

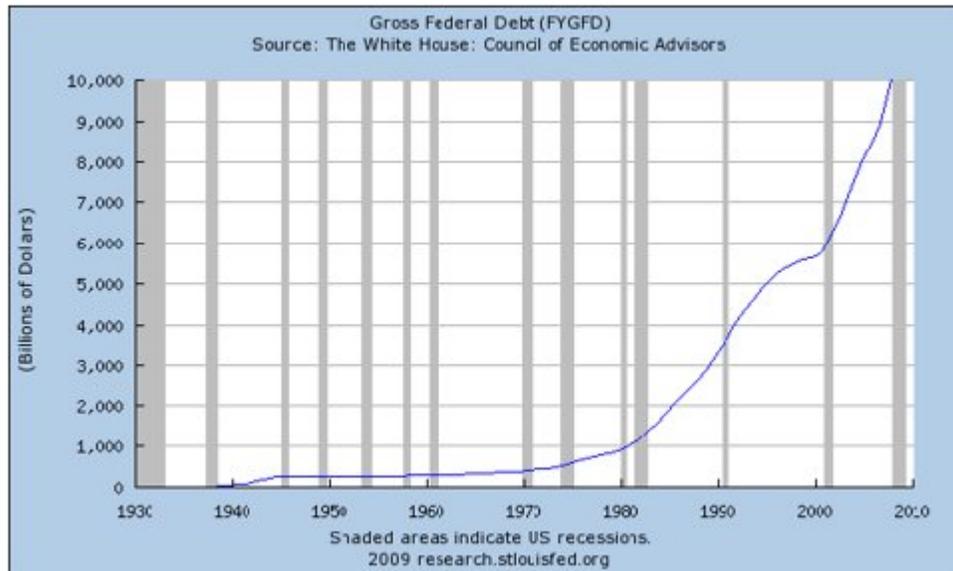
Chapter One: The Economy

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else.

– John Maynard Keynes

This is where it all begins – with the economy. First, we collapse economically, then social changes begin, and finally, spiritual changes emerge. I've been writing about the economic downfall of America since the early 1990s. I was early, but I knew it was coming. I always said that America would fall because of debt. I remember telling my dad back in the mid 1980s that we can't have these large budget deficits year after year.

At some point, the debt becomes too large to pay back. This can only have one outcome, I told him, and that is the bankruptcy of America – the eventual default on the national debt.



When Ronald Reagan became president in 1981, the national debt was \$908 billion (see charts above and below). When he left office, it was \$2.6 trillion. He, more than anyone, legitimized large budget deficits as benign. He did this by having large deficits, year after year; and yet, inflation remained low and the economy grew.

While the economy grew, in many respects, it was aided by debt. And that debt has not gone away. In fact, it has grown into a monster of more than 10 trillion dollars. Our standard of living – and our way of life – has been built on borrowed time and borrowed money.

Year	Deficit	Debt	Debt as a percentage of that year's GDP
1979	-\$40,183	-\$828,923	34%
1980	-73,835	-908,503	34
1981	-78,976	-994,298	34
1982	-127,989	-1,136,798	36
1983	-207,818	-1,371,164	41
1984	-185,388	-1,564,110	42
1985	-212,334	-1,816,974	46
1986	-221,245	-2,120,082	50
1987	-149,769	-2,345,578	53
1988	-155,187	-2,600,760	54
1989	-152,481	-2,867,538	55

U.S. Office of Management and Budget, *Historical Tables*, annual.

What Reagan did was based on Keynesian economics. This theory states that stimulating the economy through debt is beneficial in the short term – that it leads to immediate growth. Keynes was known to have defended his theory by saying, “In the end, everyone is dead.” Thus, he was implying that only the present moment matters. What would you rather have: growth now and debt later; or, stagnation now and growth later? You can see how politicians are drawn to Keynesian views. In fact, it is said today that all Washington politicians are Keynesians. That’s not entirely true, but it’s close.

Ironically, George H.W. Bush (during the 1980 Presidential election campaign) called Reagan’s economic plan “voodoo economics.” It’s ironic, because he did the same thing as Reagan after being elected in 1988. He continued deficit spending – as every

president has since (although Bill Clinton was able to balance the budget his last three years in office from 1998-2000).

President Obama wants to continue down this same path (using deficit spending), and attempt to stimulate our way out of this recession. George H.W. Bush was right, this is voodoo economics. You can't use debt on a long-term basis to expand the economy. Eventually, that debt will create major repercussions. As a nation, we have added mountains of debt since 1980, never questioning if Keynesian economics is sound. Americans are about to find out that it isn't.

Government finances are no different from those of a household or a business. How come American economists have not figured this out? I have never heard an economist, who worked for the government, who made sense. Perhaps the economics curriculum needs to be revisited?

The best way to run a business or household is to use no debt and have large cash reserves. Every investor – or homeowner – loves a balance sheet with lots of cash and no debt. Why? It's common sense to recognize that a lack of debt and excess cash create stability and strength. Why is it that economists can't correlate this to government? Some countries have figured it out. Norway has no debt and more than \$1 *trillion* in their sovereign wealth fund. Who's sitting pretty? Us or them?

Currently (2008), our national debt is \$10.2 trillion, and that does not include the additional \$1 trillion plus, promised for numerous bailouts this year. The Federal budget deficit for fiscal 2008 was \$438 billion. Ironically, politicians in Washington use Ronald Reagan's deficits to argue that \$400 billion isn't that big! They claim that, since the economy has grown, the percentage of the budget deficit is smaller. Well, they can tell that to their grandchildren, after America goes bankrupt.

