Answering Your Questions

HITTING A NERVE
THE POLITICAL CHAOS &
THE LACK OF FORMAL EDUCATION

My last piece on the lack of formal education has really struck a nerve. I have been inundated with replies from around the world covering the full gambit from students even at Harvard to traders and brokers cheering it's about time someone told the truth. Since I had referenced that one cannot go to Harvard to study the world economy and trading, it is probably appropriate to reprint an email from a student at Harvard.

> *Greetings Mr. Armstrong,*
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> *My father, an avid reader of yours turned me on to your writings and publications. I am simply speechless. You are 100 percent correct in all that you are saying. I am third year undergraduate studying government at Harvard University. I know the likelihood of a response is few and far between, however, I am very inspired by your writing and want to learn more. The fact of the matter is that the fundamentals that I have been taught, looking back are simply useless. We are killing ourselves. I would enjoy the opportunity to speak with you just to introduce myself to you and possibly assist you in your research. If not, I fully understand. I appreciate you taking the time to write what you do. My prayer is that people will listen. Thank you once again.*

Perhaps because those of us who DO just DO and those who can't teach as they say. But I find there is an academic prejudice if not a snobbish attitude that seems to prevent the advancement of knowledge in Economics. In every other science, you OBSERVE and strive to establish what are the LAWS by which nature works. In Economics, there is no science. This is all about control, oppression, and manipulation. The primary question: **HOW CAN WE FORCE THE ECONOMY TO DO WHAT WE WANT!** To win the Noble Prize, you have to come up with a wonderful theory. It does not have to be even proven as is the case in Physics. When I was in school, the physics professor said nothing was random. The economics professor said everything is random and that implied it was subject to the manipulation of some theory. Thus, we ended up with Marx and Keynes, but effectively every fiber of our economic understanding is focused upon manipulation. We **STIMULATE** to try to affect **DEMAND**. We raise and lower interest rates trying to indirectly manipulate borrowing. We interfere in everything with excessive regulation, have no clue about the collateral damage and when that shows up, we lock someone up and blame the other guy.

If I were to compare economics to the stage of advancement in medicine, I would say we are about at the same stage when bleeding the patience you eliminate the poison and leeches were a popular pastime. There is no advancement in this field whatsoever. We are stuck in the mud and the definition of insanity is well known. ***It is doing the same thing repeatedly and expecting a different result.***

The real world has been trying to cope with understanding the economy and market behavior for far more than a mere 100 years. Yet academia simply ignores what has been developing in the real world for a long time. How can the cyclical nature of energy movement in light and sound just be disregarded in economics? Jevons, Kondratieff and many others have explored the cyclical nature of the economy but they remain obscure in any classroom. The first person to observe the business cycle was Aristotle in his Politics. (***Politics, Chapter X §1258b-1259b translation by William Ellis 1912).*** One would think that the same curiosity that has advanced Physics would have inspired the field of economics.

When I testified before Congress on July 18th, 1996, they apologized because you are arranged and placed on panels. They apologized because I was the only person from the real world and the panel they had to stick me on was academics. I choose to go last for I knew what would happen. Talking about changing taxes and significant alterations to the economy, they asked the academics would this have any impact upon the dollar. They responded, in theory the dollar should remain steady. When they came to me, the party began. By the time I walked out, the academics were slamming the door since I ruined their 15 minutes of fame (*see attached*). If anything, nothing ever remains the same. Change and fluctuation is inevitable. To answer that a currency should not be affected is not realistic.

Another email I received shows precisely the apprenticeship of which I spoke:

> *Marty,*
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> *I am a self-taught non college graduate---and you are my hero! I rose up thru the ranks and currently manage approx $500 mil at [a Swiss Bank] as a broker-I am old school---*
> *No options, no bonds, no funds, no hedges, no nothing but straight equity--I can't be everything to everybody, nor do I try----It would only destroy my focus. I still keep hand charts ---so I can "feel" what is happening. I have read your stuff for the past several years and have identified with every word from the very first piece I read.*
> *I want to say thank you for the education I have received from you-----invaluable--*
> *I am truly humbled and feel luckier than I can ever express to have been a part of your active readership. I would be interested in any and every public speaking or seminar you would be doing-*
> *please add me to ALL of your mailing lists-*
>
> *Best,*

