

# Sinking Japan Keeps Adding To The National Debt

WASHINGTON – As we Americans watch with growing concern our crazy presidential elections politics, other crazy things are happening around the world, without anybody paying any attention. Western governments (US included) keep piling up more and more debt, while Central Bankers do all they can to keep interests rates at zero, or close to it, this way allowing the insane perception that getting deeper into debt is painless, and therefore fundamentally OK.

## **Japan's enormous public debt**

David Stockman illustrates this point very well in a recent piece in his [www.davidstockmanscontracorner.com](http://www.davidstockmanscontracorner.com) that focuses on Japan:

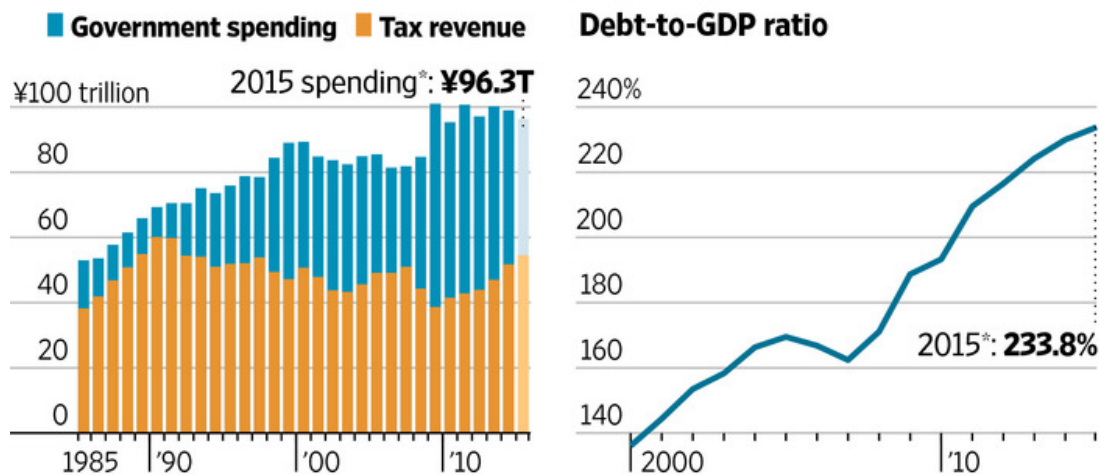
*"The government of what can only be described as an old age colony sinking into certain bankruptcy sold 30-year bonds at an all-time low of **47 basis points**. Let me clear here that we are talking about a record low not just for Japan but for the history of mankind. [Emphasis added]*

*To be sure, loaning any government 30-year money at 47 basis points is inherently a foolhardy proposition, but it's just plain bonkers when it comes to Japan.*

*Here is its 30-year fiscal record in nutshell. Notwithstanding years of chronic red ink and its recent 2014 consumption tax increase from 5% to 8%, Japan is still heading straight for fiscal oblivion. Last year (2015) it spent just under 100 trillion yen, but took in hardly 50 trillion yen of revenue, stacking the difference on its already debilitating mountain of public debt, which has now reached 240% of GDP."*

## Yawning Gap

Japan's fiscal deficit has widened sharply as spending continued to climb while tax revenues stagnated.



\*Projections

Note: Japan's fiscal year starts April 1.

Sources: Japan Finance Ministry (spending); OECD (debt)

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*"That's right. A government which is borrowing nearly 50 cents on every dollar of outlays should be paying a huge risk premium to even access the bond market. But a government with a 240% debt-to-GDP ratio peering into a demographic sinkhole would be hard pressed to borrow at any price at all on an honest free market.*

*[This is] what lies 30 years down its demographic sinkhole. To wit, Japan's population will have declined by 30% to 90 million, while its working age population will have plummeted from 78 million to about 52 million or by 33%. Moreover, its labor force participation rate has been declining for years, but even if it were to stabilize at the current 60% level, it would still mean just 31 million workers."*

### A horrible picture

Yes, these are the facts. Japan's revenue covers at best 50% of its spending. The remaining 50% is financed by issuing bonds. As a result, the national debt is now equivalent to 240% of GDP. And yes, as Stockman points out, going forward this horrible picture gets a lot worse. Given Japan's rapid

demographic decline, the number of active workers and therefore tax payers is rapidly decreasing, while the number of retirees receiving pensions, health care services and other benefits is increasing relative to the overall population. This means that going forward there will be even more spending for seniors, while less revenue will be coming in.

### **No trouble selling bonds**

And in all this, notwithstanding this brewing fiscal catastrophe, the Japanese government has no trouble selling 30 year bonds at a nominal interest rate. How is that possible? In a sane world, no government in this fiscal predicament would be able to sell any bonds, let alone at these rates!

Yes, as Stockman points out, there is a fix. Bond traders “know” that the Bank of Japan, BOJ, eventually will buy these bonds. So, they are not concerned that these will turn out to be like Argentina’s bonds right before bankruptcy. There will always be a reliable buyer.

But here is the question. The BOJ will keep buying worthless paper, paying real money for it, for ever?

### **Everybody is doing it**

As absurd as this sounds, at the moment this seems the consensus. What makes things worse is that this insanity linking fiscal profligacy and Central Bankers’ madness is now the official orthodoxy. Indeed, what Japan is doing is pretty much in line with what other Central Bankers in Europe and America are doing. The difference is only one of degree.