Another argument that politicians use to justify approving huge deficits is that other governments, such as Japan and Germany, have a larger national debt (as a percentage of GDP – Gross Domestic Product) than we do. Well, my dad taught me that it doesn't matter what someone else does; it matters what you do. Moreover, Japan and Germany fund most of their debt internally, whereas we finance most of our national debt through foreign investors.

Did you know that there are several countries today – including China, our global competitor – who, instead of having a national debt, have a national sovereign fund? They literally have hundreds of billions in savings. We could have done that, too. Instead we – with Ronald Reagan leading the way – chose debt. Shakespeare had it right, “Be neither a borrower nor a lender.”¹

Our choice to continue to expand the national debt by having large budget deficits is going to destroy the dollar. As I write this, the dollar is making its last stand, with the dollar index around 86.

The dollar index is computed by comparing the dollar against a basket of international currencies. This index was created in the early 1970s, and we had never breached below 80 until 2007. In 1985, it reached a high of 160. As recently as 2002, it was 120. The low was 70 in March 2008 (see chart below).² Thus, the dollar lost 42% of its value, versus a basket of international currencies, from 2002 to 2008. My forecast is for the dollar index to continue to drop, perhaps well below 50. Soon thereafter, the dollar will very likely be replaced by a new currency, and the original dollar will no longer hold any value, as incredible as that sounds.

This dramatic fall of the dollar since 2002 can be attributed to one factor: debt. This is easily correlated. The reason the dollar was strong in the late 1990s and early 2000s was that we had budget surpluses for four consecutive years (1998-2001).³ For instance, shortly after the euro was released in 2000, one euro was worth 83 cents. In March 2008, a euro was worth \$1.58, a nearly 100% increase in value. With budget deficits soaring after 9/11, the recession in 2002, and the wars in Iraq and Afghanistan, the dollar’s value has depreciated significantly this decade.

¹ *Hamlet Act 1, scene 3, 75–77*

² <http://www.chartsrus.com>

³ http://en.wikipedia.org/wiki/United_States_federal_budget



A day is quickly approaching when the U.S. Government will default on the national debt, and the dollar will collapse. As the national debt expands, it puts pressure on the dollar to weaken. This makes it less attractive for foreigners to purchase our Treasury Bills. Who wants to buy debt that is based on a weakened, depreciating currency?

The problem we have found ourselves in is that we are now dependent on foreigners to fund our deficits. We literally have to issue new debt to pay the interest on existing debt. This is called “rolling over” the debt. Do we really think this can last? Of course, it can’t. It’s a ticking time bomb that no one is acknowledging. Our country is literally at risk of breaking apart because of a financial collapse, but politicians would dismiss this risk as ridiculous, and not even worthy of a comment. I would submit that, as of today (October 2008), very few people are even aware of this risk. Although, by 2010, it will begin to be recognized.

The biggest mistake that we are making is adding enormous debt to an already unstable economic system. We have stopped creating wealth because we allowed our

manufacturing base to wither (more on this later). Instead of creating wealth, we are now creating poverty (although this has just begun). To create a false sense of wealth over the last 25 years, we have expanded the money supply by borrowing trillions in foreign money (which has temporarily subsidized our standard of living).

Our economy is based on a façade, and we are trying to prop it up with yet more debt. It is a HUGE mistake, but no one seems to see it coming. Warren Buffett, the so-called greatest investor alive, said that he has no doubts that America will come back strong. In fact, he has invested billions in options, betting that the stock market will be higher in the future than it is today.⁴ He is not alone in his rosy forecast; nearly every economist is expecting the economy to rebound.

Federal debt – our national debt – is our biggest economic problem.⁵ The next few years will entail huge budget deficits, expanding our national debt towards \$15 trillion. In 2009 and 2010, deficits will likely exceed \$1 *trillion*, because recessions always increase deficits, and Washington has not shown a willingness to cut programs. For those who think our national debt is manageable, they are in for a big surprise.

Federal debt is only one form of debt that is a major problem. We also have enormous personal/household debt, business/corporate debt, and investment grade debt – especially real estate related debt.

Investment Grade Debt / Housing Crash

The first debt bubble to burst has been investment grade debt, related to the housing bubble. This has already caused one major corporation after another to either declare bankruptcy or require a bailout. Already Bear Stearns, Lehman Brothers, Fannie Mae, Freddie Mac, and AIG have either needed bailouts or are bankrupt. It's early in the game, so the list will probably be much longer by the time you read this.

Investment grade debt burst because of the housing crash. Let's back up and see how the housing crash occurred.

⁴ <http://seekingalpha.com/article/66967-warren-buffett-also-a-put-seller>

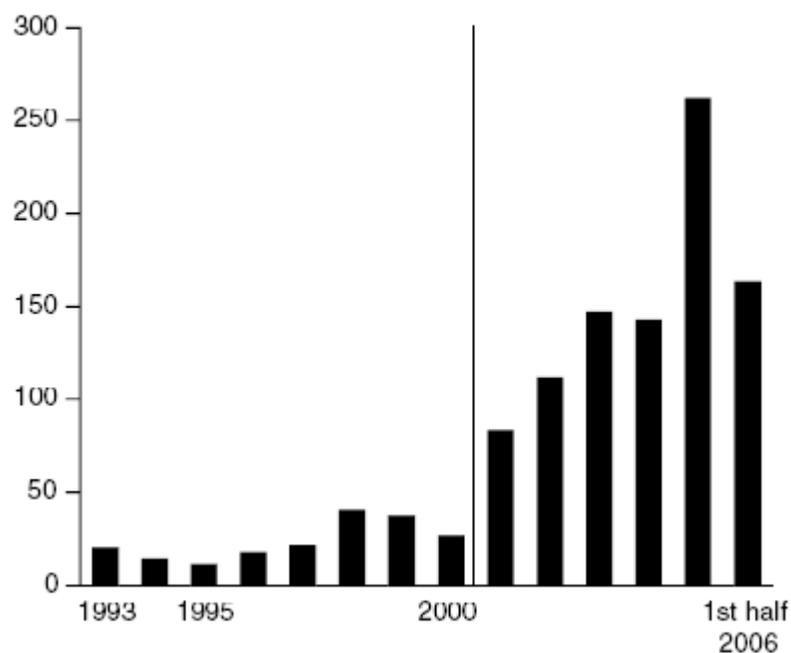
⁵ Why? Because it is leading to the bankruptcy of the U.S. Government, the destruction of the currency, or both. The fallout of these events will be nothing less than the demise of America.

