The Greatest Packagers and Peddlers of Debt in U.S. History

The growth of Total Credit Market Debt relative to Output for the U.S. has been increasing ever since President Nixon abandoned the Bretton Woods-I quasi-gold standard in 1971, and converted us to a fiat currency. Since that time there has been a very select exclusive group of powerful humans who have controlled the unbridled expansion of liquidity (money and credit). I believe the resulting extraordinary debt bubble is ***the most dangerous economic imbalance*** from which we will suffer massive corrections for years to come. The noted "powerful humans" learned to create, package, and sell debt as though it was real wealth [(1)] leading investors throughout the world with the perception they will be repaid in full, plus interest. From my "enginomics" perspective the aggregate increase in real debt that will be repaid in full [(2)] cannot be greater than the increase in real output during any given period. Debt increases greater than Output in aggregate are illusions of wealth (bubbles) to the debt security holders.

Who are These "Debt Peddlers"?
I refer to them frequently as the U. S. Financial Cartel. They include:

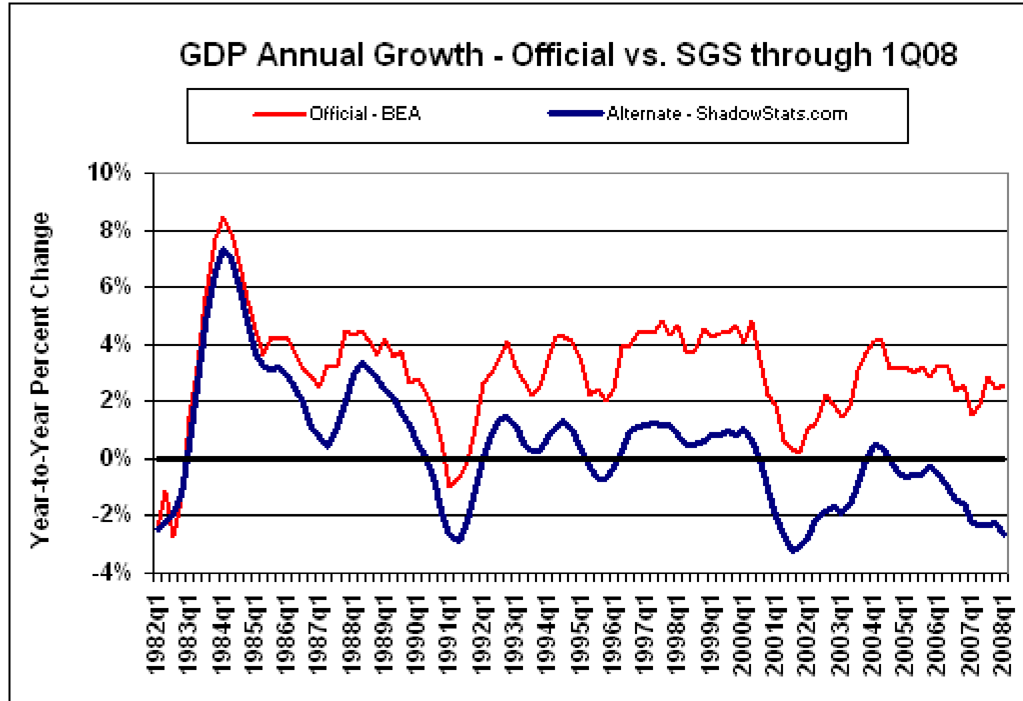
- The U. S. Government
- The U.S. Federal Reserve Bank
- The Major Brokerage Firms (Goldman Sacks, Merrill Lynch, Morgan Stanley, Lehman, etc.)
- The Major Banking Firms (J.P. Morgan Chase, Citigroup, B of A, Wells Fargo, etc.)
- The Major Hedge Funds
- The Major Private Equity Firms
- The Government Service Entities (GSE's; Fannie Mae, Freddie Mac, Sallie Mae)

Why Do They Create, Package, and Peddle Debt?
Power, control, and profit! The U.S. government packages and peddles debt by issuing and selling Treasury Notes, Bills, and Bonds. They prefer to delay the political tax increase consequence into the next administration or deny the existence of a real tax increase to pay for their new programs or expansion of existing programs.