### **Getting into debt is good**

So, here is the picture. Formerly rich Western countries keep spending way beyond their means, this way accumulating more and more debt. However, thanks to their Central Banks, the cost of borrowing is way below what it should be. And this of

course encourages more fiscal irresponsibility. Indeed, at least in the short term, there is essentially no heavy price to pay for profligacy. Japan is an extreme case, but all the others, the US included, are quickly catching up.

### **More red ink with Trump**

And, by the way, if we take a quick detour back to US politics, most estimates indicate that Donald Trump's proposed public policies would add another \$ 10 trillion in 10 years to the US national debt. This staggering figure would be on top of the \$ 19 trillion the US already owes.

And, of course, Trump is leading in the polls. Amassing more public debt seems to be a good way to "Make America Great Again".

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## **Republican Voters Want Change, Forget About Experience**

**WASHINGTON** – Yes, Donald Trump is still the number one preference among likely Republican primaries voters. And the rich New York real estate developer is followed by retired neurosurgeon Ben Carson. If you put them together, these two outsiders *who never held any public office prior to their candidacy for the Republican nomination* get almost 50% of the stated preferences of probable Republican primaries voters. Astonishing, but true.

### **Trump for President**

And yet, we do know that Trump is at best a clever, media

conscious populist who appeals to the raw emotions of lower middle class and working class Whites, an important but declining component of the national electorate.

His policy proposals are a mix of nationalism, protectionism, and grandstanding. With Trump as President –he tells everybody– we shall win again. We shall get really tough with China, Japan and Mexico, countries that steal our jobs.

We shall also engage in a massive deportation effort aimed at getting rid of all the 11 or 12 million illegal immigrants currently residing in America. We shall build a wall at the border with Mexico, and we shall force the Mexican Government to pay for it.

### **Populism sells**

Yes, to be charitable, none of this is doable. Most of it is just hot air. And yet a large segment of the potential voters love it. And they love the fact that Trump shoots from the hip. He rambles, he says amazingly crude things. But he says all this with vigor and conviction.

And he always reminds his audiences that he is not a traditional politician. The pros are weak, unimaginative, and stupid. He is very rich, and therefore smart. And he is his own man. He does not need funding from special interests.

Anyway, whatever the experienced Washington pundits may say, the package sells. Trump is ahead.

### **Not enough to get elected**

Of course, the caveat is that Trump is favored by a significant but narrow segment of the Republican voters. While lower middle class White people are important, they are not even close to being a national majority. In today's America they constitute an important voting block, but not big enough to get anybody elected.

And so, while Trump consistently polls around 28% or even 30% among Republicans he does not go beyond that ceiling. And it is obvious that 30% or even 40% of GOP primaries votes, while they may get Trump the Republican nomination, are simply not enough to win the national election in November 2016.

### **Carson is even worse**

Anyway, if Trump at number one is a bizarre leading candidate, Ben Carson at number two is an even more improbable would-be President. Carson has a compelling personal story. He was born Black and poor; and yet through personal effort and perseverance he got a good education and he became a famed neurosurgeon.

This is a great American story, very appealing. And yet in the give and take of debates and interviews Carson has demonstrated to know almost nothing about major public policy issues. The man is obviously intelligent. But he is completely untutored. He cannot handle a serious conversation about the Middle East, or US fiscal policy. And yet at least 20% or more of would be Republican voters would pick him because he is likable, and because he looks honest.

### **Have the Republicans gone mad?**

What's going on here? Why select weird candidates who have no chance to win a national election? Have the Republicans gone mad? Yes, something like that.

Look, I do understand the yearning for change. Clearly there is deep frustration with unimaginative establishment politicians. There is a widespread perception that America is stuck; and yet the people we've been sending to Washington are not doing anything about it.

### **New faces**

***Hence the desire to look elsewhere: new faces, fresh ideas.***

*Yes, except that Donald Trump and Ben Carson, while undoubtedly new, are also spectacularly unsuitable and inexperienced. Trump promises impossible or truly bad policies. Carson has no idea about most of the issues, let alone putting together a policy platform to deal with them, and a team that will execute.*

If you want to dig deeper into this baffling picture, take a look at the highlights of a recent Washington Post poll. What motivates Republican voters to select their favorite? 52% replied that they picked the candidate who will bring needed change to Washington. (OK, so you get why Trump and Carson are popular. Most certainly they will bring change). 28% replied that their choice is for the most honest among the candidates. (A very low percentage. This means that for most Republican voters bringing change is more important than personal integrity. Not a good thing).

### **Prior experience not needed**

But it gets worse. Only 11% indicated that their choice is based on who has most experience. (And this explains why Jeb Bush and John Kasich are so far behind in the polls. They are proven and capable policy-makers. But right now very few voters care about real qualifications).

But wait, it gets even worse. Only 4% of potential Republican voters responded that they picked the candidate most likely to win against Hillary Clinton in the 2016 general election. In other words, almost zero consideration about which candidate can appeal to the (relatively narrow) Republican base but also to the millions of uncommitted voters who normally decide the outcome of a general election.

### **Change above all**

Here we go. In picking the person likely to become a national candidate in a presidential election, experience and electability at this stage hardly matter at all. The GOP

primary voters are inclined to pick really strange “change candidates” simply because they are fed up with the old party leaders.

Broadly speaking, in a democracy change is good. There is inherent danger when we create a class of perennially re-elected professional politicians who dominate the scene with their established biases and prejudices.

### **What kind of change?**

Therefore, let’s open up the field, by all means. Let’s not go for yet another member of the Bush dynasty. (Jeb would be the third President Bush, after George Senior, and George Junior).

But if the GOP idea of change is Ben Carson or Donald Trump, then the Republican Party is in real trouble.

