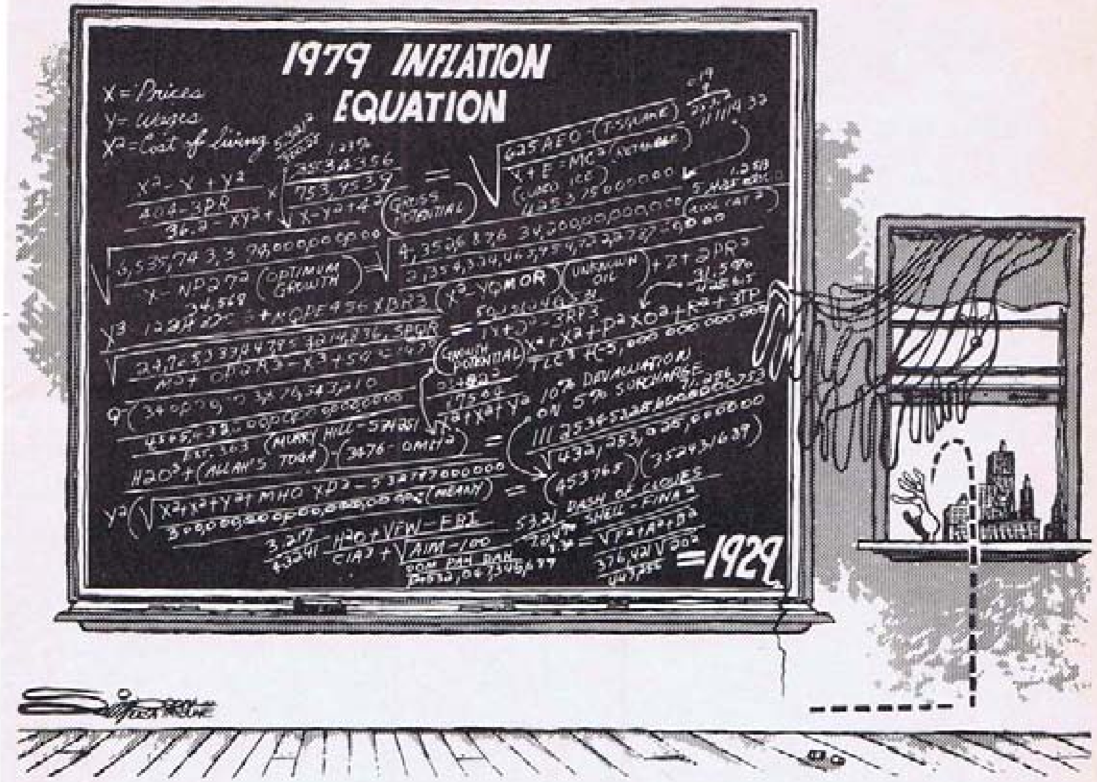

BAD DEBT

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■ THIS NATION has a rendezvous with debt. In fact, the whole world is facing such a rendezvous. Over the past twenty years we have been plunging into debt at an astonishing rate. Nations, including governments at all levels as well as corporations and individuals, have been going into hock to the collective tune of trillions of dollars with no more concern about where the money will come from for repayment than a drunk on a toot. Signing loan agreements, borrowers tell themselves that they will worry about tomorrow *mañana* since, as everyone supposes, *mañana* never comes. Except it does! In fact, it may be here as soon as, well, tomorrow.

Business analysts and economists, gazing wide-eyed at this spiraling debt, are starting to get sweaty palms. They have termed the world's aggregation of red ink "Debt Mountain." And there is growing concern about avalanche.

Even *Business Week*, the voice of the Establishment speaking to the business community, is now watching Debt Mountain with fear and trepidation. In years past, that McGraw-Hill clarion has trumpeted the theories of John Maynard Keynes, fairy godfather of debt and paper-money inflation. Did the economy have a slight case of the twenty-four-hour recession? Why a shot in the arm with

	National Debt in billions	Service charge in billions
1977	685	48
1978	746	55
1979	807	63
1980	877	72
1981	957	82
1982	1,047	94
1983	1,147	108
1984	1,257	123
1985	1,377	140
1986	1,507	160
1987	1,647	181

a dose of Dr. Keynes' red ink would have the patient up and dancing in the morning. When *Business Week* prescribed the inky elixir to the business community it all sounded so respectable, so reasonable.

The trouble is that the patient is now hooked on the red junk and addicted to perpetual debt. So voracious has the world's demand for ever-more shots of debt become that even McGraw-Hill's *Business Week*, a pusher who helped promote the process, is clearly panicked, fearing the addict will overdose. In the issue for October 16, 1978, its editors devote nearly fifty pages to an in-depth study of all the various aspects of debt. This special report, entitled "The New Debt Economy," might have made a more appropriate appearance two weeks later at Halloween. The fact is that the world's economy has devoured its treat and is about to suffer the trick.

