor their industry. They make money peddling corporate stocks or government bonds. If the US currency collapses, they will be short the dollar. If the Euro takes its place, they'll be long Euros. The occasional fines they are assessed are just a small cost of doing business.

HOW WASHINGTON POLICIES FUELED THE "BULL"

Wealth is the absence of need for debt. From 1996 to 2000, the Dow rose over 100% but the GDP grew by only 26%. Household, business, and financial debt grew by 52%. Stocks prices grew 400% faster than the GDP and debts grew 100% faster than the GDP. Did Clinton policies create national wealth?

Investors, financial advisors and most policymakers fail to critically examine (let alone explain) the reasons why Americans must finance their personal, corporate and government expenditures with debt. Throughout the 1990s, Americans used debt to buy anything they did not have the earnings to buy. The 1990s were not a period of prosperity; it was a period of corporate and political lies, jointly created by Wall Street and Washington.

Today our economy is fueled entirely by leveraged spending. New 2nd mortgages and home refinancing are creating trillions in new paper "wealth". In the past seven years housing prices have soared 30% faster than the inflation rate. This cannot continue. The banking crisis of the 1980s was created by a real estate "boom". That "boom" cost US taxpayers $½ trillion dollars. This "boom" too, will carry a price.

The following data illustrate the extent to which debt was used during the Clinton/Greenspan "era of prosperity". The last five years of the bull market was entirely financed with debt. Washington policymakers and Wall Street economists knew that using so much debt would have long-term negative consequences, for the individuals who used it and for the nation's future economic performance. That did not stop them.

	Gross Domestic Product	Rate of Change	Household Debts	Rate of Change	Business Debts	Rate of Change	Financial Debts	Rate of Change
1996	$7813		$5224		$4372		$4829	
1997	$8318	6.46%	$5557	6.37%	$4763	8.94%	$5458	13.03%
1998	$8782	5.58%	$6011	8.17%	$5324	11.78%	$6542	19.86%
1999	$9274	5.60%	$6513	8.35%	$5945	11.66%	$7630	16.63%
2000	$9825	5.94%	$7078	8.67%	$6529	9.83%	$8457	10.84%
Average Rate of Change		6%		8%		11%		15%

The demand for financial assets, in the Clinton/Greenspan era, was driven by an "easy money" policy. Washington made that happen-they control the supply of money. Be warned, inflation always follows easy money. The paper wealth created in the 1990s is no longer available to support the levels of Gross Domestic Rate of Household Rate of Business Rate of Financial Rate of consumer demand that American producers require to keep jobs rates steady.

The US markets had the longest running and largest climbing bull market in world history. It did not rise to such preposterous levels because the Federal Reserve governors could not determine how to reduce America's appetite for stocks. On the contrary, creating the "greatest" bull market in history required monetary and fiscal policies and a securities regulatory climate, specifically designed to pump up the stock market.

Clinton, Wall Street and the Fed boasted that, together, they created "unprecedented and permanent prosperity". They promised trillions in future surpluses. FRB governors, market "professionals" and economists know that all market bubbles burst. They also know the fate of nations that rely on bubble-based consumer spending, bubble-based consumer borrowing, and bubble-based tax revenues. Wall Street, Clinton, Greenspan and Treasury Secretary Rubin all knew this, yet their policies were specifically designed to spur Americans to invest in Wall Street bubble paper.

Who had the ability to stop the "irrational exuberance"? In the 1990s, every Washington policy stimulated stock investing. Two groups benefited from this, incumbent politicians were re-elected and Wall Street & Washington insiders added millions to their net worth. This was not accomplished by luck.

WASHINGTON'S ANSWER TO OUR ECONOMIC PROBLEMS

Words are precious. Sometimes just a few words provide profound illumination on complex subjects. Consider these 86 words by the president of the Dallas Federal Reserve System, Robert McTeer, in year 2001***: "They've [consumers] been doing something that's probably irrational from the point of view of the individual consumer because they all need to be saving more: saving for retirement, saving for college and all that. But we'd be in bad trouble if they started doing that rational thing all of a sudden. We're happy that they're spending. We wish that they didn't have to run up a lot of debt to do it. But it's not something we're terribly worried about right now because their assets are high."***

Recently, ***Washington's easy money policies created billions in new profits for banks and mortgage companies, however, now we have a new class of Americans - the "sucker borrowers".*** Their policy takes advantage of the least intelligent Americans. When these debtors go bust, as they are certain to, taxpayers will cover the banks losses, just as they did in the 1980s. Washington's easy money policies paved the road for millions of citizens and businesses going into bankruptcy, many more will follow; All in the name of an ill-conceived and failed economic policy, "stimulation". Is America stronger with this policy? Are we a more competitive nation? This policy provides a great benefit to a few and a cost to most Americans.