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## **America Needs Good Pro-Growth Structural Reforms**

**WASHINGTON** – After the August 24 sell off, there was no real bounce back. The US stock market regained some ground, but only some. Still too many uncertainties for investors, I guess, from the Fed and its decisions on interest rates to the real global ramifications of the Chinese sudden and somewhat mysterious convulsions.

### **Put our house in order**

Alright, enough of that. Forget about markets. The smart thing for America would be to begin –right now– to put our own house



in order. In order to do so, we need to focus on at least three major areas:

**1) Fiscal and Tax Reform**

**2) Deregulation**

**3) Public Education Reform**

**Fiscal reform**

On fiscal and tax reform, Washington had a great opportunity to start the process back in December 2010, after the release of the final Report by the **National Commission on Fiscal Responsibility and Reform** headed by Erskine Bowles and Alan Simpson, (it was also known as the "Debt Commission"). The bipartisan Report, (endorsed by the majority of the Commission members), was aptly titled "*The Moment of Truth*". It provides a good start on a process eventually leading to entitlement and fiscal reform. It is a genuine bipartisan effort led by two credible, experienced national leaders, a Democrat and a Republican. Granted, it is not comprehensive. It does not seriously address health care policies. But, there again, it was a good faith attempt to get things moving. It was a very good start.

Well, President Obama looked at the Report, thanked the co-chairmen and essentially discarded it. Notwithstanding subsequent political upheavals, Tea Party activism, Republican congressional victories and more, we have made zero progress to reach the needed political agreement on reform. And yet real fiscal reform that would have to include a major overhaul of the large and soon unsustainable entitlement programs (Social Security, Medicare and Medicaid) is essential.

**Necessary**

Let's be clear. This reform is no guarantee of long term economic growth. But it is hard to believe that we are going

to go very far while America will carry the weight of an enormous debt burden. Look at anemic Japan. Is this where we want to go?

Same for tax reform. America has an absurdly long and complicated federal tax code. We have the highest corporate tax rate in the developed world. This is not good for business.

(It would be nice to see some serious discussion about these issues in the unfolding campaign. This would be more substantive than stupid polemics about “anchor babies”).

### **Deregulation**

Ditto for deregulation. When concerns about regulatory compliance become the overriding daily preoccupation of business owners, we have a real problem.

Regulations should be about establishing and enforcing reasonable environmental, work safety and public health standards. But now we have gone way beyond that. The attempt by the US Environmental Protection Agency, EPA, to essentially outlaw coal-fired power plants (and more) by regulatory fiat, on questionable legal grounds, is just the latest illustration of this.

### **Education reform**

And finally public education. This is after all and will be the “*Knowledge Economy*”. In this new world, If you do not have a good education, you are done. If you do not know much, if you do not master sophisticated skills, you simply do not have the entry ticket. Period. No way to have access to good jobs. You will be relegated to the lower echelons of society. No prayer to become “upwardly mobile”, as we used to say.

Slice it the way you want, but if we do not get serious about drastically improving American public education standards, at

least half the country, the half that cannot afford private education and live in poor neighborhoods, will be left behind.

### **We need an action plan**

This is what needs to be done –today. Forget about Wall Street gyrations. Let's get busy and rebuild the solid fundamentals of a world-class, truly competitive US economy.

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## **In America Politics Is Theater**

**WASHINGTON** – Along with 24 million Americans, I watched the TV debate organized by Fox News in Cleveland, Ohio featuring the top 10 (in terms of popularity in opinion polls) Republican presidential contenders.

### **Donald Trump**

Of course everybody wanted to see how Donald Trump, a successful real estate developer turned into most unorthodox political candidate, would do. He came to the debate leading in all the national polls, by a wide margin.

Well, I thought that his participation was a positively deplorable spectacle.

Trump did not surprise me. He was essentially himself. Boisterous, grandstanding, and gratuitously offensive. Besides, he made several outlandish statements about what he would do as President, without any explanation whatsoever as to how he would accomplish any of this. Not to mention his unapologetic admission about having donated money to politicians in the past (mostly Democrats), so that they would

do for him all he asked them to do. So, he says he “bought” politicians, and he is proud of it.

### **It was theater**

In other words, he gave a performance. It was theater. Nothing to do with engaging in a serious debate. And yet, the day after the Cleveland event the media commentary was all about conjectures as to how this colorful show most likely will help Trump in the polls.

This is unbelievable. How could this spectacle help anybody who is running for President? Look, Trump is a successful businessman, (no question about that). And in America we respect success.

However, his business talent mixed with his bizarre personality does not translate well into the national political/policy-making arena. His debate performance, while perhaps entertaining, certainly did not indicate that he has the knowledge, the rationality and the poise that I would like to see in a good President.

### **Millions of Americans like Trump**

***But here is the thing. Millions of Americans actually like Trump precisely because of his boisterous, irreverent and, to say the least, inelegant style. The fact is that a sizable chunk of the American electorate wants to be entertained, in fact enthralled, by a man “with real guts”. These voters really like a would-be President who says, actually shouts, that all his competitors are weak and stupid, and therefore cannot get anything done.***

For them, this is really refreshing! “Tell them like it is, Donald!”, “We are sick and tired of professional politicians who talk a lot and deliver nothing”. These fans think of Donald Trump like Clint Eastwood playing the tough cowboy who rides into a town run by the bad guys and methodically kills

them all.

Except that this is real life, not a movie.

### **“Throw the rascals out”**

I do not know what to say. In fairness, it is hard to praise the political status quo.