To give you an idea of how international debt is escalating, consider it in billions piled up by the nations of the world during the following years: 1972, $14.3; 1973, $27.2; 1974, $33.8; 1975, $34.4; 1976, $52.2; 1977, $65.7; 1978, $88.0.

Do you detect a trend? If you don't, you might have trouble finding sand in the Sahara. A little quick addition shows that the nations have amassed $315.6 billion in debts in the past seven years. More significant is the fact that this year's red ink will amount to an increase of six hundred percent over that of 1972.

From where does all the money for these loans come? Some of it comes from the ever pliant U.S. taxpayers via the International Monetary Fund and other governmental loan agencies, but such monies are themselves funded from debt. The above figures include only loans from the huge private international banks operating outside the United States.

In 1974, when the Arabs began raising the price of oil higher than a harlot's skirt, there was much talk of an international liquidity (cash) crisis. Just the opposite has happened. Backward or undeveloped nations borrowed huge sums to buy Middle East oil. The Arabs put most of the cash receipts in banks which used the "reserve" to make more loans to the same customers. The Keynesian pundits heaved a sigh of relief. The inflated oil prices were not going to destroy the countries without petroleum after all, and a worldwide depression was apparently to be avoided. As *Business Week* observes: "It is that massive flow of funds from the international market that is enabling nations to keep rolling over old debt and taking on new debt nearly without limit . . . ."

Realists pointed out that the depression was merely being postponed as the process is unsound.

Merrily we borrow along, borrow along, borrow along. But how will this mountain of money ever be repaid? Don't ask. Had the money been invested in the creation of mines, factories, food production, or some other cash-producing asset, there would be hope for eventual repayment. But the vast majority of this borrowed money has gone to purchase oil (now consumed) or been squandered in socialist boondoggles.

There would seem to be only two ways for the big international banks to be repaid. Either they will have to be bailed out by the U.S. taxpayers through the I.M.F., or the banks will accept concessions of raw materials from the so-called L.D.C.s (Less Developed Countries) through allied corporations. The former would break the U.S. Treasury and the latter might lead to war when debtor countries get testy about surrendering their mineral wealth to the multinational megacorporations. Of course there is a third possibility. After rolling over the loans as long as possible, the international banks could write them off as bad debts. Is this likely? It is more likely that the Internal Revenue Service will dress all of its agents up as Santa Claus this Christmas and put them on the streets distributing thousand-dollar bills.

What worries *Business Week* is that the banking fraternity has overdone the lending-borrowing binge and tremendous financial consequences could result in the not-too-distant future. According to its economists:

"The next world recession will catch international borrowers even more extended than they were in 1974 — trying to pay off still more debt in the face of sagging world trade . . . . Yet a greater amount of debt is being encouraged today than ever before, and when the next international credit crunch does come, the squeeze on both borrowers and lenders will be worse than ever before . . . .

"By late 1979 or early 1980, the world economy could be surging with inflation rates of 10% and more in many countries, and with the prospect

of worse to come if borrowers and lenders alike do not rein in. It is at that point that the lending binge will end — a crunch that would hit nearly everyone, crippling trade, slowing economies, and pushing the LDCs right back to the end of the line for funds but with a much heavier load of debt to finance . . . ."

Another aspect of the multinational Debt Mountain is that it is creating worldwide inflation. Again we quote the warning of the McGraw-Hill economists: "Most disturbing is that the cash torrent that permitted countries to survive the oil price increase has also created a built-in international inflation machine that can endanger not merely trade but the whole world economy. Euromarket credit has become so cheap and so readily available that governments have chosen to take on more debt instead of wringing inflation out of their economies. Rather than impose severe fiscal and monetary restraints to curb imports and bring down the inflation that came from the rise in oil prices and the boom of the early 1970s, governments instead tapped the Euromarkets to finance their inflation. It is now a time of resurgent economies and continued high inflation, and in the past that combination has inevitably led to a credit crunch and then recession."

As readers of this magazine know, *inflation* is the increase in the money supply, which in turn bids up prices. New money is the cause, higher prices are the effect. Keynesians, however, have led people to believe that inflation is rising prices. Effect becomes cause. Associated Press business writer William Glasgall, in a discussion of American dollar deposits in foreign banks (Eurodollars), explains how the "inflation machine" works:

"In the United States, the FED [*the Federal Reserve Bank*] creates a dollar by purchasing — with a check that can be drawn out of thin air — a government security from a commercial bank." Thin air is an infinitely plentiful commodity. Glasgall goes on to explain:

"The bank must set a portion of this dollar aside in its reserves and may lend out the remainder. The loan is deposited in the bank account of the lender. A portion of the new deposit is held by the bank for reserves and the rest is lent, and then the process is repeated. The Fed sets reserve requirements for its member banks and uses them to figure how much money its original dollar will create as it is lent out again and again. Those reserves don't earn interest and they limit a bank's profits on loans."

