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If you're so smart, why are we so broke?

America's ongoing jobs depression - which is what it deserves to be called - is the worst economic calamity to hit this nation since the Great Depression.

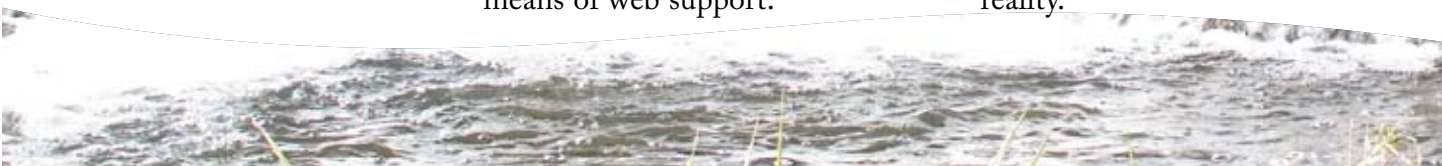
— Robert Reich, Clinton Administration Labor Secretary, *economist*

It seems that Reich's comments are something every American, and probably most citizens of the developed world can unite upon. The problems we face seem to be agreeing on the means to combat, fix, or lessen the jobs problem.

The Chronicle has some of the smartest readers in the human universe. If you read these columns on a weekly basis you are going to have to work your way through two to three times the verbiage that accompanies the more popular pundits and commentators. Mainstream media doesn't pay people to develop specific topics; it just takes up too much space that could be used for advertising revenue. This is becoming an even more important symbol in the Internet age, as click to external commercial sites become the major means of web support.

I have been told I am a smart guy, even a close personal friend of over a quarter of a century has said I need to print and distribute business cards that say: "Genius For Hire!" I would say in the total picture, I do have a few unusual gifts that are somewhat unique, that we touched upon last week, which I seem to be able to see or comprehend things in a way other people can't see, or more likely don't want to see. This is sort of a disharmony in which many people seem to be afraid to look for. Others have called it an obtuse way of looking at life.

This week we will begin to develop a theory that just sort of popped into my mind as we have watched the development of the bear stock market and the various pundits, commentators and analysts' response to this developing reality.



Much of the time these responses are offered within the context of some type of evolutionary theory. As a person that believes that evolution is just a sad atheistic attempt to describe the natural world around us, I sometimes use the word in satire, but in reality what they are really describing is not evolution, but natural law. Natural law being defined as the common, interconnected informational and energetic realities that provide the stable planet on which life can continue.

For example natural selection is not evolution, but natural law. Quantum leaps of organizational complexity is the basis of true evolutionary theory, and has no demonstrable basis in reality, just a huge (unenlightened and unexamined) leap of faith into a world where natural law becomes subservient to human wishful thinking; to describe the world without the need for God.

A prime example of the common evolutionary discussion occurs in the Afterword of Niall Ferguson's *The Ascent of Money*. I bring this up really as a contrast to Mr. Reich's Keynesian worldview. Ferguson's work is best described as Austrian school economics, which relies heavily on natural phenomena to describe the working of human enterprise markets. Within that context what he properly defines generally as monetary Ascent, and Descent in the Afterword, are just humans using their God given creative capacity, human intelligent design, ultimately pointing to and giving glory to the God, who created it all.

Into these intelligent design developments in economics and finance, we now have a closed system, hence a zero sum game based on compound interest and leverage of money. Which is basically the foundation of Adam Smith's capitalism. As this system as developed over time the closed, unnatural ecosystem, basically needs booms and busts to allow for the process to equilibrate. Because it does adequately eventually account for real world risks, mainly because it relies heavily on highly illiquid fixed assets, and has no provision for open inputs to wealth commiserate with risk, it has no way to create what we call agricultural wealth returns.

Furthermore this faux world exists independently of the causative agents that make

the system work, namely emotional human beings who basically are responsible for it all; through extremes of euphoria (booms) and busts (fear). In short we need better economic models that take into account the very human nature of what we call life.

The Gross Domestic Product (GDP) model we have used, more and more commonly over the last generation, as we have moved from historic compound interest and leverage, into the world's now crumbling financial situation, is to maintain it all through increasing debt, not by looking at the model itself.

Last week when we looked at Financial Fizzics and Fleeing Fear using the arithmetic formula for GDP, we see it is equal to the total contributions of Consumption (C) plus the contribution of Investments (I) adding in the role of Government (G) and either adding or subtracting the Net (N) difference between national Imports (I) and Exports (E). This gives us the popular formula and the yardstick by which all nations and states are measured in terms of there now perceived value to the world economy: $GDP=C+I+G+N(I+E)$.

Furthermore these are not independent variables as the formula implies, neither is there any method to quantitatively determine the intended or the unintended consequences of the interactions within and among the variables, and any attempt to model or quantitate these relationships, defeats the whole purpose of the desired simplicity we started out to use.

While thinking about it all however, there is something significant that is missing in the whole equation, and that is the role of the national central bank, in the case of the United States, the "independent" Federal Reserve. With the talk of Greek default within the Eurozone, and subsequent ramifications around the world, the real players are not the cause and effect agents in the GDP formula at all, but rather the World Bank, the IMF and banks in general.