After the 9/11 tragedy (September 11, 2001), the Federal Reserve Bank (the Fed) dropped the Federal Funds interest rate from 6.5% all the way down to 1%, in a series of rate cuts that ended in 2003. They did this to combat the recession that began after 9/11.

The result was two-fold. First, it created an incredible opportunity for people to refinance their mortgages. However, instead of simply refinancing at a lower rate to reduce their payments, people took out larger mortgages, thereby pocketing the excess cash. This provided billions of dollars in cash flow to families and individuals. In fact, cash-out refinancing exceeded \$800 billion from 2001 to 2007 (see chart below).⁶ This huge windfall has been added to existing mortgages. From this cash-out refinancing, millions of families hold mortgages that are now higher than the value of their homes. In fact, nearly everyone who did a large cash-out refinancing after 2001 is now upside down, with no equity.

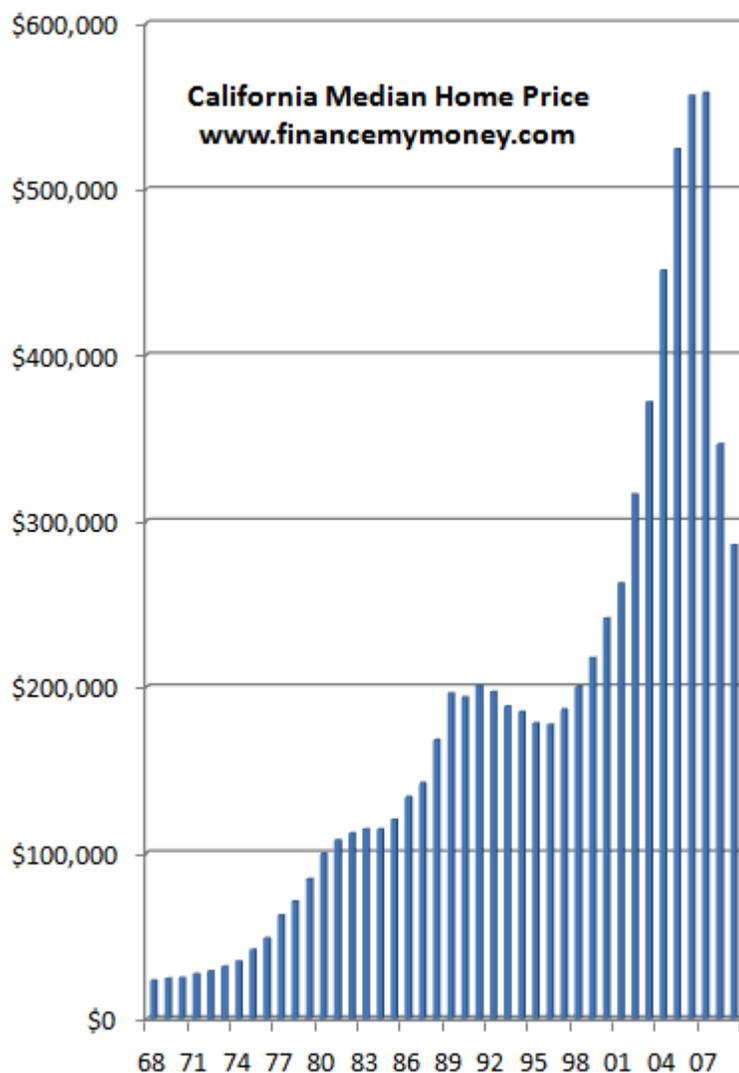
Cash-Out Refinancing Grows

(\$ Billions)



⁶ http://www.larouche.com/eiw/public/2006/2006_40-49/2006-48/pdf/30-35_648_ecolede.pdf

The second result of low interest rates was that it made housing more affordable. In 1999, the median price of a home in California was \$200,000 (see chart below).⁷ By 2005 – at the housing peak – it had reached \$548,000. In the entire U.S., it wasn't as dramatic, starting at \$113,000 in 1999 and reaching \$235,000 (see chart of U.S. House Prices on page 26). However, the house buying mania was just as explosive as California for many U.S. cities.



⁷ <http://financemymoney.com/california-housing-still-over-priced-examining-case-shiller-data-and-seasonal-distortions-the-impact-of-shadow-inventory-on-price/>

In October 2008, median prices were back down to \$300,000 in California and \$206,000 nationally, indicating price drops of 45% and 12% from the peak. For prices to go back to 1999 levels, we still need to see *additional* drops of 40% in California and 45% nationally. Most people do not expect this to happen, but I can make an argument why it is *going* to happen.

From 2002 until 2005, nearly everyone was aware of the housing boom. It was the talk of the town, and it seemed like everyone who invested in real estate was making money. There was literally a euphoria that this would continue.

Most people actually believed that housing prices would not drop, and that *any* investment in real estate was a good, long term investment. The common mantra during this period was to invest in housing. If you didn't have a house, then you were told to buy one. If you had one, then you were expected to either fix it up or buy a nicer one – and get as much as you could afford. If you already had a nice house, then it was recommended to buy a rental or, perhaps, multiple rentals.