Now comes the kicker which reveals why American banks operating overseas, along with foreign banks, have been able to make Debt Mountain higher than Mt. Everest. Glasgall reports: "A new Eurodollar is created when a depositor moves his money from a U.S. bank to a foreign bank, or when an Arab oil producer takes his revenue — dollars from the United States — and deposits it in a foreign bank. That bank lends out the dollars, and the money is lent again and again. But *there is no official reserve requirement* to limit turnover, so $1 could be the base for $10 or $100 or $1,000 or more in loans. That same dollar within the United States might create $10 more in loans because of reserve requirements."

You can see why American banks set up offshore branches. In theory the international banks can inflate to the moon by making loans to nations and multinational corporations. This is the international "inflation machine" which *Business Week* describes, but does not explain. Americans buy oil from the Arabs. The Arabs deposit the dollars in a bank outside the United States. The bank can now lend that money out over and over again without setting aside a penny for reserves. The banks love it. Check the earnings of Chase Manhattan, Citicorp, Bank of America, or any of the megabanks. Fifty to eighty percent of their earnings come from overseas corporations.

The multinational corporations love this system also. They use this bottomless well of "money" to finance corporate expansion and acquisitions. Glasgall cites the recent example of how a U.S. company raised money overseas. In this case, Texas International Airlines wants to buy National Airlines. To finance part of its stock purchases, it sold $24.2 million in convertible debentures (essentially bonds convertible to stock) to investors outside the United States. The investors used their Eurodollars deposited abroad and the dollars came home to Texas International's U.S. accounts. In other words, T.I.A. bought National Airlines with money which may very well have been created "out of thin air" since there are no reserve requirements on the banks making Eurodollar loans. As you can imagine, the potential of this ploy is mind boggling. It sounds like something the original John D. Rockefeller might have dreamed up to facilitate monopoly.

However, as *Business Week* obviously realizes, this "inflation machine" is not really the perpetual-motion contraption it may appear to be. In the short run, those who know how to use and manipulate the machine will accumulate fortunes, just as those who knew how to use leverage made millions in the Twenties. But those who hung around too long wound up trying to fly out the windows of tall buildings. Such perpetual-motion machines don't work forever.

Moving closer to home, it is certainly not a man-bites-dog story to say that the federal government is virtually going berserk in the debt department. Our official National Debt is now in the area of $746 billion. Astoundingly, *half* of this has been piled up in the 1970s. A chart showing the moving averages of deficits since 1951 is extremely revealing. The average deficit rose very slowly in the period between 1951 and 1966 with the yearly additions to the National Debt starting in the area of three billion dollars and rising to ten billion in 1966. Then the deficits oscillate until 1972, at which point the chart takes on the appearance of a Saturn rocket heading for space. Whereupon we start getting deficits of thirty, forty, and fifty billion dollars. Clearly this kind of rise is unsustainable.

Leonard Santow of the J. Henry Shroder Bank is considered one of the leading experts on federal financing. In his latest report he estimates the 1977-1978 federal deficit at fifty billion dollars. Then he predicts that, despite the Carter Administration's claims, the current (1978-1979) deficit will be even greater. (Remember when Carter promised a balanced Budget by 1981?) Santow sees government spending running five billion dollars over government predictions.

One thing which makes this especially frightening is that we are now into our fourth year of "recovery" from a recession. The Keynesian theory is that deficit spending will propel the economy out of the blahs. As we come out of a tailspin, the size of the deficit is supposed to shrink. In the early 1950s, Dwight Eisenhower spent three billion deficit dollars to "cure" a recession. But, as Dr. Gary North has pointed out, deficit spending is the economics of addiction. It takes a bigger fix each time to prevent the onset of withdrawal symptoms. Now the periods of stagnation are coming with increasing frequency and each requires a larger dose of junk money to reverse. This time it took about two hundred billion dollars in new federal Debt to nudge the economy out of recession. That is a long way from the Eisenhower days.

Worse yet, no sooner are we out of one recession than virtually every economist of whatever ideological persuasion is predicting that the economy will soon start trembling and lurching into withdrawal again. The brutal truth is that Uncle Sam is a Debt junkie. The next recession will probably require seven hundred bil-

lion dollars in fixes to restore it (temporarily) to what on the surface appears to be normality. After that, folks, get out the wheelbarrows.