It is true that gridlocked Washington, run mostly by mediocrities and now paralyzed by partisan rancor, offers a sad spectacle of immobility; while the country needs urgent action on many fronts: fiscal policies, entitlements, taxation, and education.

Because of all this, the old, if simplistic, American “*solution*” of “*throwing all the rascals out*” sounds very appealing, at least to some. And Trump presents himself as the guy who will actually throw the rascals out. For a sizable number of conservative Americans, (for the moment, at least), he is the savior we desperately need.

Indeed, for them Trump is the tough and experienced pro who will come in and fix things, in no time. After all, he has done well in his real estate business. So, why can't he do the same in Washington? He will go in, fire all the bad people, promote the few good ones, and finally get things done. Simple, no?

### **Impossible**

Yes, great idea. Except that it is impossible.

Even assuming that Trump had an elaborate and credible policy agenda, (and he does not, at least not yet), the idea that any President can implement his or her program by first offending almost everybody he would have to work with is a bit unrealistic.

Yes, it is true that Washington has become exceedingly, in

fact absurdly, complicated. There is the executive branch centered in the White House, and then two very independent and very petulant branches of Congress, with a myriad of committees and subcommittees sometimes run by overly ambitious, media hungry chairmen. These committees have subpoena powers. And they can call any member of the administration to testify under oath on practically anything. And any member of the Senate has the power to delay or block almost any presidential appointment. In practical terms, this means that in this system it is extremely easy to delay, block or derail almost anything.

And then there is a gigantic federal bureaucracy. Finally, this unwieldy blob is kept together by tons of often incomprehensible federal legislation, a good mix of executive orders that are in fact new laws in disguise, and trainloads of regulations.

### **A President needs to forge and lead a coalition**

This is hardly an ideal setting for any President who wants to govern. However, the problem is that this is how things are today.

Which is to say that a good President would need good ideas, and will power, for sure. But he or she would also need to forge and keep together a broad-based coalition, with many, many true allies who will help him or her move anything forward.

I can hardly believe that President Trump would have a lot of people in his corner, since he has already offended most of the actual and potential players, by calling them incompetent, weak and stupid.

### **How about the others?**

Well, if Trump appeals to many registered Republicans who will vote in the primaries, how about the others candidates who

shared the Cleveland stage with him?

Again, here I am also mystified.

After the debate, I heard sophisticated commentators praise rather cheap appeals to raw emotions uttered by other mediocrities on that stage. *"This was good stuff"* –they said. Using this "appeal to emotions" metric, Texas Senator Ted Cruz and Florida Senator Marco Rubio are also considered good presidential material. And why? Because they said a few banal things –but they said them with passion. Same about former Arkansas Governor Mike Huckabee.

And so, these otherwise ordinary and truly uninteresting politicians are considered debate "winners" because their radical ideas (Huckabee articulated a truly bizarre idea that should lead to the end of legal abortions), or irrelevant claims ("I was born poor") were expressed in a way that looked sincere.

### **More theater**

So, here we go again. Back to politics as theater. The made for TV would-be President has to have "empathy". He has to "connect" with the emotions of his audience. He has to make them believe that "he is one of them". And if he can do this with a happy mix of ease and gravitas, delivering a few clever lines, with occasional humor, then he is almost there. Delivering entertainment that stirs emotions: this is what we call "presidential" substance, these days. Forget about policy agendas.

All this shows that TV audiences want politics as a gripping spectacle that will mesmerize them, excite them. Never mind the substance. Never mind how plausible or implausible the ideas and policy solutions presented by the candidates are.

The important thing is to articulate anything, including banalities and glaring factual errors, with eloquence and

passion. This makes people believe that the candidate is sincere, therefore likable, and therefore electable.

Sadly, this is about all there is to it.

### **Bush is too ordinary**

The candidate I actually liked, Jeb Bush, did not even get a nod from the critics. The pundits dismissed him. *“He did barely OK. The most that we can say in his favor is that he did not embarrass himself. But he did not say anything memorable. If he wants to make an impression and get some real traction with the voters, he has got to show that he has some fire in the belly,”*.

Well, I thought that Bush’s quick but clear outline of his achievements as a two term Governor of Florida, one of America’s largest states, was impressive. His record on fiscal responsibility, well above average economic growth, immigration issues and education reform is very good. His goal to grow the economy by 4% as President is difficult, but achievable –showing incidentally that he aims high.

But no, according to the critics, this was only about resume recitation, and boring wonkish blah, blah, blah.

### **The people like passion and drama**

In the end, nobody cares about fiscal surplus figures and economic growth statistics. Who cares about a former two term Governor who actually did something really substantial –for 8 years? (By the way, this –a record of real achievements– also applies to sitting Ohio Governor John Kasich, also a candidate on that same stage).

These days, in a national political campaign substance is irrelevant, in fact, unwanted. We need clever lines, well placed jabs at opponents, and above all an attitude that exudes strength and self-confidence. This –attitude– is what



separates a leader from the rest of the pack. This is what people want and what people will remember.

Sadly, it is through this show business process that we shall nominate a candidate for President. We are treating this political contest as if it were the American Idol talent show.

If this is really so, God help us. It would mean that, as a nation, we really lost any connection with reality and rational thinking. Forget about a record of competence and achievement as credentials for the highest office in America. We'd rather have a guy with "fire in the belly".

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## The Real Problem With Welfare Is Dependence, Not Cost

**WASHINGTON** – The standard argument in favor of the welfare state and its multiple entitlement programs is that modern, relatively affluent societies have a moral obligation to help their disadvantaged citizens.