Moving on up. A large number of families decided to take advantage of the low interest rates and buy their first house. The percentage of people who owned a house increased from 67% to 69% during this period.⁸ The construction and mortgage businesses were booming. During this period, it was easy to sell houses. In fact, demand was so strong that homebuilders sold many of their new houses before they were even built. It was not uncommon for lines of people to show up to purchase houses or condos that only existed as vacant lots. This often resulted in bidding wars, where people paid more than the asking price. This didn't happen all over the country. But in California, Arizona, Nevada, and Florida, it was pervasive.

Once the mania began, Wall Street became greedy. There was a voracious appetite to purchase all of these new mortgages and bundle them up into investment grade securities. The best known of these were called mortgage backed securities (MBS). Wall Street investment banks would then sell these MBS to banks, pension funds, hedge funds, insurance companies, or other investment banks. Holders of these securities were then paid by homeowners through their monthly mortgage payments.

⁸ http://en.wikipedia.org/wiki/Homeownership_in_the_United_States

Wall Street advertised to the mortgage brokers and banks who were originating these loans that they would buy ANY new mortgage. This induced the originators to begin using a variety of new types of mortgage loans that allowed more people to qualify.

Neither Wall Street, nor the regulators, scrutinized these new types of loans. Things degraded to the point where you could get a loan without stating your income (liar loans), or paying whatever you wanted (pay option loans). For pay option loans, if the payment did not cover the interest, then the difference was added to the principle – eventually leading to a reset of the minimum payment. Pay option loans were literally time bombs, because eventually the minimum payment would exceed the amount that the borrower could pay.

By 2005, there were many different types of loans available: interest only; option ARMs (Adjustable Rate Mortgages); ARM hybrids; and pay option. Each of these loan types had many alternatives, and an array of fine print details. It was confusing, and many people had no idea what they were signing. Many of these “exotic” loans had a temporary low payment period, which expired after a few years. Some people called these “exploding” ARMs, because, once they reset, nearly all of them went into default.

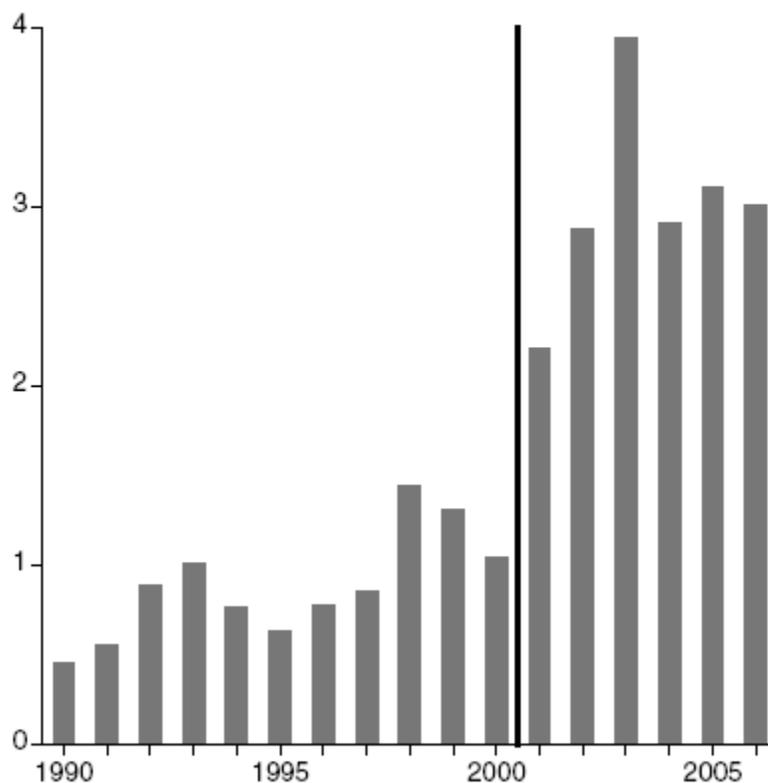
There was literally an explosion of mortgage originations during the mania. In the 1990s, originations averaged \$1 trillion per year. But in the mania after 2001, it exploded to \$3 trillion per year (see chart below).⁹ All of these mortgages (\$15 trillion worth!) were like manna from heaven to Wall Street. They bundled them up and marketed them as investment grade securities to financial institutions all over the world.

Thus, the financial meltdown was our fault. We spread the contagion – worthless securities – all over the world. We literally bankrupted Iceland. Their banks woke up one day and realized that their assets were worthless. I don't understand why they didn't sue the Security and Exchange Commission (SEC), and the United States rating agencies, such as Moody's. Clearly, someone allowed securities that were non-investment grade to be peddled as AAA investment grade. Isn't that someone's fault?

⁹ http://www.larouche.com/eiw/public/2006/2006_40-49/2006-48/pdf/30-35_648_ecolede.pdf

Annual U.S. Single-Family Home New Mortgage Loan Originations

(\$ Trillions)



Most of the people who signed these exotic mortgages did so because it allowed them to buy a house that they could not otherwise afford. They were betting (with Iceland's money!) that their house would increase in value, and they could later refinance using the equity.

The mortgage originators literally marketed these loans to people who couldn't afford a house. It got so bad that, by 2005, anyone who wanted a mortgage received one. There were literally thousands of people buying houses who made minimum wage. There were office workers, who earned \$12 an hour, who owned more than one house. There were cab drivers living in \$500,000 houses. You name it, and it was happening. Many people were buying houses and then not making a single payment! It was a crazy period.