Even if we look at some of the greats in economics such as David Ricardo (1772–1823), you will find he was **NOT** formally educated as an economist since economics did not become a course at Cambridge until 1903. He was a trader and business man who made a fortune and then turned to write to explain **HOW** the world really worked. Even John Maynard Keynes (1883–1946) actively traded in stocks. However, even academics such as George F. Warren (1874-1938), who wrote ***Wholesale Prices for 213 Years; 1720-1932,*** we not accepted mainstream because he actually **OBSERVED** the data and said hey –

this isn't right! My friend Milton Friedman (1912–2006) was not accepted until the 1970s only when the economy was not doing what the traditional academics said it would do. Milton had begun as a subscriber to Keynes. He later abandoned that adopting a monetary view of the world. Milton became a realist and this was his greatest contribution though his words are still ignored today. http://www.youtube.com/watch?v=RWsx1X8PV_A Instead of there being a spirit of collaboration to advance the field that is so important because it is why we have the political chaos we do today, all we get is condemnation and people holding up the silver cross and hope the real world goes away.

The prejudices are tremendous and may be just too hard to overcome. It is like trying to convince people the world is just not flat. Government wants to manipulate the people and doesn't want to hear it has no power to accomplish that goal. In economics, there is a core theory that somehow it is possible to eliminate the business cycle and make every day perfect, clear, sunny, and no rain. However, these manipulations only aggravate the cycle causing the booms and busts to rise in volatility.

This battle of the total lack of formal education in real world tools also justifies the goals of government. It is their self-interest to eliminate any advancement in the knowledge of economics because they will have to behave themselves and get rid of the leaches. The entire government structure would change. Government would then have to deal with reality and knock off the bullshit. The credit-ceiling debate is an example. People are actually asking who is winning. This is showing nothing but politics like a hockey match and who is scoring the most points. The problem is, the system is totally broke and nobody is paying attention that at the end of the road there is a cliff. Nobody is doing anything about really trying to sit down and figure out where the hell we are going.

Just for once, it would be so nice to set the nonsense and bullshit aside with the bias and just look to see if anything moves the way the theories taught claim. In economics, we have discovered the way of perpetuating our mistakes forever. The real world has developed numerous types of analysis. Yet these tools are rejected on a wholesale basis. I was invited to Macquarie University in Melbourne. I was given a tour of a program funded by the banks. They had taken a hotel and each room was wired to simulate a dealing desk. The professor would pretend he was the central bank. He would raise rates or lower them and then grade the students according to their reactions. The problem was, all the data was simulated and the response expected was according to theory. When I asked about charting, they were shocked and replied you look at that stuff? I replied most traders on Wall Street do. How can you judge the future without a map to show where you have been!

I mourn the fate that awaits us for there is no stopping it because we lack truly independent government thanks to political self-interest. Until 1913, you did not vote for a senator. The state legislature appointed who they liked. In 1947, they introduced the 22nd Amendment limiting a President to two terms. It was Thomas Jefferson who voluntarily adhered to a two-term limit writing "***if some termination to the services of the chief Magistrate be not fixed by the Constitution, or supplied by practice, his office, nominally four years, will in fact become for life.***" It was Eisenhower that said the second term had become a "lame duck" referring to the diminished political power when everyone knows he will be gone.

Our greatest problem is a professional class of politician whose self-interest is to stay in office and thus they will not risk that career by trying to fix something in advance of disaster. They are only toxic waste management specialists taking charge after the event. John Quincy Adams (President 1825–1829) had warned: "***Where annual elections end [is] where slavery begins.***" Richard Henry Lee (1732–1794) a great Virginia statesman argued that the Constitution was flawed because of the absence of legal limits to tenure, together with certain other features, rendered it "***most highly and dangerously oligarchic.***" Both Jefferson and George Mason had also advised that term limits to the Senate and to the Presidency were necessary. Mason said: "***nothing is so essential to the preservation of a Republican government as a periodic rotation.***" We have people in office their whole lives never holding any private job totally disconnected from the people.

Unfortunately, advancement in the field of economics is diametrically opposed to the current political system. No one will risk their career to prevent what is coming. They always prefer to probe, pontificate, and prosecute **AFTER** the fact – never before! So our fate is thus sealed. We must endure a complete meltdown of the sovereign debt crisis because (1) it is against the self-interest of politicians to revise the current system, and (2) why should they act without proof that the system will collapse?