This was the policy that Clinton followed all through the 1990s, and it continues today. The policy to extend debt to everyone is no substitute for a policy that allows American businesses to once again become international competitors. Washington has an obligation to implement economic policies that, a) are good for all classes of Americans, b) are certain not to harm the weakest segment of our society, and c) encourage national wealth building. The present policy to encourage more debt and spending is certain to reduce our nation's financial flexibility and independence.

The Fed is faced with a "catch 22"; policies that encourage saving dampen economic growth, as they reduce employment, corporate profits and net tax revenues. By contrast, leveraged spending creates more jobs and so on, until the day of reckoning. The masses have little cash and can only buy with debt. If American debt levels have peaked, now, to buy more, Americans must earn more. Without debt usage, what policies will help us grow?

This month, Federal Reserve Chairman Alan Greenspan said: "a swift return to government spending discipline was vital for economic health". In the past decade Mr. Greenspan developed policies that encouraged Americans to borrow and spend. Why the sudden change? Under his policies American consumers, corporations and government bodies took on massive debts. Won't these debts have the same effects he warns against, now? Have not the massive and still growing trade deficits that exploded under his "leadership" contributed to the decline of the US economy? Does Greenspan offer any policies that allow American corporations to compete more effectively with foreign businesses and to increase national wealth?

Greenspan's economic analysis, today, is no less flawed than that of his predecessors in 1929. Today, Greenspan cautions that if the United States returns to a period of continuous large spending deficits, there would be serious consequences for the country's economic prospects. He said, "History suggests that an abandonment of fiscal discipline will eventually push up interest rates, crowd out capital spending, and lower productivity growth and force harder choices upon us in the future." We know this, yet he, his banker and political friends do not suggest how to boost "un-leveraged" demand.

Washington policymakers publicize the fact that they lower interest rates to stimulate consumer spending. What eludes most Americans is that, all through the 1990s, while Federal Reserve bankers occasionally spoke of the market's lofty heights, their policies, in fact, encouraged stock investing. As they watched Americans invest their last 401k dollars in the Wall Street's paper, they may have thought, "it's not something we're terribly worried about right now because their assets are high." These men had other considerations: while average Americans were buying, they and their friends were selling. The majority of insiders, Wall Street and their friends, cashed out of the market in 2000 and 2001.

The analysis of Greenspan and his colleagues is important because the US congress will enact future fiscal policies based upon his thinking. Those policies will determine, to a great extent: 1) America's competitiveness, 2) inflation rates, 3) corporate profitability, 4) employment rates, and 5) future stock markets prices, and much more.

In 1929, businesses desperately needed to sell more goods and services and the average American both desperately needed and wanted to purchase more goods and services. However, they lacked the income necessary to buy more goods and services. Like today, they faced a great imbalance between the supply available and the demand, at profitable prices to businesses. Policymakers failed to understand the nature of that crisis. Today, Greenspan and his colleagues have no better understanding of how to respond to these imbalances, than the policymakers of 1929. Washington has implemented two policies to stimulate demand: 1) lowering consumer interest rates, and 2) new government borrowing and spending programs. They have no policies to create added national wealth. Government programs that support rich farmers and hire tens of thousands of airport security guards (at $45,000 per year) will not correct our fundamental economic imbalances. Our Choice: Leave a Legacy of Greater National Wealth, or, a Welfare State, Plundered by Debts

The 86 words from the president of the Dallas FRB reveal the true nature of our economic crisis: Washington policymakers have no better strategies to improve today's economy than did Washington policymakers in 1929. Policymakers are under the misguided impression that their goal is to "stimulate" the economy. Thoughtful Americans recognize that "stimulation" is not the goal. Winning is the goal. We win when America has greater national wealth. To win, America must have a perfectly clear goal and a perfectly clear plan. Our goal should be to create national competitiveness and the opportunity for any (not all) Americans who are willing to pay the price, to win. To increase our national wealth, we must have a new economic competitiveness. Our goal must be to win! Policymakers have not acknowledged that winning economically is both an international competition and a battle. There are now and there always will be, winners and losers. Washington policymakers act as though national wealth is an outcome of government programs and "stimulation"! They are dangerously wrong.

No amount of government spending will provide national wealth or allow our children to become winning competitors. America did not become the strongest nation in the world because the government spent 30% of our GDP. No amount of government spending will reverse our growing reliance on borrowing (and more than ever, borrowing from foreign lenders). Examine the results of a decade of Japanese government "stimulative" spending and examine the results of a decade of American stimulative spending in the 1930s. All they and we accomplished was to create more debt. Keynesian policies do not rebuild national wealth;

rather they leave a nation weaker. Government spending provides no greater (economic) health than "bloodletting" provided to sick people in the 19th century.