The Keynesians used to pooh-pooh those who worried about the National Debt with the vacuous cliché: "We owe it to ourselves." It was the perfect "Liberal" slogan, fraught with irony but devoid of substance. Supposedly it meant that the National Debt was owed to fellow Americans and American institutions. But even this is no longer true. Foreigners now hold $120 billion of our certificates of Debt. Naturally, these creditors want to halt the dollar slide and stop the U.S. from inflating. One way for the Fed to do this is to raise interest rates until it hurts. The high interest rates may throw us into a recession, but the Arabs and other creditors are, in effect, holding our National Debt for ransom. Without high interest rates to compensate for the dwindling purchasing power, the boys in the bathrobes will simply pull their money out of U.S. Debt securities, with the possibility that this could kick off the collapse described by former Swiss banker Paul Erdman in his best-selling book *The Crash Of '79.**

So much for "We owe it to ourselves."

Owing *it* to anybody is getting pretty expensive. Dr. H.A. Merklein, Professor of the Graduate School of Management, University of Dallas, has done some projections on the National Debt and its costs. As anyone who knows what the banking industry is talking about when it refers to "the magic of compound interest" will understand, the compounding interest on an expanding debt will in time destroy any financial entity. In a decade, Merklein predicts we will by paying $181 billion a year interest on a $1.6 trillion National Debt.

Dr. Merklein states that the net capital-generating capacity of the

*We are told that privately Erdman does not expect the Crash of '79 to occur until 1982 or 1983. The year 1979 was picked to coincide with the fiftieth anniversary of the Crash of 1929 to enhance sales appeal.

U.S. is about one hundred billion dollars per year. Based on this figure, the chart on page thirty-seven tells the story. Between 1982 and 1983, the service charges (payment of interest) on the National Debt will move above one hundred billion. At that time the cost of carrying the Debt will eat up the entire capital-generating capacity of the United States. To put it bluntly, we will not be able to pay the costs of carrying it. Many economists believe that this will trigger the collapse of Debt Mountain.

As astronomical as these deficit figures are, they still don't begin to tell the whole story. There is the matter of so-called "off Budget" items, a phenomenon begun in 1973 to hide the enormity of federal spending and deficit spending. The off-Budget spending items will add another $12.5 billion to the Budget. However, that is not the only impact that off-Budget federal agencies such as the Postal System, the Export-Import Bank, and the Federal Financing Bank have on the economy. This year they will enter the credit markets to borrow an astounding fifty-three billion dollars. Along with the on-Budget deficits, this makes total federal borrowing of eighty billion dollars. Additionally, the Treasury has to "roll over" (refinance) about one hundred fifty billion in existing securities. The rollover problem becomes more acute all the time because, during inflation, lenders are not willing to make long-term loans to the government.

But *Business Week* notes: "As in the past, the government will get all the money it wants, regardless of the condition of the financial markets." In other words, Uncle Scrooge gets his and private enterprise feeds at the last spigot. With the country generating one hundred billion dollars a year in new investment capital, and the government borrowing eighty billion a year, this means that Big Sam is extorting the equivalent of eighty percent of all newly created capital. Think about it, folks: You can't have capitalism without capital.

The long-term aspects of the deficit problem are even more appalling. For decades politicians have been getting elected by making promises of future pensions which did not have to be funded out of current taxes. This ploy was a bigger boon to politicians than the rock-music craze has been to manufacturers of hearing aids. The King of Cons is without doubt the Social Security system. For many years Conservatives pointed out that Social Security was little more than a chain letter and there would be insufficient monies for the people at the bottom half of the chain. Dr. Rita Ricardo Campbell of the Hoover Institution at Stanford University estimated that the unfunded liabilities of the Social Security system over the next seventy-five years amount to nearly seventeen trillion dollars. Since that time, the Carter Administration has doubled Social Security taxes which, it is estimated, will cut the deficit down to a measly $8.5 trillion.

The accounting system used by the government greatly distorts the true Debt obligation. The U.S. Government operates on a "cash" basis of accounting. Normally, even moderately large businesses use the accrual system, *i.e.*, present income and future obligations. John N. Myer, in his book *Understanding Financial Statements*, writes: "The cash basis is so simple as hardly to require any knowledge of accounting . . . . As will be shown, this method of measuring income does not produce a useful estimate of performance, and, therefore, its use is limited to small retail business. . . ." Unfortunately, it is the system used in the multitrillion-dollar instance of our federal government to keep the voters from knowing what is being done to them.

The National Taxpayers Union has applied the accrual system to federal budgeting and revealed some staggering facts. In a full-page advertisement in the *Wall Street Journal* of May 14, 1976, it was reported:

The one trillion dollar misunderstanding could be the basis of national bankruptcy. One trillion dollars is the amount that the total financial obligations of the federal government grew last year.