Career politicians have indeed created an oligarchy. They are subject to lobbyists and the bankers who keep the perpetual borrowing game in play who are the biggest political contributors. We are about to slash and burn social programs while keeping the borrowing going. Keep following this path and we end up with 100% of total expenditure will be going to the bankers and if the elderly get sick, ***Just Die and Get it Over With*** will be the new motto replacing ***In God We Trust***. It's not just the debt ceiling. It's the whole national debt. We have to revise the entire monetary system before it is too late. http://www.foxnews.com/politics/2011/07/27/debt-ceiling-beltway-debate-carries-echoes-5-impasse/

We are reaping what we have sowed. Yes we have to stop the borrowing. But this debt ceiling confrontation is not the way and could push the confidence off the edge entirely. There is a way to save the system and eliminate the borrowing, but it will take a change in the academic ideas in economics that will object and doom us all. Even the proposal I made in 1996 will not be sufficient today. There is little hope of leaving for our children a better world than what we inherited. The politics of the system has paralyzed us into inaction and the economic academia-crowd simply resists evolution in economic ideas because they do not want to hear that government is incapable of managing the economy. Hold on to those public grants. They may look good for framing when this is all said and done or if you have no home, perhaps they will warm a camp fire.

When I use to do the **World Economic Conference**, they were great because it brought together hundreds of people in one spot and the synergy of ideas allowed one to see the capital flows in the room itself. I will try to put that together in Philadelphia. It seems that it is more important today than it was even a decade ago. I will do my best to try to work this out. Sign up if you are interested at ArmstrongEconomcs@Gmail.com.

Princeton Economics International Ltd

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Mr. Chairman, members of the committee. I would like to thank you for inviting me here today to offer what information PEI has gathered from our experience in dealing with the multinational corporate and institutional sector of the global economy. As a brief background, PEI maintains offices in the US, Tokyo, Hong Kong, Sydney and London. We currently provide corporate and institutional advice under contract on global assets exceeding US$2.5 trillion, an amount equal to about half of the US national debt.

In our capacity as an advisor serving the international community in real live decision making rather than theory, PEI may be uniquely qualified in providing insight as to how and why both investment and business capital flows are affected by a nation's domestic policy objectives.

It has been our experience, that there are five key factors that provide the core stimulus behind capital flows internationally.

1) Foreign Exchange
2) Taxation
3) Labor Costs
4) Inflation & Interest Rates
5) Security (geopolitical & financial)

Foreign Exchange fluctuations have become the number one cause of corporate losses. The percentage movement in the exchange value of currencies has become as high as 40% over a two year period. Exchange losses have impacted every sector of business in every nation to the point that the very way multinationals operate today is dramatically shifting from that of only 10 years ago. Multinationals have been forced to change pricing policy as well as the location of manufacture in an effort to reduce extreme financial risks for their shareholders. Deals such as Rockefeller Center, MCA etc. resulted in significant losses to the Japanese investors more so by the 40% depreciation of the dollar than the actual decline in value of the underlying assets. Japan Airlines was forced to lay-off 25% of its work force last year due to the fact that their cost base was Japanese yen while their revenue was largely foreign currency denominated. In Germany, Mercedes has been forced to restructure their pricing policy as of July 1st, 1996 due to foreign exchange. Instead of pricing the product in DMarks around the world, which has cost them market share, product will now be priced in local currency thereby transferring the currency risk back to Germany.

These are but a few examples of how the more recent extreme fluctuations in the exchange value of currencies has impacted business and investment decisions on a global scale. While it may be politically preferable to manipulate currency values in an attempt to impact trade flows, in reality trade accounts for less than 10% of the total world capital flow movement. Our warnings delivered in a letter to Congress and the White House back in 1985 cautioned against such intentional currency manipulation as enacted in the G5 September Plaza Accord. The net result of attempts to influence trade through currency manipulation led to the 1987 Stock Market Panic. PEI's research was requested by the Brady Commission and we would like to think that we had some impact upon its findings since two of our clients were on the Commission itself. Mr. Brady later stated that he believed that currency fluctuations had played a role in the Panic of 1987. Offered here is a graphic illustration of the net capital flow movement for that period. The upper portion of the graph plots trade and the lower portion capital movement which included stocks, bonds and real estate investment. What is important to note is that ever since 1987, the fluctuations in net capital movement have become more than 10 times as volatile when compared to the p re-1987 era.

I offer this information because it tends to help illustrate the importance that domestic policy objectives have in the new global economy. The second most important factor influencing net capital flow movement is none other than taxation. However, taxation is more than a pure income tax. Taxation contributions imposed on business based upon social objectives for labor are of greater importance than the mere superficial level of corporate income tax rates alone.