The perception of the public is that a delay of payment for a delivered government service or good will be readily and painlessly absorbed somehow via future economic growth. In fact they have been told and believe there will be such extraordinary growth, due in a large part to tax cuts, that government will collect sufficient revenue in spite of the lower tax rate. Optimists offer proof of this "Laffer [(3)]"effect by noting tax revenue has increased every year since the Regan and Bush tax "cuts" have been in effect.

Somehow common sense has been lost. The Laffer argument suggests the taxpayer will become so motivated that his enhanced production output will more than offset the mathematical effect of a lower tax rate; hence, flood government with greater revenue into its coffers. Unfortunately, the truth is that Real Output has actually been on a declining trend since 1984. See the graph below developed by the Shadow Government Statistics Group that utilizes non-manipulated inflation data to generate the more accurate

"blue line" GDP Growth rather than the misleading and stagnant "Official-BEA" "red line" Growth….



Rather, what has increased dramatically is the expansion of liquidity (money and credit) much greater than Real Output giving the public the illusion of greater wealth. The excess liquidity drives greater profits, government tax revenue, and keeps all financial asset prices levitated far above fundamental justification.

The rest of the noted Financial Cartel packages and peddles debt to earn a fee. Their pitch is to act as a "benevolent" agent offering sophisticated "diversified" investments, then sell them to unsuspecting buyers who believe the packages will produce secure low-risk attractive returns on their investment. By the way, they accept lavish fees in return for this wonderfully accommodative activity.

How Do They Package and Peddle Debt; The Disconnect Between Real and Financial Debt?

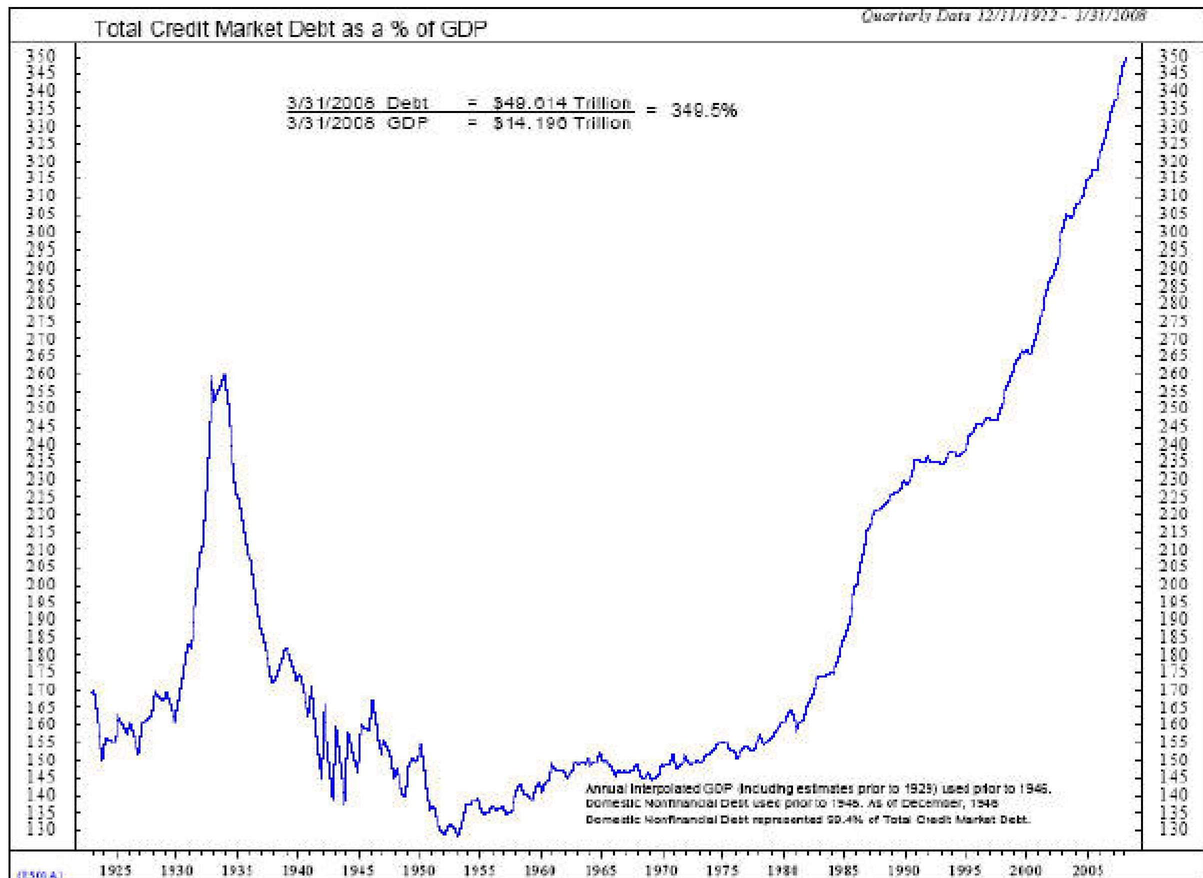
The U.S. government simply auctions or sells bonds to any interested buyer on earth. The debt is perceived to be the "safest" possible "investment" on earth because the U.S. government will "never" default on its obligations. They will "always" have the power to print more money and satisfy any claims against it, thus never experience a technical default. The disconnect occurs because there are no taxpayers identified who are even aware they are committed to pay this future tax burden increase greater than what otherwise would have been. Taxpayers have been conditioned to believe only "tax cuts" are in their future ad infinitum.