The so-called "national debt" represents a small fraction of the total future financial obligations of the government. It is like the tip of an iceberg floating in a sea of red ink. Consider these Treasury Department figures:

National Debt	*$595,000,000,000*
Other Fiscal Liabilities	*69,000,000,000*
Undelivered Orders	*130,000,000,000*
Long-Term Contracts	*12,000,000,000*
Government Guarantees	*175,000,000,000*
Insurance Commitments	*1,481,000,000,000*
Social Security Obligations	*2,710,000,000,000*
Unadjudicated Claims	*10,000,000,000*
International Commitments	*10,000,000,000*
Miscellaneous Commitments	*31,000,000,000*

This isn't even a full list of the federal government's debts. NTU recently completed a computation of the unfunded liabilities of 21 of the federal government's 80 employeee retirement plans. This computation shows that taxpayers will pay out $499.155 billion in pensions, even if there is no inflation for the rest of the century. A small inflation rate for a few years would astronomically increase these pension obligations.

Last year alone, $12 in unfunded financial obligations were created for every dollar of deficit spending. While the "national debt" increased by $84 billion in 1975, the inflation created by deficits raised the future obligations of government at a rate of about $83 billion per month. In all, more than $1 trillion in future obligations were created.

Unchecked, this can mean nothing but disaster. A vicious cycle of deficit spending and inflation is underway. Each new deficit causes greater inflation, which causes greater deficits, which cause still greater inflation.

The longer the situation is allowed to continue, the smaller the likelihood it can be corrected. The Office of Management and Budget has predicted that a continuation of current trends (with no new programs added to the books) would lead to an annual deficit of $700 billion by the end of the century.

The National Taxpayers Union calculated that the true National Debt is really nearly six trillion dollars. It is, of course, much larger if one calculates Social Security over the next seventy-five years as Dr. Campbell has.

State and local governments are not about to miss out on the spend and borrow mania. They will go further in hock to the tune of sixty-two billion dollars this year. Supposedly, the wild spending desires of state and local governments have been chastened by the financial agony of New York City and the passage of Proposition 13. The *Business Week* study is very skeptical that this is really the case, noting that in New York City, for example, estimates of future budget deficits keep rising — to $1.2 billion for Fiscal 1982 — while the city fathers twist and turn to avoid making painful cuts.

Not to be left out in the cold, the nation's corporations are leaping upon the borrowing bandwagon. Total corporate debt runs in the neighborhood of one trillion dollars. Short-term business borrowing has boomed this year, growing some ten percent to $205.5 billion in just the first half of 1978. Even the money-center banks

of New York and Chicago are turning up more borrowers, and many big regional banks are simply running out of lendable funds. During the past three years, corporate debt has been expanding at the rate of twelve percent per year.

Part of the reason that corporations must plunge deeper in debt is that for many years profits have been inadequate both to finance modernization and pay dividends. So business has had to go to the bank and to the bond market.

Government-sponsored inflation has also put a dagger into the heart of the stock market and largely dried it up as a source of new capital. Since 1974, the equity market has performed so badly that the issuance of stock is not considered a viable alternative by most businesses. The stock of many companies is selling well below book value. So these companies have issued bonds at high rates and thus have poor ratios of debt to equity. *Business Week* observes: "This is worrisome because the borrowing binge that peaked in 1974 skewed the ratios of so many companies that experts began to fear for the very safety of U.S. business."

In case you missed the point, the McGraw-Hill economists say: "The reason for the stock market's slump is, of course, the debt economy — old and new. In the decade between 1952 and 1961, total U.S. debt grew by 6% each year, and the market value of stocks rose 14% annually. Between 1972 and 1977, by contrast, debt soared 10.7% a year, inflation approached 7% and stocks posted a feeble 1/2 of 1% annual advance."

Corporate equities are no longer attractive to institutional investors. Private pension funds, for example, which control some two hundred billion in assets, are now the single most important factor in the stock market. Traditionally, seventy percent or more of their funds are invested in stocks, but since 1974 that figure has slipped to fifty percent as the funds have built up their cash positions or loaded their portfolios with bonds.

Again, you can't have capitalism without capital. When capital markets are supplanted by debt markets, the capitalist system is up to its gizzard in trouble. And it is obvious that the McGraw-Hill economists, who prepared the lengthy *Business Week* report we have been reviewing, expect major changes. They note:

"The grim truth is that for most companies the equities market works no better in 1978 than it did in 1973. Nor is there much reason to believe that it will work any better in 1983 than it does today. Behind that analysis are these five factors:

"• Government economic policy now favors immediate consumption — of cars, homes, and other big-ticket items — at the expense of long-term investment.

"• Federal Reserve monetary policy in recent years has made debt capital widely — if expensively — available, while the same policy of easy, costly money has caused investors to shy away from stocks.

"• U.S. tax policy permits corporations to deduct interest payments on debt but not dividend payments on stock. Coupled with this has been the government's tougher bite on capital gains and, more recently, great uncertainty about the future levels of capital gains taxation.

