Saved from the Brink of Ruin?

BY MARTIN WITKERK

In his new book, David Stockman, Director of the Office of Management and Budget (OMB) under President Ronald Reagan, uses Donald Trump's successful presidential candidacy as a peg on which to hang a highly critical study of American economic policy over the last generation. A steadfast fiscal conservative, his economic analysis is nevertheless occasionally reminiscent of the quaint communist propaganda of yesteryear: the upshot being that our system is rigged to help the rich get richer while working Americans are cheated of the fruits of their labor.

But this resemblance is not his fault; it is simply what the numbers show:

> Real [inflation adjusted] hourly wages are lower [today] than they were in 1985. Constant dollar median household income is down 21 percent since the turn of the century. Working Middle America has never before had such a deep and sustained setback, even during the Great Depression…. At the same time, the top 1 percent has experienced a 300 percent gain owing to the fact that the stock market has been transformed into a gambling casino by the massive monetary intrusion of the Fed…. The real wealth of the Forbes 400 has risen by 1000 percent.

The roots of the current system lay in the 1980s, when Pres. Reagan cut taxes and increased military spending while largely refusing to cut other government spending. The result, of course, was a massive increase in the deficit. Stockman has already told this story in his book *The Triumph of Politics: Why the Reagan Revolution Failed* (1986).

In August 1987, Alan Greenspan assumed the Chairmanship of the Federal Reserve Bank, and only a few weeks later, on October 19, the stock market lost nearly a quarter of its value in a single day. The former advocate of the gold standard quickly "discovered the Fed's printing press." Inflationary policies simultaneously eroded the savings of ordinary Americans and fueled an orgy of stock market speculation, which Stockman describes as "the Warren Buffett economy."

The "Sage of Omaha," perhaps the most emblematic figure of the new economy, has seen his fortune grow by a factor of 19 since 1987. As Stockman writes, "a real 19X gain in three decades can occasionally be achieved by inventors of something fundamentally new and economically transformative. Thomas Edison, Henry Ford, and Bill Gates fit that mold, but not an insurance portfolio manager from Omaha." Buffett has never even invented any new insurance product or new way of investing. He has merely done a better job than most investors of "riding the bubble" created by Fed policy. But even the average investor has multiplied his fortune by a factor of eight over the same period.

TRUMPED!
A Nation on the Brink of Ruin…
And How to Bring It Back
David A. Stockman
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And nothing about the underlying economy has justified this steep rise in equity prices. Since Greenspan took over at the Fed, nominal [not inflation-adjusted] wages of American production workers have risen from $9.22 to $21.26 per hour. This has made American labor uncompetitive, leading to massive offshoring to India and elsewhere.

Over the same period, the median inflation-adjusted household income has actually gone down 20 percent, while total household debt has risen from $2.7 trillion to $14.3 trillion. This puts the ratio of household debt to income at more than double its historical level. What good are higher nominal salaries in this context?

Much household debt has taken the form of "home equity loans." For years, around-the-clock advertising encouraged Americans to hock their homes—which for 75 percent of them was their principal or only significant asset—and splurge on the proceeds. Total mortgage debt thus soared from $1.8 trillion in 1987 to $10.7 trillion at

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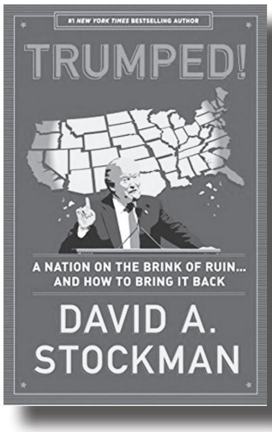
its 2007 high, a six-fold increase. Although housing prices more than doubled over this period, the ratio of equity to owner-occupied housing asset value plunged from 67 percent to 37 percent. When the bubble burst in 2008, 15 million households faced foreclosure.

Another major source of household debt is student loans. In the last decade alone, total student loans outstanding have nearly tripled, rising from $500 in 2006 to $1.34 trillion at present. Most of this debt weighs on flyover America. A major contributor to the problem has been for-profit "tuition mills" such as Phoenix University and Strayer Education. At their peak a few years ago, enrollment at these institutions totaled 3.5 million. Typically, 90 percent of their revenues are derived from student grants and especially loans, but less than one-third of that money actually goes to the cost of education (teachers, classrooms, books, etc.) Well over a third goes to "Selling, General and Administrative Expense," with a special emphasis on the "selling" part. Expenditures on commissions and bonuses for recruiters at these institutions have been prodigious. Between 2001 and 2011, for-profit colleges were the fastest growing and most profitable companies in America. The combined market cap of the six largest public companies went from less than $2 billion to upwards of $30 billion over that period.



Meanwhile, America's employment situation has greatly deteriorated. In January 2001, as Bill Clinton was packing his bags to vacate the White House, there were 72.7 million breadwinner jobs in America; today the number is 71.3 million. The workforce has increased by five million during this time and, in effect, *none of these people have a job*.