The Brokerage firms and GSE's purchase thousands of individual debts, then package, securitize, and resell these debts to investors, and offer various risk/return options. For

example, a typical Collateralized Debt Obligation (CDO) will offer Senior, Mezzanine, and Equity tranches that represent different risk levels along with associated reward (interest rates) levels. If the underlying liquidity (money and credit) is expanding, it will artificially push up existing real estate valuations for example. The rising real estate valuation magic opens the door for massive refinancing and home equity loans, thus increasing total debt with no increase in OUTPUT!!! … another "Disconnect"??

Debt Increases Greater than Output Increases are an Illusion of Wealth
Based upon logic from my Debt Axioms [4] Real Debt levels cannot increase a greater amount than Real Output over a given period of time. Since the Financial Cartel players have been able to expand debt to a seemingly endless reservoir of buyers, the illusion of wealth continues to grow. That reservoir of buyers is now shrinking. Hence, the powerful debt peddlers are now begging our government to be the buyer of last resort.

How Large is the Illusion of Wealth?
The graph below from Ned Davis Research represents the Total Credit Market Debt relative to Output in the U.S. since 1922. On the surface one could argue we have an illusion of approx. $35 trillion in U.S. debt ($49.0-14.2). However, I have developed a calculation method that accounts for capital stock vs flow and reconciles "Financial Economy" Debt to "Real Economy" Debt. The approx. size of the debt illusion based upon this calculation methodology ***is $17 trillion***…. Still mind-boggling!!



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When will the Investing Masses and Foreign Governments Discover this Illusion?

Baby Boomers all over the industrialized world begin to retire in mass beginning this year. For example, the U.S. Boomers born from 1946 to 1964 will begin turning 62 this year. As they attempt to cash in on the illusory assets, they will rapidly discover they are worth much less than originally perceived. I believe the critical mass of Boomers attempting to retire from 2008-2010 will be more than sufficient to trigger the discovery of the illusions of wealth. The illusions can only be corrected or diffused by painful debt security defaults or inflation.

What will be the Consequences of the Discovery?

The consequence will be a second Great Depression that we will enter between now and the end of 2010. It will last approx. 8-10 years because the magnitude of the illusory bubbles representing the "Financial Economy" and the "Real Economy" disconnect is greater than the first Great Depression.

Conclusion

The capability of the U.S. government and Financial Cartel to expand debt seemingly oblivious to any future consequences has created the most extraordinary illusion of wealth in the history of the Republic. Grave consequences will result. Hopefully, enough people will recognize the reasons we got into this mess in the first place, and avoid a repeat for at least the next two generations.

References:

(1) Real Wealth is defined in the second paragraph of this article: http://austrianenginomics.com/IfStockMarketsJumpUporDownDoesRealWealthChangeA.pdf
(2) "Full" in this context means repaid fully in non-inflated remunerations, plus interest. I.e. NOT being repaid in a currency debased more than the projected inflation rate at the time the debt contract was executed.
(3) The Laffer effect references the logic developed by Author Laffer where under some conditions a cut in marginal tax rates will actually encourage enough increased business activity to increase total tax revenue to the government even with a lower tax rate. This phenomenon is known as the "Laffer Curve" effect.
(4) See the Debt Axioms in this article: http://austrianenginomics.com/OurAggregateDebtSealstheFateofEconomicDepression.pdf

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