"• Institutional investors, which control the vast bulk of equity capital, seldom put it into companies that need equity capital the most: the non-glamour, bedrock companies of U.S. industry.

"• Companies are unwilling to sell equity in a market, which, for all of the above reasons, has valued their stock at price-earnings ratios that remain close to their historic lows."

For 1978, business has total cash needs of an estimated $102 billion. A miniscule nine percent will come from equity investments. William Freund, chief economist at the New York Stock Exchange, observes that this situation does not hurt the megacorps, but stiffs the up-and-coming outfits. Says Freund: "One of the problems is that usually, for equity issues, the largest and most highly rated companies are the ones that get their needs filled first. And the companies that really need the equity capital — the volatile, innovative, and entrepreneurial firms — don't. To stimulate growth, there has to be some risk taking, and bonds just don't do that."

But this is only part of the negative psychology. During the past year or so the American public has become convinced that the price increases are a perpetual problem and are not going to be stopped. Prior to that time, the people were concerned about the upward price spiral, but tended to believe the promises of politicians that it would be halted. One of the main responses has been that the public is plunging into debt at an unprecedented rate. Inflation psychology says buy now because tomorrow whatever you want will cost more. So people are going in debt to buy things they may not actually need. As Miner Baker, economist for the Seattle-First National Bank, puts it: "The rising level of debt means we are spending beyond our means. Everybody is trying to consume more than they produce, and that inevitably pushes prices up."

Consumer installment debt rose at an annual rate of thirty-nine billion dollars during the first half of 1978, compared with thirty-one billion for all of 1977 and twenty-one billion in 1976. Consumers are taking on new debt at a rate fifty percent faster than their incomes are rising. Total consumer debt, including home mortgages, now stands at one trillion dollars — equal to about $4,600 for every man, woman, and child in the land.

After consumers have paid their taxes, another twenty-one cents of every dollar they earn must go to pay off existing debts, an unprecedented burden on the wage earner. The danger of this credit-buying binge is obvious. The *Business Week* report puts it this way:

"As long as the economy stays in high gear and the paychecks continue to roll in, consumers should be able to keep their heads above water. But if the economy begins to sputter — even temporarily — then the carrying cost on this enormous debt could brake consumer spending on everything from ranges to ranch houses. And this sudden brake on spending could quickly transform a small sputter into a full-scale recession . . . . No one yet knows at what point the consumer becomes overextended and starts retrenching by cutting spending. Nevertheless, by all historical standards, consumers have entered what F. Gerard Adams of the Wharton School calls 'a high-risk situation.' "

That "point at which the consumer becomes overextended" may have come on November first when President Carter announced that the Federal Reserve was raising the rediscount rate an unprecedented one percent. The prime rate is now 10.75 percent — up 39 percent so far in 1978. This could be the point at which credit becomes so expensive consumers start saving and postponing purchases. When the retrenching starts, the recession will follow as surely as the knight follows Guinevere.

The *Business Week* economists say: "The grave danger is that short rates are about to burst out into the double-digit zone. [*They just did.*] That means that mortgage credit will surely dry up as it did in 1974, and housing starts will plummet. Coupled with a decline in other consumer spending, this could well shove the economy into a deep recession. The impact of recession on a credit-burdened public could be horrendous."

Keep in mind that the staid (if not Conservative) economists of McGraw-Hill are not accustomed to using adjectives like "horrendous." And within three weeks of the time this special feature on "The New Debt Economy" appeared, prime rates had reached a new high along with the Federal Reserve's discount rate.

For many families, the situation will be more serious than just trying to figure out how they are going to make the monthly installment payments on the washer and dryer. Consider:

Because of the dramatically increased market value of homes, many families have been tempted to take out a second trust deed on their house so that they can enjoy some of their increased equity. Indeed, in California, where home values have mushroomed, the giant Bank of America chain, the nation's largest, runs radio ads urging people to come down and borrow up to twenty-five thousand dollars against the equity of their home "for any purpose." So, thousands of households are hocking the family homestead to buy (choose one) **A.** a motor home; **B.** a cabin cruiser; **C.** a mountain cabin. Now the family has another five hundred or so dollars in monthly payments to make.

All this is peachy keen as long as the boom continues. But, booms created by Keynesian money treachery always skid out and go into reverse. When the crunch hits, what is the first thing the family is going to unload? That's right, the boat, the motor home, or the cabin. But the price of such property will drop like a rock since there is little demand for these in a recession. Those who have cash will be able to buy up such luxuries at twenty cents on the dollar.