Why rent, when you could buy a house with nothing down, and pay less than you could rent for? Or better yet, live there for free. For example, I know of a guy in San Diego who bought a house with nothing down, and never made a payment. After several

default notices, he refinanced, and then continued not making payments. He lived in the house for over a year, and it did not cost him a dollar in mortgage payments. The only risk was to his credit rating.

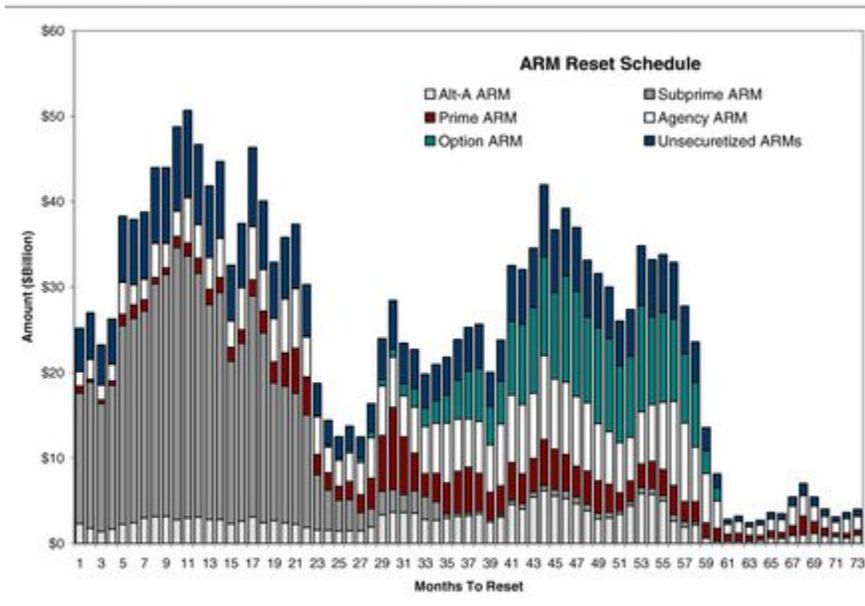
Many people executed a similar gambit and paid only interest, or better yet, whatever they wanted – using pay-option loans. If housing prices continued to increase, they had a good chance of refinancing and avoiding foreclosure, or maybe even selling for a profit.

Of course, these bets were longshots that were doomed to fail. What is incredible is that they were allowed to occur at all. One number that gets my attention is the increase in total household mortgage debt. In 2000, it was \$4 trillion; by 2008 it was up to \$14 trillion.¹⁰ A large portion of those loans are at risk. Why? Not just because many were made to people who could not afford them. Not just because the recession will force many to lose their jobs and their houses. But because, by my estimate, we are going back to 1995 housing prices.

The scary part is that, soon, nearly all mortgage loans made after 2001 will be significantly underwater. The losses related to these loans are going to be profound. The estimate that I keep reading is \$1 to \$2 trillion in losses for the mortgage related investment securities. That is way too optimistic. Freddie Mac and Fannie Mae will probably lose that much by themselves. Banks, hedge funds, insurance companies, and others are on the hook for another \$3 trillion or so in losses, perhaps even more.

The foreclosure wave began shortly after prices stopped rising in 2005. By the second quarter of 2006, foreclosures were up to 300,000 per quarter. Through 2008, they are up to 700,000 a quarter, which means nearly 3 million houses per year! The wave is projected to continue through 2012. It will take that long until all of the people with option ARMs and other exotic mortgages are forced out of homes they can't afford. Today, many families are paying low monthly teaser payments that will reset between now and 2012. Nearly all of them will lose their homes. See the Credit Suisse Bank reset schedule below. Resets do not slow down until we get to 2012, and the average monthly reset amount is approximately 25 billion dollars.

¹⁰ <http://mortgagestats.blogspot.com/2009/02/mortgage-debt-outstanding-1952-2007.html>