### **Help the needy**

The poor, the elderly, single mothers supporting sometimes many children struggle to survive. Quite often they fall further behind, and so they get into a negative spiral that leads them from poverty into despair.

Benign policy-makers cannot ignore this plight. Hence the idea to come up with various support programs. This is the "social

safety net” that will prevent the weak from falling into the abyss of the perennially destitute.

### **Benefits for ever**

Fair enough. However, while theoretically these programs are supposed to help people to *“get back on their feet”*, in practice it is not so. In practice, temporary assistance has a way to become permanent, while little is done to enable recipients to become once again (or for the first time) self-sufficient.

Moreover, once we have accepted as a society that there are some deserving categories of individuals who must be helped, we have also created an almost irresistible drive to augment the ranks of the deserving, while increasing, little by little, the range of subsidies, free services and more they are entitled to receive.

### **Huge cost**

And this explains the huge financial burden created over time by large and growing social programs. In political terms, the “fiscally responsible” argue that all this public largesse is unaffordable. Therefore the ranks of the “entitled” have to be reduced, while restrictions have to be enacted regarding how much can be given out and for how long.

### **Let the rich pay**

The socially minded “progressives” argue that one can find the money to pay for all this by increasing taxation on the (undeserving) rich, many of whom gained their extraordinary fortunes by gaming the system.

Within most western democracies the political divide is indeed on these issue: *“How much social spending is necessary, and how much can we afford”*.

### **Welfare breeds apathy**

But this is not the whole story. Empirical evidence shows that societies that devote a huge amount of resources to social programs tend to be affected by economic stagnation. Little innovation, no dynamism, no real growth. Many welfare state critics argue that there is a clear cause and effect relationship between spending a lot on entitlements and feeble growth.

### **Dependence is the issue**

But allow me to look at the issue from a different angle. The real problem with entitlement programs is not that they cost too much. The real problem pointed out by many but difficult to express in political language is that they cause unhealthy dependence.

In other words, individuals who get progressively used to get enough to survive through public assistance programs lose the drive to look after themselves. They have little incentive to look for better jobs. Likewise, they have no motivation to learn new skills that would help them move up in the labor market.

***Dependence: this is the insidious, unintended consequence of public assistance not tied to a commitment to self-improvement.***

### **Self-sufficiency is the goal**

Broadly speaking, modern psychology argues that a self-sufficient individual is also a more balanced person. It is now recognized that facing challenges is good for you, assuming that they are not in the shape of overwhelming calamities. Which is to say that reasonably competent, mature individuals can rise to the challenge of looking for a new job. Dealing with cancer, or with the consequences of a devastating hurricane is another matter.

So, where do we go with all this? If we accept the above, then

we should agree that all public assistance to the needy has to be geared to make the needy self-sufficient within a reasonable period of time.

### **From assistance to independence**

The emphasis should be not in giving enough money so that the person or family will not fall into destitution. The emphasis should be in devising "customized strategies" that will lead the recipients to increasing their chances of self-improvement. Learning new skills, getting more education, receiving training in marketable skills increases the chances of getting a job, or a better job.

If we accepted this approach, welfare programs would be redesigned so that they are no longer a life raft. They will become a ladder to self-sufficiency. In so doing, in the long term we achieve positive goals. We progressively reduce the cost of entitlement programs; and at the same time we increase the ranks of productive, self-confident citizens who are better positioned to be economically independent, while contributing to society.

### **Resistance to change**

As you can imagine, the large, established constituencies of "the perpetually needy", all the bureaucracies created to attend to their needs and their political patrons will resist reform, claiming that any proposed change is really a thinly disguised effort to cut benefits, this way condemning so many of our fellow citizens to be destitute outcasts.

### **A difficult task**

Indeed, even with sufficient political support, this is going to be very difficult. Teaching people to find motivation from within, at the same time accepting that in life one has to learn how to face challenges is difficult.

Teaching these life skills to adults who never had the opportunity to learn any of this at a younger age is even more daunting. And yet this is the only way to overcome this dependence on costly welfare that condemns millions to be forever semi-marginalized.

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## [Bernanke Says “Highly Accomodative Policies” Still Needed, And Markets Shoot Up](#)

By Paolo von Schirach

July 11, 2013

**WASHINGTON** – No, America, the Fed is not going to remove the highly spiked punch bowl from the party. You misunderstood. In truth, Fed Chairman Ben Bernanke clumsily said something about slowly ending QE3, this way getting everybody scared that the Central Bank induced festivities would soon be over. But, no, he did not really mean it. On the contrary, he just said that the US economy still needs “*highly accomodative policies*” for the foreseeable future. Got that? Not just “somewhat accomodative polices”. No, Mr. Investor, America needs “highly accomodative policies” which means zero per cent interest rates for quite a long time.

### **The party will continue**

After hearing the latest from Bernanke, the Wall Street crowd cheered. The stock market shot up. The dollar went down, to the delight of US exporters trying to compete with the equally

“highly accommodative policies” of Bernanke’s counterparts in Europe and elsewhere, including accommodation on steroids now pursued by the Bank of Japan.

So, here is the new “rephrased” message. The Fed will not change its course, because the US economy, despite some improvements, is still too weak. Unemployment at 7.6% is too high, growth below 2% is modest, and inflation is not a problem.

### **Fed moves markets**

It is amazing how a US Central Banker, a man who makes about US \$ 200,000 a year, (yes this is the ridiculously low salary of the Fed Chairman), with just a few words can move hundreds of billion in and out of stocks, bonds and currencies.

It is amazing, and also not at all good. Capitalism should be based on market forces that should help all players discover the real value and therefore the appropriate market price of all assets, at the same time allowing for realistic risk evaluation.