Yet at the same time, the "Flyover CPI"—a more accurate consumer price index adjusted to the economic realities of middle America—has increased at 3.1 percent per year since 2000. This helps explain why the number of persons in households receiving government benefits has risen from 50 to 110 million.

In the midst of all this recklessness and deterioration, the Fed has been responsible for a "monetary stimulus" like nothing before in history. Interest rates have remained near zero for 93 straight months now. According to Keynesian theory, this is supposed to improve the economy by encouraging households to spend, thereby increasing "aggregate demand." This could work, after a fashion, as long as households had assets against which to borrow. But by late 2007, when average household debt stood at 220 percent of household income, additional borrowing became impossible.

Inflation, caused by the Fed's easy money policies of near-zero interest and quantitative easing, has eviscerated Americans' purchasing power, with what had been $68,000 in today's purchasing power at the turn of the century being worth barely $55,000 today. And the only reason inflation has not gotten even worse is that we have been relying more heavily on imports from, and job outsourcing to, the world's emerging markets: in other words, exploiting a practically endless supply of very cheap labor from the third world. In the meantime, America's own productivity, the driving force behind long-term economic health, has been steadily diminishing. The "economic recovery" we have been hearing so much about over the past eight years is, in Stockman's words, nothing but a "giant Potemkin village of phony economics and egregious financial asset inflation."

The author writes:

> In the face of the "China price" on goods and labor, what was needed in America was the very opposite of what Washington's Keynesian academics and policy apparatchiks delivered. Under a regime of free markets and sound money there would have been high interest rates, falling consumer prices, and an upsurge of household savings in response to strong rewards for deferring current consumption. From that enhanced flow of honest domestic savings the supply side of the American economy could have been rebuilt with capital and technology designed to shrink costs and catalyze productivity [including through] massive reinvestment in the nation's aging capital stock.

Published less than a month before the election, Stockman's book has little to say about Hillary Clinton except that her "ideas about how to fix the coming economic and foreign policy crises are so unequivocally and irremediably bad that it is not possible there is anything worse." His judgment of incoming President Donald Trump is a great deal more mixed. He clearly does not care for Trump's personal style ("a rank demagogue", "an egomaniacal rabble-rouser," "rude, impulsive and loutish," etc., etc.), but acknowledges that Trump may be "the battering ram that is needed to shatter the polite lies and delusions on which the current regime rests."

Stockman gives Trump little credit for his understanding of economic issues, calling him a "blank slate" whose "economics are purely glandular" and remarking that he sometimes seems to lean toward different policy solutions on alternate days of the week. Specific criticisms are aimed at Trump's support for low interest rates, a $10 minimum wage, public infrastructure programs, and preserving Social Security and Medicare (this last an absolute electoral necessity). He also believes Trump is wrong to blame bad trade deals for conditions that actually result from mistaken economic policy.

Yet Stockman realizes it may be possible to influence Trump with sound advice in a way that would never be possible with Hillary Clinton, and much of the book is devoted to the sort of advice he would offer President Trump. As a first example, Stockman believes that any attempt to foster domestic production through protective tariffs would "wreak havoc beyond imagination." Instead, he proposes to make American workers internationally competitive once again by eliminating all federal payroll taxes. In the case of a Rust Belt industrial worker making $25 per hour, e.g., this would amount to an additional $4,000 per year in take-home pay. Yet it would amount to an 11 percent cut in the cost of U.S. labor. Offshoring, which involves costs of its own, would no longer be so economical.

Other recommendations include: (1) replacing taxes on businesses and workers with taxes on consumption and imports, (2) denying federal insurance to banks "involved in Wall Street trading and other forms of financial gambling," (3) turning over Washington's welfare and education programs to the states, (4) freezing all new government regulations and subjecting all existing regulations to cost-benefit analysis, and (5) getting the federal government out of law enforcement, including ending the "War on Drugs."

Stockman also favors a far less aggressive international posture for the United States. He approves of the Iran Nuke Deal and advocates the dismantling of NATO and cuts in defense spending. He also includes a chapter on "Hillary's War Cabinet in Waiting," which is already obsolete.

The book's overall message is difficult to argue with: that debt cannot be piled up forever, that a nation cannot spend its way to prosperity, and that, without quick and decisive action, it is only a matter of time before our central bank-fueled stock market boom is paid off in the form of a prolonged deflationary contraction. Trillions of uneconomic assets will be written off, industrial sector profits will collapse, and the great inflation of financial assets over the last 29 years will meet its reckoning.

At least on matters of economic policy, President Trump would do well to provide himself with advisors as wise as David Stockman. ■

David Stockman, former Director of the Office of Management and Budget (OMB) under President Reagan (1981-1985), is the author of *Trumped! A Nation on the Brink of Ruin and How to Bring it Back* (2016), *The Great Deformation: The Corruption of Capitalism in America* (2013), and *The Triumph of Politics: Why the Reagan Revolution Failed* (1986).