Put succinctly it is not money makes the world go around, but rather banks that make the modern world function, or as seems to be the case and the formula indicates, without banks the whole system collapses. The way the world is currently constructed, banks are the foundation on which the whole global economy rests. In other words you take the whole GDP

formula and divide it by some constant, or variable (v) for the health of the appropriate banking system (B) and you have a updated formula: $GDP=[C+I+G+N(I+E)]/B(v)$.

Now to put this into some sort of historical context, we used the quotation from Keynesian Robert Reich at the beginning to illustrate that in his worldview that Government can be the mechanism by which essentially an New-New Deal will get the economy back to creating jobs. That basically means government is the means to boost Consumption, Investments and Exports.

Republicans for their ante in the game say that is all wrong; it is Investments that drive the economy, which creates jobs and Consumptive demand for more goods and services, as well as create Exports. We need a Reagan Revolution Revival and we need to get the government out of our lives as well.

They are both up the deep river, in a little holey boat, without a paddle, because their only sources for the money for them to patch the hole, purchase a paddle, or buy a motor essentially only comes through the monetary workings of the central bank. The FED and as we are finding out quite readily, can only work with the GDP variables by trying to manipulate or manage the money supply, it cannot on its own create demand in any GDP sector. As we have seen recently, all this has done is provide free liquidity for a bunch of greedy fat cats that have enlarged their personal portfolios. Using another metaphor; that is simply as far as FED policy can push the string.

To paraphrase the theme of Ron Paul, "If that is all they can do, why do we need the FED?"

That really doesn't answer the question about the wisdom of FED functions, but creates a wonderful talking point. I would doubt that few citizens today would vote to give the monetary power to any of the branches of government. The real problem is with the dominance of banking as the FED's only portal into the rest of the economy. There's no other way to get money into the culture except through banks using the leverage of their fractional reserves.

Today this is really almost totally centralized in "too big to fail" financial institutions, government and the related corporate dinosaurs, leviathans, behemoths, who are the only ones who have access to the FED liquidity and then if they want it — to be able to continue to merge, acquire, and regulate unsustainable and cancerous positions within globally regulated markets.

When Congress and the President, both Democrats and Republicans, rely on these titans of bureaucracy, directly and indirectly for their reelection, probably the only method for substantive change must come from external environmental sources, such as a continual slide in equity markets of 3000 or 4000 points in the Dow; perhaps below the 7063 mark reached in early 2009.

The problem, as we are attempting to point out is any changes reflecting the hindsighted models for the last hundred years, and especially the last quarter century are not going to change the future reality toward anything but a continual slide toward this true catastrophe. Going back to Austrian school economics, evolution, or natural law, your choice; we need some Creative Destruction within the United States and the rest of the global economy, so that we can create both the enterprises and the infrastructure for the future.

In a way this is going to be the most fundamental change in the way the world works since Adam Smith. At least for the short term, compound interest and leverage do not provide enough of a risk premium, especially when it runs through the current fractional reserve banking system.

As coined by Joseph Schumpeter, the historic understanding of Creative Destruction is that human creative endeavors, expressed through industrial mutation, revolutionizes markets from within. The problem we are seeing today is essentially the dinosaurs are banking all the liquidity, for their financial fizzes says they should flee from fear, and there are too many currently strong human self-preservation emotions to continue working outside this me-first reoccurring theme.

We have proposed an enterprise hydrologic cycle as a means to foster creative construction, and we are not talking about another housing bubble, but rather an enterprise startup revolution that is really the means

of phylogenesis of new enterprises, rather than the ontogenesis of the Industrial Age.

One could make the strong case that what made the United States the foremost economic and political power the world has ever known, was the diversity of her banking system. The tens of thousands of small regional banks and many localized branches has given way, not to just massive centralization, but also the again unification of traditional banking with investment banks, when in November 1999 the Glass-Steagall Act was repealed.

While not perfect, Glass-Steagall did keep investment banks from taking investment risks with bank depositor money, which essentially makes perfect sense to anyone but a true believer in monetary theology. OPM-OPR (Other People's Money and Other People's Risk) is the only meaningful rational way to hedge against human irrationality. Just ask George Soros.

The irrational thing to do, would be to break up the big banks and go back to the way it was in the mid twentieth century, but that is not really creative destruction but rather responding to fear.

Some time ago the State of Washington created the framework for a Business Development Company. This concept came about in 1980 through changes in the Investment Act of 1940. This, broadened into regulation free zones, is where our proposals for Entrepreneurial Pioneer Areas (EPA) could provide creative destruction. By making these EPA companies available to local levels, with direct access to some special form of FED backing as unique enterprise hydrologic cycle funds, they could be specifically designed to foster the creation and seed money funding for small startups.

Coming at it from the other end of the financial spectrum, it is like successful microloan programs in developing countries, only focusing on equity financing, not just to create a successful independent business entrepreneur, but rather to produce sustainable wealth and secure jobs, with early investments of \$100,000, topping out at \$1 million, with eventual EPA development investment limits of \$10 million.

Next week we will look at our need to increase financial diversity, rather than reinforce the increasingly bureaucratic uniformity, which does nothing more than provide a fixed path to a systematic failure.