### **Interference is not good: you get fake numbers**

As long as Central Bankers keep interfering with the fundamentals, investors will not know the real value of anything. And, what is worse, as of a few years Central Bankers interference is the established “New Normal”. Once upon a time the Fed would act may be once a year in a fashion that would move markets. But we have been living in a Fed induced market place since the Great Recession of 2008.

Today we are experiencing the consequences of the latest Fed pronouncement. As interest rates will stay low, stocks will continue to benefit from a Bernanke premium. To the extent that interest on US 10 year bonds will adjust down, US borrowers will get the added benefit of lower interest rates on their new mortgages, this way boosting the entire US

housing market.

The plain truth is however that the real economy is not performing as well as an all time stock market would indicate. Just like all those records broken a few years ago by baseball players on steroids, all this Wall Street froth is mostly fake stuff.

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## [Lower Taxes May Help Attract New Investors – But Much, Much More Is Needed](#)

By Paolo von Schirach

May 1, 2013

**WASHINGTON** – The FI has a rather prominent story on how the state of New Mexico in the US plans to attract new investors via lowering corporate taxes. The article quotes Susana Martinez, the recently elected Republican Governor, speaking passionately about the need to be competitive, because investors, you know, do have choices. They can go anywhere else in the world. So, lowering tax burdens for corporation looks like a good idea.

### **Lower taxes get you in the game**

Sure. A great idea. But, let me ask: “*That’s it?*” Is a lower corporate tax rate the essence of New Mexico’s investment promotion strategy? If this is indeed the case, I suggest that policy makers study the issue a lot more. Of course competitive tax rates do matter. If any state has punitive taxation, investors will look elsewhere. But the point here is

that lower taxes at best may get you in the game because, guess what, everybody else is doing the same thing. Only states or countries that know nothing about investment promotion strategies will keep high corporate taxes. But, once you have lowered your taxes, then you have to see how everything else compares with what competitors may be able to offer. And the list of important items is as long as it is critical.

### **The broader investment climate**

First of all, investors want qualified manpower and the reassurance that the state has the good schools and universities that will produce it. If the potential investor is a high tech company, decision-makers scouting for locations want to see good or superior universities, with state of the art R&D facilities. Investors want to see, in place, a network of potential high quality suppliers and vendors. Investors want to see modern, cost effective infrastructure and logistics. They want to see how their supply chain will be positively affected by moving or adding operations in that particular state.

And, yes, they want to know about quality of life. They want good schools for their kids, recreation opportunities, low crime levels, affordable real estate, culture, nice weather and state of the art communication networks.

Yes, they want all that. Of course, they will not find all of it in any given location. But they will chose the place that has the best mix. New Mexico does have impressive federal laboratories (think of Los Alamos) working on cutting edge energy issues and other high tech sectors. That's an important advantage. Still, New Mexico is a rather poor state, with mediocre to bad public schools; while it has more than its share of minorities who do not speak much English. It is not centrally located. It offers no special logistics infrastructure.



The idea that lowering corporate tax rates will –by itself– trigger an avalanche of new investments into New Mexico, (or anywhere else for that matter), is rather naive. In fact, quite silly.

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## Critics of Rogoff-Reinhart Argue That High Levels Of Debt Do Not Produce Ill Effects – So, Let’s Go Ahead And Borrow Some More

By Paolo von Schirach

April 30, 2013

**WASHINGTON** – Economists Kenneth Rogoff and Carmen Reinhart came up with a major book, (*This Time Is Different: Eight Centuries of Financial Folly*), in which they pointed out how very large levels of structural public debt undermine economic vitality. Well, it turns out that some of the calculations used by the authors to support their basic arguments were wrong. This is, of course, embarrassing for two eminent scholars. But what is far more interesting is that their critics have used these flaws to argue that these errors mean that the larger point about large debt being unhealthy must also be wrong.

**Debt is OK**

*“So, do not worry, America. After all, debt is good”.* Now this

is pure politics. And it is stupid politics, at that. Even a lay person will understand that the real issue is not about "debt" *per se*. It is about the overall amount, growth and composition. During WWII America piled up an astronomic level of debt. But this was due to the need to finance an unprecedented military effort. Once the war was over, things got back to normal relatively quickly. The US Government had no longer any need to borrow so much, and bit by bit it managed to pay off its obligations.

### **Borrow to do what?**

Well, if we fast forward to our times, it is obvious that our current debt levels are due to a structural (and progressively worsening) imbalance between revenue and current spending. This is not about extraordinary borrowing in order to face an emergency situation like WWII. No, this is about built-in, major spending commitments, in the form of transfer payments, made in another era that are simply unaffordable today, unless we want to increase taxation to really ridiculous levels. No, we do not borrow to fund a world war. We borrow mostly to fund payments to seniors.

And this shows that the issue is not "debt"; but "debt to do what". Any business person knows that loans are necessary to start or expand a business. Of course, loans are a form of debt. But we would all agree that a loan aimed at starting a (hopefully) profitable enterprise is a good thing.

While we recognize that many business ventures do fail, (and this entails losses for the entrepreneur and for the bankers/investors who funded him), some will succeed bringing along growth, new jobs and increased prosperity.

But if a household with modest income year after year borrows money to buy new cars, expensive furniture and pay for exotic vacations, then every lay person would know that these people are getting themselves into serious trouble. They are getting into debt only to finance a life style they cannot afford.