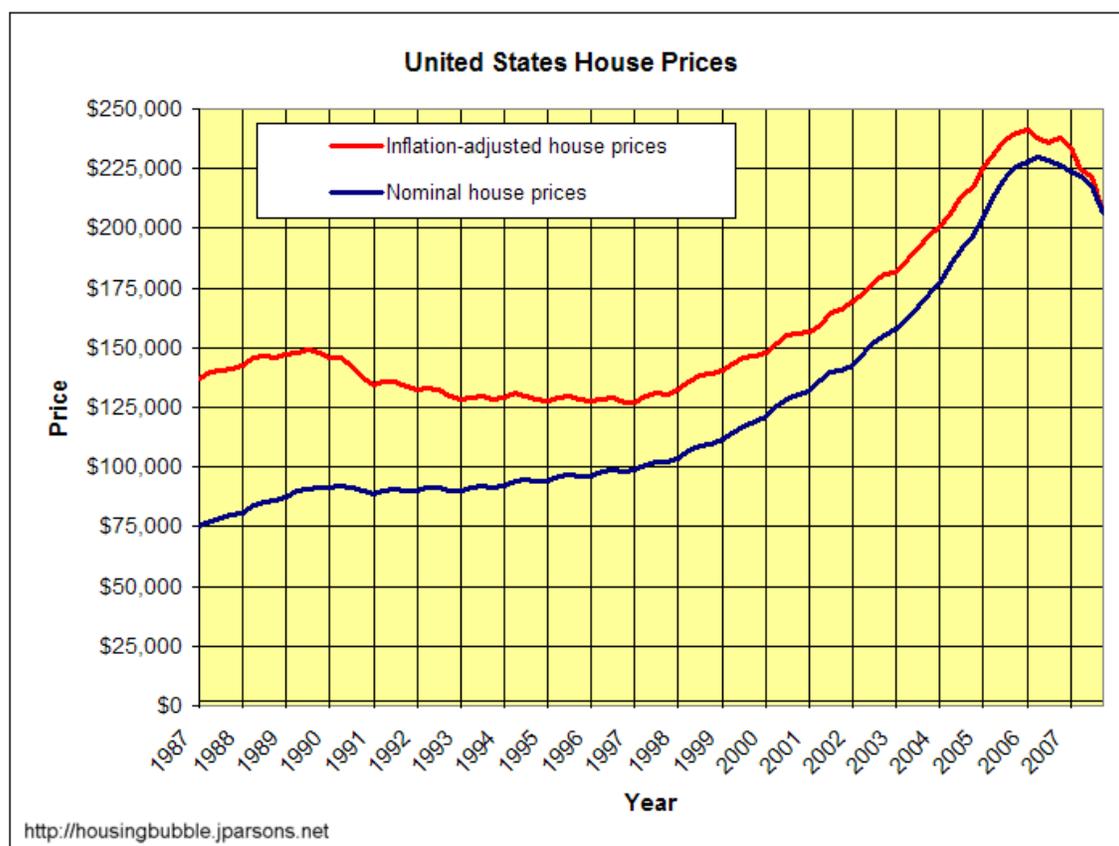


Note: Data as of January 2007.

Source: Credit Suisse Fixed Income U.S. Mortgage Strategy.

The question on everyone's mind is, when will we reach the bottom in housing? Looking at the next graph (see chart below)¹¹ gives a glimpse that we have a long way to go.

¹¹ <http://housingbubble.jparsons.net>



The wave of foreclosures will continue, because housing prices must fall back to the historic mean. Prices exploded from 1999 until 2006. That bubble has now popped, and prices are heading back down.

As this graph reveals, housing prices gradually increased from 1987 until 1998. (This correlates with a gradual increase in income.) Then around 1999, prices exploded. During this period, housing prices and income diverged, and a bubble formed.

Historically, the median price is approximately three times the average household income. Thus, until the national median price decreases to \$135,000, I don't think anyone should be talking about a bottom. In fact, I think the bottom will be somewhere close to 1995 prices, which would be approximately \$100,000 nationally. I wouldn't consider buying until prices get to \$125,000 nationally, which should be in 2011-2012.

People who work in the housing industry – builders, agents, mortgage brokers, etc. – are probably muttering something like, “No way. That’s too low.” Why would they

say that? Builders don't believe that they can build new houses at those prices. Agents are afraid of the long slump required for prices to fall that low.

As mentioned previously, since 2001, a huge number of houses were refinanced for *more* than the original mortgage by people using cash-out refinancing. Thus, if housing prices continue to drop, nearly everyone who either bought a house *or* refinanced for a significant increase, since 2001, is likely to be underwater with no equity.

For example, let's say that you had a \$150,000 mortgage in 1995. By 2005, your house was worth \$300,000. Wow, look at all of that equity! You could tap into it by increasing your mortgage to \$200,000 and receive a check for \$50,000 – and it wouldn't cost you a cent. People considered their houses to be piggy banks, and the only way to get it out was to refinance for a larger mortgage. Now the bill is due.

There are millions of families in this situation. These are people with high credit scores who can afford their payments. However, will they? How many will walk away from their mortgages, when they get too far underwater? It is likely that millions will walk away. And what about the families who bought after 2002, at high prices? How many of them are underwater already? Most of them. How many will walk, when rentals become available for half of their current mortgage payment?

Thus, in both of the scenarios above, these are not foreclosures from people who used exotic loans and cannot pay, but from people who will *choose* not to pay. This is a time bomb waiting to happen. Between now and 2012, we are looking at 12 million foreclosures and perhaps *another* 8 million from people who will walk.

Who is going to absorb all of these losses? And how are housing prices *not* going to collapse with this much inventory, during an economic downturn with high unemployment?

I keep thinking of Al Pacino in the movie *Heat*, when he says, "That's exactly what they're gonna do, they're gonna waaaalk ... this is my operation, I have tactical command that supersedes your rank, they will walk away and you will let them."

Corporate Debt

Mortgage related investment securities was the first debt bubble to burst, and corporate debt – bonds – were next in line. While defaults have not yet begun to match the MBS market meltdown, it is becoming very expensive, and for some corporations, impossible, to borrow money. The entire debt financing of the U.S. economy has been ravaged. The integration and interrelation of the financial community has now become apparent. Moreover, as the wave of foreclosures continues, the financial community will continue to feel its effects.

One piece of information that is not well understood is the huge proliferation of corporate debt. In 1980, corporate debt was only 12% of GDP.¹² Today, it has risen to more than 100%, with estimates as high as \$17 trillion.¹³ The biggest portion of this debt, by far, is corporate bonds. Companies such as Lehman Brothers were leveraged 30 to 1 (debt to assets). General Electric (GE), one of the bastions of corporate America, currently has over \$500 billion in debt!¹⁴

The idea of using large amounts of debt to achieve a financial objective became a practice that started with President Reagan's budget deficits. It then made its way to consumers and businesses. Looking at the charts and trends (see charts below) of these increasing debts, it is clear that the practice of using large amounts of debt is widespread and ubiquitous throughout America.

Another domino that is poised to begin tumbling is commercial real estate. This is the bread and butter for many local and regional banks – where they make their money. If we fall into a deep recession – and I don't see how we can avoid one – the losses related to investments in commercial real estate will exceed \$800 billion.

While that's small potatoes versus residential real estate, it will still force many banks into insolvency and exacerbate the credit crisis. Moreover, it will likely force Washington to write a few more big bailout checks. In fact, I doubt that the FDIC (Federal Deposit Insurance Corporation) can remain solvent under this onslaught of bank

¹² <http://zerohedge.blogspot.com/2009/04/observations-on-us-debt.html>

¹³ Ibid.