But this also means that the family which borrowed twenty-five thousand on their house to buy the expensive toy will be out twenty thousand dollars and still owe monthly debt. On top of this, the market value of the original home will probably have shrunk more than the second loan. Leverage is great going up, but it will kill you when it goes into reverse. The government's Keynesian game has lured many people into putting their financial heads in a noose. Even the boys at McGraw-Hill are worried about rope burns.

Government, corporate, and private borrowing piled on top of each other have created a debt structure of enormous proportions. "The only time that debt will go down is when the economy crashes, a recession or a depression," says economist David A. Bowers. But Americans are betting that personal income and corporate earnings will jump every year and that the government's monetary and fiscal policies will continue to inflate enough to allow the "recovery" to continue. But this can't go on much longer without runaway inflation.

Thus the Carter Administration is caught between a monetary rock and a fiscal hard place. Domestically, it might be able to live with inflation if unemployment stays down. But with the dollar being slaughtered in the world's currency markets, and foreigners sitting on $120 billion of America's National Debt, the situation is just not that simple. The financial piper must be paid and the funny-money is coming home to roost.

David Rhoads, author of *How To Survive A Spastic Economy*, believes that we have traveled along Debt Road about as far as we can. He notes that just about every business and individual has taken whatever assets they have and borrowed against them from lending institutions. He observes that "changes in our debt and money markets since World War II have converted *all* forms of debt into short-term 'parking lots' for cash. And we can conclude that we've mobilized our debt — we've effectively *activated* all that potential money. The result has been an exploding 'debt-money' supply and today's inflation. Mobilizing debt and converting it to money has become a major national pastime."

Rhoads holds that if we stop turning assets into debt money the machine will go into reverse. He notes "the stability of our money depends directly upon the credit worthiness of those who take on debt. If a borrower can't service a debt, his whole portion of debt/money may dissolve in bankruptcy. If a lot of borrowers suddenly can't service their debts, a major portion of debt/money disappears and the event is called a credit crisis."

Before the creation of the Federal Reserve System, over expansion of debt would automatically take care of itself and the economy would go through a quick catharsis, eliminate unsound investments, and start to rebuild. Now, thanks to the inflation machine which is the Federal Reserve System, debt is piled upon debt to produce perpetual expansion. Well almost. When there is nothing left to hock, we will have the catharsis to end all catharses and hit rock bottom.

Rhoads informs us: "By the end of 1977, we achieved $4.49 of debt/money per $1.00 of real production — the highest rate in history. We got there by sucking into our debt-money whirlpool the world's most marginal borrowers. Then we loaded them with ever more credit. Now, today's debtors have reached their absolute borrowing limits. That's what the money and credit problems around the world mean: our mountain of loans is running sour. It's being transformed into a pile of pending adjustments — failures, defaults and bankruptcies.

"The mountain is metamorphosing into a waiting avalanche. If it ever lets go, the economy might even snap back to its old level of $1 of debt/money per $1 of real production. This would mean collapse of 75% of the nation's debt and credit. Of course, prices would fall too — but we tend not to think about that so much when we're going down the credit tubes."

Rhoads says that nobody can predict Avalanche Day. His belief is that the government will continue to try to walk the thin line between runaway inflation and depression, but that inevitably somebody in Washington will make a mistake; somebody in the Federal Reserve or the White House will zig when they should have zagged. Although Rhoads does not mention the possibility, it may be that somebody would deliberately start the avalanche.

Richard Russell, author of the "Dow Theory Letters," writes that "the nation is now loaned up . . . . All those loans have to be serviced. If the economy declines, then tax receipts to the government fall off, bringing about huge new deficits. Recession would also bring about a corporate squeeze, as profits dwindle and debt demands remain. As for the consumer, any increase in unemployment would bring wholesale loan defaults."

Despite the confident talk from Washington, in private our rulers are chewing their fingernails, as indicated by Betty Beale in a recent Washington Comments column:

"From the appearance of the party for new Federal Reserve Board Chairman and Mrs. William Miller at the exclusive 1925 F Street Club, it was another one of those chic political dinners for which Washington is famous . . . . The mingling before dinner seemed as cheerful as always. . . . And the after-dinner remarks started out on a light note . . . .

"But after that the boom fell. One can't remember when dinner toasts sounded such a note of dire warning.

Not even during Watergate was the feeling in Washington so dismal for the U.S. and her global allies.

"Javits expressed his gloom: '. . . What's at issue is whether our economy will stand up, because in the final analysis it's the private enterprise system which assures our freedom.' . . .

"Said Ambassador Yaqub Khan in a subdued, concerned voice, 'I'm convinced that the next four or five years are surely going to be decisive in the political and economic sphere for centuries to come.' There was silence as many of the 50 guests wondered what the White House would do about 'the storm that awaits us.'