## **Borrow to invest or to fund current spending?**

President Obama in his April 30 press conference indirectly provided an argument for making this distinction between debt for investment and debt for financing an unaffordable life style. The President lamented that an international survey revealed that a list of the 25 most modern international airports does not include even one single American facility. Not even one. So, the country that invented air travel has only sub par infrastructure to support civil aviation. How shameful. The President provided this argument in the context of the ongoing diatribe on the ill effects of the "sequester".

I think that this point of inadequate investments in critical infrastructure such as airports is quite revealing in the context of my argument. Look at it. The US Government has been running astronomic, trillion plus annual deficits for years and yet in all this unprecedented spending apparently there was no money to upgrade airports. How do we reconcile historic levels of deficits and debt and no money "invested" to upgrade basic infrastructure? Where did all these hundreds of billion go?

## **Debt incurred to finance entitlement programs**

Well, quite simple. Most of the borrowed money has been and will be used to fund transfer payments to needy and senior citizens, along with current levels of day to day spending that are essentially unaffordable. Very little of this borrowed money is used for productive investments. The money is mostly additional income and health care support for older Americans. The point is that, as a Nation, America long ago undertook to pay for things it cannot afford today. What is worse, the payments keep getting bigger year after year, while revenues do not grow as much. Hence higher debt levels, year after year.

The very notion that, since we are enjoying a long period of

historically low interest rates, all this debt simply does not matter is incredibly stupid. The economic impact of this heavy debt burden may not be felt immediately; but it will be felt eventually.

### **The cost of debt service keeps going up**

That said, we see some impact already. Even if we take into account very low interest rates on US Government bonds, the percentage of the annual budget going to pay for interest on existing debt keeps going up. And this means that, since the US has to pay its creditors, every year there is less money available to do other things. And yes, that would include spending to upgrade US airports, Mr. President.

In summary, there is nothing sinister in borrowing money. It all depends on how much is borrowed relative to size of the economy and projected revenue, for how long and –most important- *“to do what”*. The notion that mounting levels of debt incurred mostly to fund unaffordable social programs do not matter because, as of today, we are not yet bankrupt is truly insane.

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## **America's Problem: Half The Country No Longer Believes In The Virtues Of Free Market Capitalism**

**WASHINGTON** – America's biggest problem –as the recent presidential elections have demonstrated– is that a bit more than half the country no longer believes in unfettered free

enterprise as the main engine of both personal and national growth.

### **Government is better**

Obama's re-election (with 51% of the votes) as the defender of entitlement programs as they are, of state intervention and as proponent of income redistribution through taxation shows that a majority of American voters today believe that the benign hand of government helping them is a better and safer bet than the Republican promise to lower taxes and public spending, so that the spirit of can-do enterprise can be once more liberated and put to work. At least 51% of American voters are not so sure about free enterprise.

### **Capitalism as a model lost the battle of ideas**

Let's face it. The 2008 recession destroyed capitalism's credibility and mystique. The system failed. And it failed big time. Most of the almost theological assumptions about the sanctity of markets were proven wrong by the Financial Catastrophe.

Nothing illustrates this failure more than Alan Greenspan's contrite admission that he –The Flawless Maestro– had made a huge mistake. All his life he believed that financial markets would self-regulate in a fashion that would allow them to price risk appropriately and thus avoid excesses. Well, it wasn't so. No self-regulation. On the contrary, even the most elementary rules dictating restraint were broken.

And it turned out that our Wall Street Captains were not just unwise, they were in fact complicit in a sinister orgy of speculation and greed in which they all succumbed to the zany idea that financial manipulation would make them super rich. In so doing, they almost sank America.

### **Romney successfully portrayed as the enemy of the common people**

Right or wrong, this is the prevailing narrative. And this is what those who voted for Obama believe in. Poor Mitt Romney came along saying that he had the super manager credentials to really fix this mess.

The premise for his challenge was that Obama had done a poor job as economy's steward during his first term. *"Well –said a confident Romney– let the amateurs go back home and let me, the real pro, handle the economy. I know this stuff. I have done it all my life"*.

Well, this impeccable resume became Romney's main political liability. Precisely because of his close identification with venture capital, Romney was conveniently depicted by the Democrats as the arch-enemy, as the fox in disguise who wanted to run the chicken coop. Thanks to the clever character assassination dished out by the Obama campaign, Romney was doomed.

### **The audience does no longer believes the old story about capitalism**

But Romney was doomed also because a bit more than half of the audience no longer believes the old American narrative of "self-help and individual effort". People are tired and disoriented. Capitalism failed. Corporate leaders behaved like gangsters.

Therefore, now a liberal Government that promises help looks like a better bet.

And so it was. Obama won the political battle.

That said, the Obama policy medicine is a disaster. He may want to help out with more of this and that –and the people cheer. But he of all people should know that the cupboard is bare. There is no money, while public spending is still trending up.

## **America does not grow**

*Obama's ideological blinders prevent him from understanding that the country needs first and foremost higher growth. From a post war average of about 3%, we are down to 2%. This trend will get us closer to stagnating Europe and all its problems. In order to get to higher growth, it is essential to have a new Grand Bargain that would place entitlement programs on a sustainable course, while reforming our incomprehensible tax system in order to provide a strong encouragement to business creation.*

## **Public assistance for ever?**

Of course we need to extend a helping hand to those in need. But only if this is a way to make people self-sufficient sooner rather than later. *Unfortunately, the message now is that there are some perpetually weak constituencies that will need assistance in perpetuity.*

If you are on the receiving end of these public goodies, this may sound great. Easy for the moment to ignore the combined consequences of low growth, high spending (that goes mostly to assistance and income support, as opposed to investments), and more debt. If we looked at where sorry-looking Southern Europe is today, after having followed exactly this course of action for a few decades, the end game should be obvious. But nobody within this new majority will point this out.