¹⁴ <http://www.thestreet.com/story/10540019/1/why-ge-is-still-a-good-short.html>

closings. Now that deposits are insured up to \$250,000 per account, this fund will go belly up much sooner than expected.

If we look back at the Great Depression of the 1930s, the banking crisis didn't really hit until 1931, two years after the stock market crash in October 1929. In fact, the majority of bank closings were in 1932, three years after the crash. This is what we will likely see this time. Thus, it will probably take a few years after the stock market crash of October 2008, before the banking crisis reaches its peak.

Household Debt

After Federal debt, household debt is perhaps the most problematic. Do you remember the commercial where that guy is smiling and says that he is up to his eyeballs in debt? Well, household debt is now 90% of GDP.¹⁵ In 1980, it was only 50%. The average family now has nearly \$8,500 in credit card debt, \$14,400 in auto and college loans, and \$95,000 in mortgage and home equity debt.¹⁶

In 2002, 61 % of U.S. credit card users carried a monthly balance, averaging \$12,000 at 16 % interest. This amounts to about \$1,900 a year in finance charges.¹⁷

The scary part is that, since 24% of households have no debt, those that do have debt have higher numbers than these. The facts are obvious: families are strained. As the graph below reveals, consumers now owe \$12.5 *trillion*. This has doubled since 2000. A big portion of this debt will be defaulted, because consumers are simply tapped out.

Since the 1960s, the savings rate for households has steadily declined. In 2007, for the first time in history, the savings rate was actually negative. In other words, the

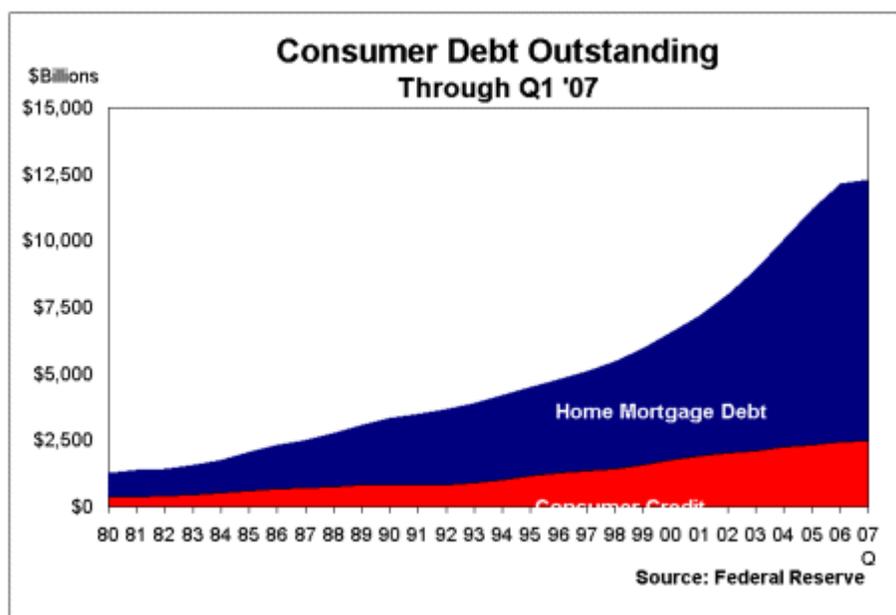
¹⁵ <http://mwhodges.home.att.net/nat-debt/debt-nat-a.htm>

¹⁶ http://www.nytimes.com/2008/07/20/business/20debt.html?_r=1&oref=slogin#

¹⁷ <http://www.worldwatch.org/node/810>

average family spent more than they earned. What this means is that the average family cannot pay their bills. They have no choice but to take on more debt each month. What happens if someone loses their job? Will they have any savings? Not likely. Our economy is literally living paycheck to paycheck.

Most Americans have a big portion of their retirement/savings in 401K plans. Already, there is a big push by consumers to borrow from their 401K, since you are literally borrowing from yourself. However, when the stock market crashes, these plans will be devastated, along with a large portion of household wealth. My forecast is for the DOW to fall below 7,000 before 2012. We could see a major crash any day.



We have been living beyond our means for quite some time. It began in the 1980s, when our manufacturing base was decimated (in the name of free trade), and we began importing everything from Asia, Canada, Mexico, Europe, and the rest of the world (see chart below).¹⁸ In 1980, the trade deficit was \$20 billion. By 1984, it was over \$100 billion, and it has steadily climbed ever since. This year (2008), it is approaching \$800 billion.¹⁹

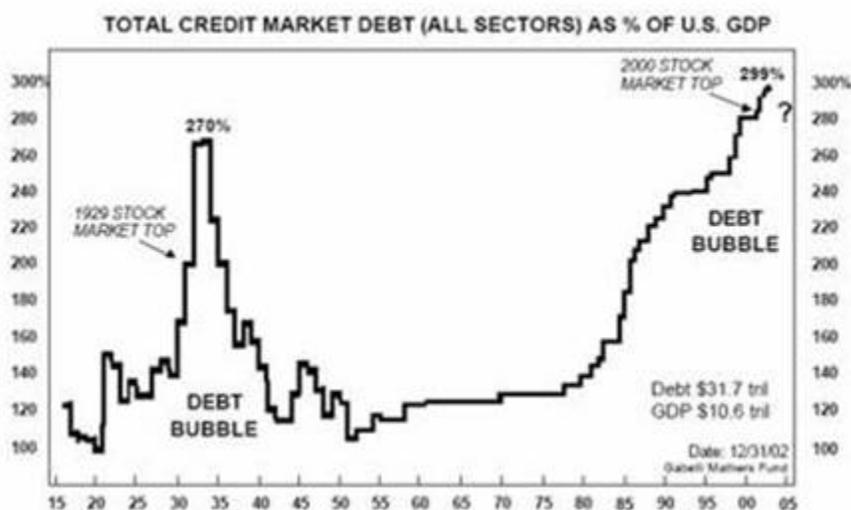
¹⁸ http://internationaltrade.suite101.com/article.cfm/america_s_trade_buddies