It is wrong to assume that manufacturing jobs flow to merely the lowest possible labor cost. If this were true, then all manufacture should be conducted in Mexico, South East Asia or better still - Africa. In our capacity as a corporate advisor helping to make such strategic decisions as to where companies should or should not locate, there are 5 primary considerations that go into the final decision process.

1) Rule of Law
2) Labor Skill availability
3) Taxation Contributions Required on Labor
4) Corporate Tax Rate
5) Regulation

We have clients who have turned down what appeared to be lucrative business ventures in 3rd world nations as well as Russia or China based upon the lack of a Rule of Law that is required to secure the capital at risk. Without a solid Rule of Law, business cannot operate. Such ventures that do develop in those parts of the world depend upon government guarantees from their native country of origin in an effort to underwrite the political risk at hand.

While it is obvious that labor costs are closely associated with labor skills, what is largely overlooked are the social taxation and regulations associated with a work force. We found Asian companies who wished to open manufacturing plants within the EC made their decision based upon the level of skills available and then secondly choose the lower total cost of labor. For example, the UK attracted more than 40% of all foreign investment into Europe due to the fact that it had a skilled labor force but its cost was much less compared to that of Germany or France. This cost factor was determined not by mere wages, but included the social taxation that companies were required by law to provide. On that score, the labor costs in the UK were 40% less than Germany.

When a company did NOT require a major work force but instead merely needed a legal entity within the EC, then the primary deciding factor became the corporate tax rate. While the UK corporate tax rate was 19% less than Germany, they were still more than twice that of nations such as Spain and Ireland. Therefore, corporate headquarters or low skilled labor requirements tended to gravitate to the lowest possible corporate rate within the EC. This is illustrated by the impressive Irish economic growth rates of 9% compared to European economic growth rates of 2.5%. We have found that there is a correlation between high unemployment and high total taxation and regulation costs across Europe today.

Of course, regulation was a major factor as well. This we can see within our own US borders as well. Southern States are activity competing for Northern corporations and jobs. If we look at those states where regulation is the least intrusive and taxation is the most favorable, you will find the highest number of corporate relocations and new foreign business ventures within the United States.

Domestic Taxation policy must take into consideration our new global economy. We must be sensitive to being competitive not merely on labor costs, but also on the total taxation and regulation costs if we hope to avoid the dismal European example with its chronic unemployment in excess of 10% year after year. We must also keep in mind that taxation itself is largely influenced by philosophical decisions made by governments without considering the true total economic impact. For this reason, taxation has been a major factor in altering world capital flows as well as economic growth levels. When the US corporate tax rate hit nearly 70% during 1968-1969, virtually every American company began shifting manufacture offshore. Today, over 65% of the US trade deficit is made up of US companies importing their own goods manufactured somewhere else. In fact, if we allocate world trade according to the flag a company flies instead of the last port of assembly, you will find that the US has a net trade surplus in excess of $150 billion.

Much of the economic turmoil in Japan today is being caused by excessively high tax rates. In fact, 3 of the first section listed companies on the Tokyo Stock Exchange have renounced their Japanese heritage and moved to Hong Kong due to a 15% tax rate compared to nearly 70% in Japan. Our economy contracted from the 1960s for 12 years. Japan appears to be facing the very same long-term trend. After 6 years, the Japanese economy remains in the throes of a near depression and taxes have still not been reduced. Despite the fact that interest rates have fallen in Japan to 0.25%, there remains no interest in borrowing for domestic economic expansion.

The method of taxation through domestic social objectives is also a key factor in shifting global capital flows. For example, the US is one of the very few nations that seek to tax their citizens and corporations on worldwide income. Most British Commonwealth nations tax worldwide income if earned in a tax free zone. Therefore, if the US were to totally eliminate the corporate income tax, we would run the risk of corporate earnings in the US being considered as income from a tax free zone.

Furthermore, US tax code classifies income made overseas as if any overseas income is derived solely to avoid domestic taxation. The 50% and/or control rule for US companies as the sole criteria for taxation penalizes US enterprises forcing many into join ventures simply to avoid double taxation in the US. We also discriminate against American companies trying to enter foreign markets by passing the tax burden directly to personal income even if such earnings are not distributed. Our tax code assumes that any offshore entity is merely trying to avoid taxes without testing whether or not an actual business is being developed as compared to an offshore account for investment purposes.