## **Who will make capitalism believable?**

Until and unless somebody will come up with a credible message that will reignite enthusiasm for free market capitalism and sober governance, along with policies aimed at opening up real opportunity to all, America will continue to slowly slide into higher debt, mediocrity and eventually national decline.

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# Obama's Social Justice Agenda Is Unaffordable – But The Republican Message Of Fiscal Responsibility Has No Traction

By Paolo von Schirach

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January 22, 2013

**WASHINGTON** – President Obama's priorities, as outlined in his Inaugural Address, (see above link to related piece), are in line with the political *Zeitgeist* that his first term contributed to create. And here they are: more government, strong defense of existing entitlement programs, more support for the needy, pushing a green energy agenda. All this is popular in America, and Obama's re-election attests to this.

## **Unaffordable**

The problem is that single mindedly pushing policies focused on these goals of social justice, equality and what not will lead America to fiscal disaster. We run out of money long ago. Irrespective of the noble goals, the notion that it is



possible –indeed morally righteous– to defend an essentially unchanged (and unaffordable) system of costly entitlements in a country drowning in debt (mostly because of entitlement spending) is almost surreal.

### **More will than wallet**

Does President Obama know that, in part thanks to his actions, America is running trillion dollar deficits every year? Does he know about the size of the national debt, (\$ 16 trillion plus), a big chunk of it added during his first four years in office? I presume he does know. But I also think that the President, following I have no idea what kind of logic, believes that America's deteriorating fiscal position is just a small detail that we shall attend to at a later date. Securing benefits is priority one. Paying for them is a secondary matter.

### **America believes we can afford anything**

This is border line insane. And yet the President won re-election on his pledge of defending the welfare state as we know it against the vicious attacks of the mean spirited Republicans. Against all odds, President Obama managed to obfuscate his own mediocre record as steward of the US economy, while extolling his role as champion of the poor and disadvantaged. And he won.

### **Debt: termites in the basement**

But how is it possible that America approves all this when you look at the fiscal disaster building up because of entitlement spending and debt trends? Well, it is quite possible. A mounting fiscal crisis is painless until it breaks out. And so it can be ignored. As someone said "**Debt is not the wolf at the door. It is more like termites in the basement**". If you do not know the termites are there, you see nothing and fear nothing. In the meantime, they are literally eating your home. When you find out, it is too late.

For the time being, ordinary people do not feel the pain of a mounting national debt. A mixed blessing in all this is that (thanks to the Fed) interest rates on US Government Bonds are ridiculously low and so Uncle Sam keeps borrowing, paying only a small price in terms of interest on these loans.

### **Wise people call for action**

All the wise people, (think of the Simpson-Bowles duo, co-chairs of the "Debt Commission"), have said and repeated that this course is unsustainable and that we should act now in order to "*bend the spending curve*".

We do not need to all of it at once. But we need to act now, so that public spending in the future will be substantially reduced, giving us a chance to regain fiscal balance.

### **Grow the economy**

And the wise people also tell us that we should incentivize enterprise, business creation and innovation --the proven drivers of wealth creation and more widespread prosperity. A major overhaul of our complicated and outdated tax system would help to secure these goals. Well, except for subsidies targeting his pet green tech/renewable energy projects, President Obama is essentially silent on this.

Does he really think that the current lackluster 2% growth is optimal, when the post war average was 3%? But there again, the public likes his social justice message, the media and most opinion makers nod, and few dare challenge his agenda in which more equality can and will be achieved via more debt and a mediocre economy.

### **Republicans in a pickle**

And here is the immense challenge for a disoriented and fractured Republican Party, at times dominated by the voices of strident ideologues.

When Ronald Reagan run for office in 1980 his slogan of ***"Getting the Government off the backs of the people"*** was a stirring cry for unleashing the power of American free enterprise. Big Government produced by the liberal left was the enemy. And most voters agreed with him. So, at that time, deep spending cuts and even slashing and burning were seen as smart, high minded, morally superior and liberating.

Well, not today. After the shock of the 2008 financial crisis, the private sector lost its lustre and indeed its respectability in America. Making no distinctions, the public dislikes business in general and not just the reckless Wall Street bankers and sub prime mortgage companies.

### **Private sector is bad**

In the aftermath of the financial crisis we have established a new narrative. The private sector is made out of greedy people who couldn't care less about the common folks who work for them.

And so the poor and the disadvantaged need the Government to protect them against the rich and ultra-privileged who –as we all know– long ago gamed the system so that it works only in their favor: they get all the money and pay essentially no taxes.

This is the narrative. The private sector is the villain. Mitt Romney, the country club vulture capitalist with horses, luxury cars, too many homes and off shore bank accounts is its personification.

Benign and thoughtful Big Government led by caring Obama is the defender of the oppressed. Thank God that we have this good man, (a former Chicago community organizer who learnt the ropes by helping the poor), in the White House to help us out.

**Can the Republicans be fiscally responsible and popular?**

Yes, this is an incredible and dangerous distortion of reality. But this is what most Americans believe today. It will take a heroic effort for the Republicans to build a new, credible and compelling image as the party of growth and fiscal sanity; but also as the party of fairness, inclusiveness and real opportunity for all Americans.

As of today, any Republican policy mix that includes any spending cuts will be not just unpopular; it will be portrayed as vicious and mean spirited.

That said, Obama's agenda is good politics but terrible policy.