"The Fed's chairman, one of the most influential men in America, responded by trying to hit an optimistic note that only revealed his own anxiety. 'I am convinced that once we have reestablished confidence in ourselves we will strengthen our institutions and purge them of their faults; that we will once again coalesce into a nation that does know its destiny, does know where it's going and does know that it has a key role to play in the world and the world depends on it.'

"The free world is worried and the Washington social scene is reflecting it as never before."

Is there anything which the American public can do to avert a financial holocaust? There are two answers to that question: **1.** Yes. **2.** We'd better.

Julian Snyder, author of the biweekly financial newsletter, "International Moneyline," is a strong advocate of individuals protecting themselves by owning gold. But Snyder is not so naïve as to believe that one can just buy gold coins, bury them in the back yard, and become rich during a period in which the economy collapses. He tells his audience:

"I'm asked over and over again, 'What can I do about inflation? What can we do to preserve our assets? Where can we hide? Shall I buy Krugerrands? How many Krugerrands shall I hold? What if they confiscate gold? What if I can't get to my Swiss bank account? What can I do?'

"And more and more I'm telling people what they can do is write to Washington and tell them to stop printing money, because the best defense of your assets is, in the end, a political defense which establishes stable money. There is no hiding place in a deteriorating, inflationary, fiat, monetarily dominated society. There are only brief resting points where opportunities for making profits, sometimes under hair-raising conditions, can be found. As Shakespeare said in *Hamlet*: 'Diseases desperate grown, by desperate appliances are relieved . . . or not at all.'

"Action can still be taken to save our economy and our country. Let us start now by letting the leaders of our country know through every medium and means of communication — by mail, by petition, and personal conduct — that we want no more unrestricted printing or other creation of intrinsically worthless fiat dollars."

Dr. Gary North, another strong advocate of a gold-backed currency, maintains that those "gold bugs" who think they will live in the lap of luxury while the economy dissolves into a shambles are living in a fool's paradise. Dr. North says that so many people have followed Harry Browne's advice on how to profit from a devaluation that they mistakenly believe that the bigger the national monetary crisis, the bigger their profit. Wrong! North reminds us that we are not just talking about an adjustment in which those who understand the situation can indeed make genuine profits, but a collapse of the system. What we are talking about, says this top analyst, is the end of civilization as we know it.

An astronomical price for gold means an astronomical crisis in our economy. Bands of looters will be making forays out of the central cities into the suburbs. Production and distribution will come to an agonizing halt. Under these circumstances, nobody increases their standard of living.

Saving a civilization is infinitely preferable and easier, says North, than trying to survive a collapse and then working to rebuild a sound society and economic system.

So what do we do to get out of the mess that the Establishment *Insiders*, "Liberal" politicians, and power-hungry bureaucrats have put us in? It will not be easy, but here is a plan of action that makes sense.

First: We must employ the full power of American foreign policy to stop the excesses of fractional-reserve (and no reserve) banking abroad. This must be done immediately, and Congress must insist upon it.

Second: The Congress must balance its Budget and stop authorizing the huge deficits which are turned into fresh inflation of the money supply.

Third: Government must stop taking an extortionate percentage of the wealth of productive citizens in the form of taxation. Taxes must be lowered to provide incentives for new investment to modernize production capacity and stimulate technological innovation.

Fourth: We must greatly expand productivity to compensate for the inflation which has already been pumped into our economic system. Output per worker in the United States has grown only slightly since 1965. Government regulations and an increasing army of bureaucrats to enforce them have almost totally offset technological gains. Even Secretary of Commerce Juanita Kreps admits regulations are reducing technological innovations, perpetuating inefficiency in the economy, and lessening this country's ability to compete internationally. She confesses that the costs of current government regulation are estimated at one hundred billion dollars annually. (Others put the figure at one hundred thirty billion.) To produce our way out of the imminent depression, the bureaucracy must be virtually decimated.

So what are our choices? The first of these points can only be done effectively with the full support of the President, who is virtually a captive of the international bankers. It will be two years before we can change Presidents.

The rest could be initiated with the passage by Congress of H.R. 14234. This bill is the one designed by Howard Jarvis's American Tax Reduction Movement. The Jarvis proposal would freeze government spending at eighteen percent of the Gross National Product and mandate that the Budget be balanced except in times of emergency. It would force Congress to reduce federal spending (and hence the size of government) by twenty-five billion dollars a year over the next four years. Half of this reduction, fifty billion dollars, would go to stopping all deficits and starting to pay off the National Debt. The other half would yield a twenty percent across-the-board cut in federal income taxes as well as reduce the capital gains tax to fifteen percent.

These sound proposals, although far from reestablishing a truly free economy, would control inflation, scale down government spending, force enormous reductions in the bureaucracy, and restore production incentives. The plan is not perfect, but it is a *politically attainable* start which could save the economy from destruction. I believe it deserves our enthusiastic support. ■ ■