The rising use of debts in the 1990s obscured America's declining economic competitiveness. Overall, our nation spends far more than we earn, and we save nothing! These irresponsible "habits" are responsible for destroying families, businesses and great economic national powerhouses of the past. For the first time in our history China has supplanted the US as the most attractive destination for foreign direct investment. This is very bad. Liberals are fine with this outcome-they say America must fall behind. Fortunately, our fore-fathers did not suffer from such emotional complexes.

America must clearly define "national wealth". We need clear policies to re-establish economic competitiveness. National wealth should never again be confused with high stocks prices or GDP growth.

Americans need a clear moral purpose with responsible fiscal policies. Liberal democrats appear willing to tax more and spend more on every program that either makes them "feel" good or gets those votes. They do not acknowledge that high tax and spend policies have endangered the economic future of every American. Politicians who have very rarely even seen balance sheets and income statements cannot be trusted to manage the nation's economy. On the other hand, the business "community" has not earned America's trust. Just as, few democrats care about fiscal responsibility, equally few businessmen appear able to act honestly and ethically.

Neither party has offered strategies to foster greater national wealth. Strength only comes from rigorous exercise. If we are to become a stronger nation we must learn and commit to, the right "exercise" programs. American government absolutely cannot solve the problems of the unfortunates of society-the morally decrepit, the weak, the not so bright and the lazy. Americans must stop trying to fix these problems with rising tax dollars. The problems have not decreased and the taxes have soared. If this trend continues we will implode economically. Policymakers must inform Americans that they have a choice to make: America can either become a world class economic competitor again, or become a stagnant nation like Japan. We will not have both higher government spending and greater security for the masses. Will we continue to allow America's economic fate imperiled for the benefit of special interest groups?

POLICIES TO CREATE NATIONAL WEALTH

If America aims to afford greater individual liberty, greater economic opportunity and manage our economy prudently, we must reconsider conventional liberal and conservative policies. America must:

1. Decrease federal & state expenditures,
2. Decrease tax rates for the middle class,
3. Substantially increase the minimum wage,
4. Radically alter our trade policies, and
5. Make energy independence a national priority.

We must cut federal & state expenditures and then cut middle class taxes. Government (federal & state) directly spend about 30% of the GDP, indirectly that number is closer to 40% of the GDP. Twenty five years ago, that number was about 20%. This trend must be reversed, not just slowed.

The average federal employee salary rate is about $26.88 per hour (in the DC area, which rate rises to about $33.84 per hour); state & municipal employees earn an average of $20.56 per hour. Private sector employees average $15.46 per hour. Do federal and state employees "deserve" more than average working Americans? This policy is un-American!

We need to assist government employees and welfare recipients to become self-sufficient productive Americans. If social programs led to self-sufficiency, such programs would put themselves out of business (that would be very bad for government employees and their unions). Liberty and independence are the natural state of all human beings. America owes no citizen anything more than the opportunity to earn these treasures. Trying to do more imperils all of us. We need to cut spending and lower taxes, rather than just one or the other.

Twenty years ago, republicans blamed "big spending" democrats for the deficits. Today, democrats blame "tax cutting" republicans for the deficits. Neither party concedes that deficits are caused by too much spending and too little taxes. Liberal propositions to raise taxes and redistribute income will destroy jobs, and that income redistribution will destroy worker incentives. Deficits are not the problem. Powerful voting blocks of self-serving Americans, misguided policies, and lack of moral and rational leadership are the obstacles America faces. Our great challenge is to find politicians with the courage and leadership to help Americans appreciate and choose freedom over big government programs.

Taxes should be used only where private enterprise fails to ameliorate major social problems. Taxes are both the hallmark of a civil society and an enemy of liberty. So tax levels must be balanced very judiciously.

Only a growing, affluent middle class can absorb the growing output of the greatest producer of goods and services on the earth. Yesterday's affluent middle class didn't need to borrow to live well. Today, our middle class is ten paychecks away from insolvency. To prosper, America must have higher wages. Then workers can buy goods with less debt. Businesses and workers will benefit, and corporations can make greater profits and hire more workers. That is not happening today.

Good paying jobs have been moving overseas. America cannot continue to buy imported goods (on credit), from low wage countries. Foreign workers are not paid sufficient incomes to purchase US-made goods and services. We do not have "trading partners"; rather, we have very real trade competitive conflicts. To create greater demand for the goods and services produced in the US, we must reassess our trade policies. America must end its reliance on foreign oil. We send billions of dollars to fascist's governments that teach their children to hate us. America can be energy independent, if we make it our highest priority. Hundreds of billions will be saved in oil imports and millions of new good jobs will be created. America's future rests upon developing and implementing the right mix of innovative economic policies and high spirited nationalism.

Solutions to our economic problems are needed before they become more serious. If Americans continue to borrow as they have, they'll all be broke by retirement age. Broke retirees make loyal democrats. If prudent and national wealth building policies are not implemented, socialist liberals will win the vote. Liberty and the potential for prosperity in America would then cease to exist.

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