In addition, our prejudice against capital gains versus short-term income within our tax code provides an incentive to manufacture and develop domestic products offshore. The US is one of the few nations who's tax system punishes long-term investment while rewarding short-term speculation. Again, the capital gains taxation has exported more American jobs not because of the mere rate, but due to the fact that losses have been treated differently from short-term income while disallowing the impact of inflation indexing. Consequently, while virtually every electronic produce from VCRs, CDs and assorted appliances were designed and patented in the US, their final development and manufacture have been more fairly treated by nations such as Japan. This uncompetitive social philosophy inherent with American tax code has been one of the major causes of forcing US companies offshore into joint ventures than even the net level of income tax itself.

While many will argue that corporations pay little in income tax, what is grossly ignored is the taxation of labor that is a huge direct cost to business. If we look at our own revenue statistics, you will find that the taxation contributions to the payroll tax paid by corporations is substantial - generally twice the level of corporate income taxes.
We must also take into consideration the net cost of taxation upon the nation as a whole. While it is true that the national debt doubled under Ronald Reagan moving from $1 to $2 trillion, this alone does not mean that lower taxes or Reaganomics failed. Under Bush and Clinton, the national debt has now more than doubled from $2 to $5 trillion despite raising taxes.

We must honestly review the economic facts of the past 16 years in order to understand our future. Since Ronald Reagan, we have actually had a balanced budget from the perspective of revenue v. spending. At 8% compounded, you double your money in a bank in about 8 years. The interest expenditures during the Reagan period were equal to nearly $1 trillion. Today, we actually collect about $100 billion more in revenue than Congress actually spends on programs. This is being absorbed by our interest expenditures. In fact, since 1950, the total interest expenditures paid now equal 68% of the total outstanding national debt. We are indeed becoming a banana republic.

At times, up to 40% of our national debt has been held by offshore investors who pay no income tax in the US. This means that domestic spending from Congress is no longer stimulating our domestic economy. If fact, an analysis of capital flows reveals that the Japanese earned more from the US on their investment income in the past 16 years than -they did on trade.

By taxing interest income, we penalize Americans and overpay foreign investors exporting more capital than would otherwise take place. If we eliminate the income tax on government bonds, we could reduce the interest rate to the actual net return after taxation. This alone could result in an instantaneous balanced budget since we currently collect more in revenue than we spend on programs.

Capital is rushing around the globe today much in the same manner as it did going into the Great Depression. Herbert Hoover wrote in his Memoirs that "capital acted like a loose cannon on the deck in the middle of a torrent." In 1985, the largest futures mutual fund was $100. Today, $1 billion funds are a dime a dozen. Everyone is investing somewhere else to avoid local taxation. It is now estimated that over $2 trillion sits offshore, untaxed and unregulated emanating from all nations. If we eliminate the personal income tax, then America itself will become the international magnet for this vast pool of capital. Our interest rates would decline as it always does whenever excess capital emerges. This single step alone, combined with creating a tax free government bond structure, could spark untold economic growth and help to actually begin reducing our national debt rather than waiting for everything to go bust beyond the year 2000.

If the purpose of this Committee is to fairly reflect upon how our tax code can be used to attract jobs and stimulate economic growth rather than employ gimmicks such as currency manipulation, special one-off tax deals or deny the damage that Marxism has created in the postwar world, then it is clear from our " experience that there can be several important conclusions.

1) End the discrimination against long-term investment by at least allowing capital gains to be indexed to inflation retroactively.

2) Promote honest reform of the Social Security System whereas contributions made should be privately managed as is the case in many other nations. The Postal Savings System in Japan actually has on deposit in real funds nearly $10 trillion which is then managed by the private sector under the watchful eye of government. This will help reduce the cost of labor in the US, create jobs through increased savings, and result in lower payroll tax contributions for business over the long-term.

3) Eliminate the taxation on government bonds.

4) Eliminate the personal income tax and replace it with a national sales tax of 10%.

5) Reduce the corporate tax rate to 15% matching Hong Kong. Allow interest paid to be deducted as a part of the cost of doing business.

Mr. Chairman, members of the Committee:

This is a brief overview of our experience in dealing around the world on a first-hand observation basis. We strongly believe that the replacement of the current income tax system on individuals with a national sales tax in combination with a corporate tax rate of 15% will prove not merely to be revenue neutral, but also a major economic stimulus that will help our domestic economy grow while forcing major economic change around the world restoring the beacon of hope and liberty by our example.