¹⁹ <http://www.census.gov/foreign-trade/statistics/historical/gands.txt>

Top 10 Countries Contributing to U.S. Trade Deficit (2005)

1. China ... -\$201.5 billion (up 95.4% from 2002)
2. Japan ... -\$82.5 billion (up 17.9%)
3. Canada ... -\$78.5 billion (up 62.9%)
4. Germany ... -\$50.6 billion (up 40.9%)
5. Mexico ... -\$49.7 billion (up 33.6%)
6. Venezuela ... -\$27.6 billion (up 157.9%)
7. Malaysia ... -\$23.2 billion (up 69.3%)
8. Nigeria ... -\$22.6 billion (up 361.2%)
9. Saudi Arabia ... -\$20.4 billion (up 142.9%)
10. Italy ... -\$19.5 billion (up 37.3%)

These large trade deficits require foreign money to circulate back to America, or else our wealth is transferred overseas. We have accomplished this by selling foreigners our national debt. Thus, we have tried to live the American Dream by using foreign debt. Well, that has now caught up to us. Very shortly, foreigners are going to say, “No mas” to our debt offerings (U.S. Treasury auctions).



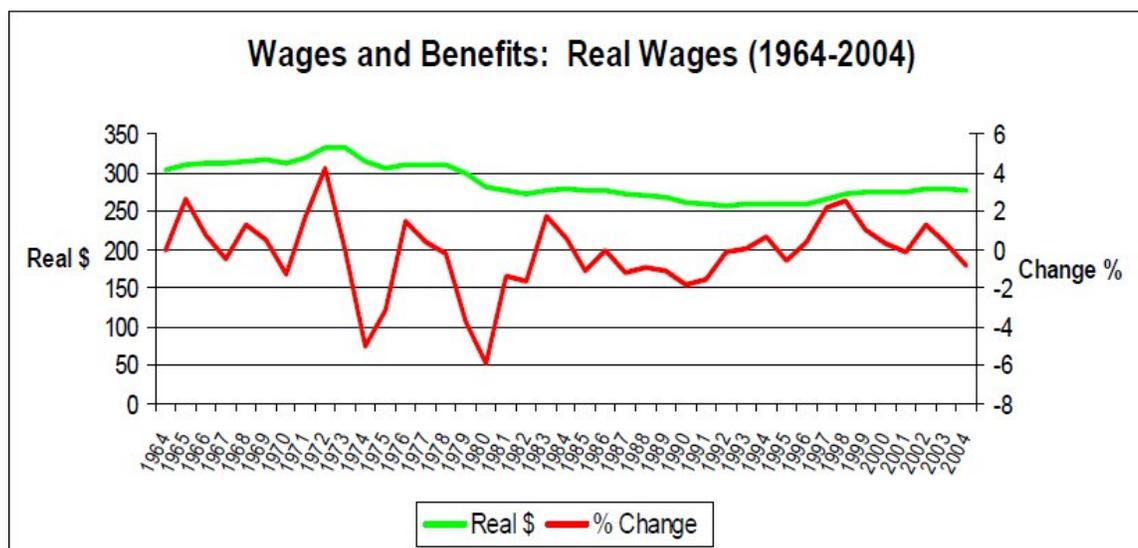
The chart above²⁰ clearly shows that the debt explosion began in 1980. During this period, we allowed our manufacturing sector to wane. We became preoccupied with improving our standard of living through rabid materialism and economic growth. It should be noted that most of the growth was fueled by consumer spending, which today

²⁰ <http://www.rense.com/general47/curr.htm>

accounts for 70% of GDP. Clearly, we have been using debt to finance our standard of living for 25 years, and now the bill is finally coming due.

Another factor leading to the proliferation of debt – and correlated to the reduction of our manufacturing base – was the flattening out of real wages. From 1900 until 1972, real wages steadily increased in America, as we provided goods to the world, and our standard of living became the envy of the world. In 1972, median wages peaked at \$331 per week (in 1982 dollars).²¹ In 2004, wages were languishing at \$279 per week (in 1982 dollars).²² Thus, wages have been stagnant for over 30 years (see chart below).²²

In order to increase our standard of living, we have had to borrow large amounts of money. However, that model is no longer tenable. We are going to try to borrow trillions more to maintain our standard of living, but it's not going to work. Instead, we will face a crisis. It will be a crisis significant enough to bankrupt this nation, and will actually lead to its breakup.



It wasn't just the reduction of manufacturing that led to the decrease in wages. Vast numbers of women and immigrants (mostly illegal) entered the work force during the 1970s and 80s. Also, the computer led to enormous productivity improvements. The combination of these forces led to downward pressure on wages. Stagnant wages were an

²¹ 1982 dollars, inflation adjusted.

²² <http://www.workinglife.org/wiki/Wages+and+Benefits%3A+Real+Wages+%281964-2004%29>

assault on our standard of living. As a result, we tried to borrow our way to prosperity. As long as we managed the debt, everyone thought we could continue to grow at 2-3% per year. But it was always a ticking bomb – of debt.

The day is quickly approaching when we will no longer be able to service our debt. This is already happening on Wall Street and Main Street, and it is only a matter of time before it happens on Pennsylvania Avenue – Washington D.C. Make no mistake, America is headed toward defaulting on all of our debt obligations – bankruptcy. There is no avoiding it.