The Way We Were

By The Mogambo Guru

10/17/01

The Daily Reckoning Presents: THE MOGAMBO GURU explains why based on an overwhelming accumulation of historical precedent, one can reasonably expect that we will have several decades, or more, of increasing misery from a depression.

THE WAY WE WERE

The American economy will probably not recover for at least a decade. There is no reason to expect that it will. The immutable laws of economics have not gone away, nor have they changed overmuch in the history of the world.

Since before the time of the Pharaohs, all nations have contended with the same financial forces in existence today. They had (in one form or another) money, debt, and taxes.

They all had government spending. And every single one of these nations, in all of history, was eventually ruined by its government. Their money was debased to the point of worthlessness by the government spending too much to do too much, and then the country collapsed.

Why should we expect to be any different?

To combat the evil of the debasement of the money, the Founding Fathers wrote into the Constitution that money will only be of silver and gold.

As thinkers of the Enlightenment era, Jefferson & Co. surely studied history and saw, with alarm, what happened to every nation that resorted to fiat money: the value of the money went to zero and the people were pauperized.

They believed that there had to be constraints on government spending, and the only constraint available was to limit the currency to something relatively rare and valuable. Ergo, the gold standard, which limited spending to the amount of gold and silver you had.

But the Supreme Court, in its infinite wisdom, rather in a series of idiotic decisions that is part of its lasting shame, acquiesced to the fraud of allowing absolute disregard for this important, crucial piece of the Constitution. No longer would the dollar be, “as good as gold.” Et voil…, fiat money.

Since the sixties the government has been on a deficit- spending spree. That is, they “borrow” money and spend it. This is, of course, the Keynesian approach to battling a recession. It works. How could it not?

There is, unfortunately, a price to be paid. And the price is the accumulation of debt. Piles of it. Whole mountains of debt. Keynes himself said that the debt accumulated during a stimulus program has to be paid back out of the subsequent recovery. Congress, to its sorry shame, forgot this part of the equation.

We now have $6 trillion of “official” government debt. The interest on the debt already eats up a third of government revenues. And it never goes away – except by paying it or repudiating it. Normally, debt can only accumulate to some limit. One limit, obviously, is when total debt service eats up 100% of revenues. In reality, it is a much lower amount. And when that point is reached, the game is over. Normally.

Enter the central banks. After three decades of fiscal stimulus by Congress, the geniuses at the Fed decided the economy also needed direct, constant monetary stimulus – to help the government pay the interest on the ravenous debt.

The Fed, you’ll recall, is a government-mandated, semi- secret club of the banks, all meeting together behind closed doors. Their “job” is to safeguard the banking system. They set monetary policy for the government in the name of “the common good.” Meaning: “making sure the banks are profitable.”

Since the Fed does not actually have any money to pay for anything, they invent magical money. It literally appears on a whim, out of thin air, onto account balances at the bank. The Fed says, “I have – presto! – money! Take this money and sell me some of that government debt you are holding. Look, now you have money to lend!”

This is such an obvious fraud that it is also obviously only an emergency power of the Fed. It was not supposed to be used as “party favors” during the boom. But under the woeful stewardship of Alan Greenspan through the 90s, that is exactly what it became.

Week after week, month after month, year after year, the Fed poured pure adrenaline into the banking system. It wasn’t just for investors that Alan Greenspan pronounced the mania as “irrational exuberance.” He was also describing the actions of the Fed. The operative word is, of course, “irrational.”

It is not rational to expect that fiat money will forever hold it’s value. It never has. It is not rational to expect that a stock market will forever go up. None ever has. It is not rational that a country can forever spend more than it makes. None ever has. It is not rational that debt can grow forever larger. It never has. It is not rational to believe that a government can keep getting bigger forever. None ever has.

The enormous amounts of money magically brought into existence during the decade of the 90s also made superstars of every hotshot with a penchant for numbers and access to Other People’s Money. In each case, it was a matter of cleverly coming up with another idea to “free up” untapped sources of money, and putting it “to work.”

Receivables were constantly sold forward, ordinary debt was broken into weird little pieces and sold at premiums, unrealized profits were borrowed against, equity in anything was borrowed against, futures bought, options sold, etc. The velocity of money zoomed, as the vortex twirled round and round, twisting tighter and tighter, sucking in more and more money with each revolution.

The Japanese, for their part, lent mountains of money at zero percent interest, which was immediately snapped up around the globe and plowed into something, anything, making that “something” go up in value. You could almost hear them exclaim, Frankenstein-like, “It lives! We are geniuses!” You can still hear the echoes of the masses replying, “You ARE geniuses! You are gods! Here’s my money!”

Add the newly formed IRA’s, 401(k)’s, and a plethora of retirement plans, and trillions of dollars got sucked into the stock and bond markets. Interest rates dropped when the money went into the bond market. Investments boomed liked nobody’s business when it went into the stock market. IPO’s! Mergers! Acquisitions! Construction! Houses! Malls! Real estate! Antiques!

Congress, always eager to butt into everything, passed NAFTA, GATT and God-knows what all free trade stuff. Companies moved production of goods offshore, taking advantage of the wide differential in wages and regulatory burdens to fatten bottom lines. The goods were then imported into the USA for manic Americans to buy, via credit.

And credit was everywhere in abundance, because money was everywhere in abundance. And the Americans bought everything that was offered! By the ton! Consumer credit soared to $1.6 trillion! Commodity prices tumbled, as hard-scrabble foreign nationals now had cheap entry to the US for their low-tech commodities production, and thus kept primary inflation at bay.

No wonder services boomed! What else is there to buy, now that we are chock-a-block full of TV's and cars and houses and vacation property and investments and snowmobiles and vacations and swimming pools and videos and clothes? We actually thought we could have an economy based on services. Laid off from the plant? Who cares? Get a job in services! The factory production of actual tangible products is absent in the U.S.A.? No problem! Get a job in services!

So, here we are. Debt up to our eyeballs for toys that are mostly broken and old. Debt up to the government's eyeballs. Debt up to the state's eyeballs. A fiat currency. A gargantuan government. A huge trade deficit and a huge current account deficit (meaning goods shipped in and dollars shipped out of the country) to provide the consumer goods, while we merely peddle these imports and services to one another. A nation of retail clerks and hairdressers today, a nation of pyramid- builders and quarry workers yesteryear.

So what is so different now? Nothing. Another page in history, telling the same old story over and over again. Mogambo sez: if the story is always the same, why should we expect the ending to be any different?

Cheers,

Richard Daughty