Alternative Proposals for U.S. Non Convertible Currency Regime

"The Financial Sector is a Lot More Trouble Than it's Worth"

Fifteen minute presentation

30 slides, 30 seconds per slide

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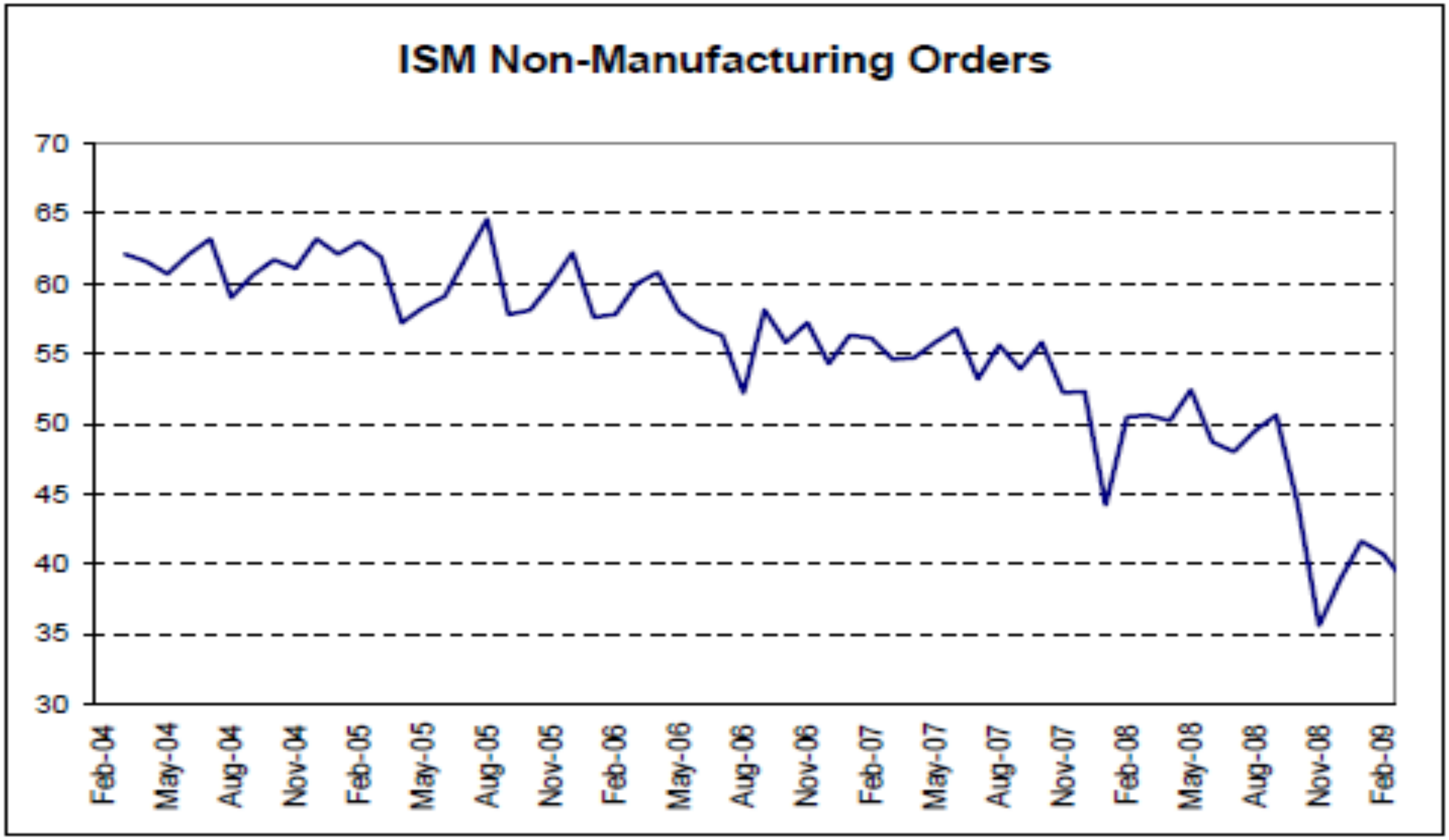
Why has Output and Employment Declined?

- Lack of aggregate demand
- Inventory liquidation
- Delayed fiscal response

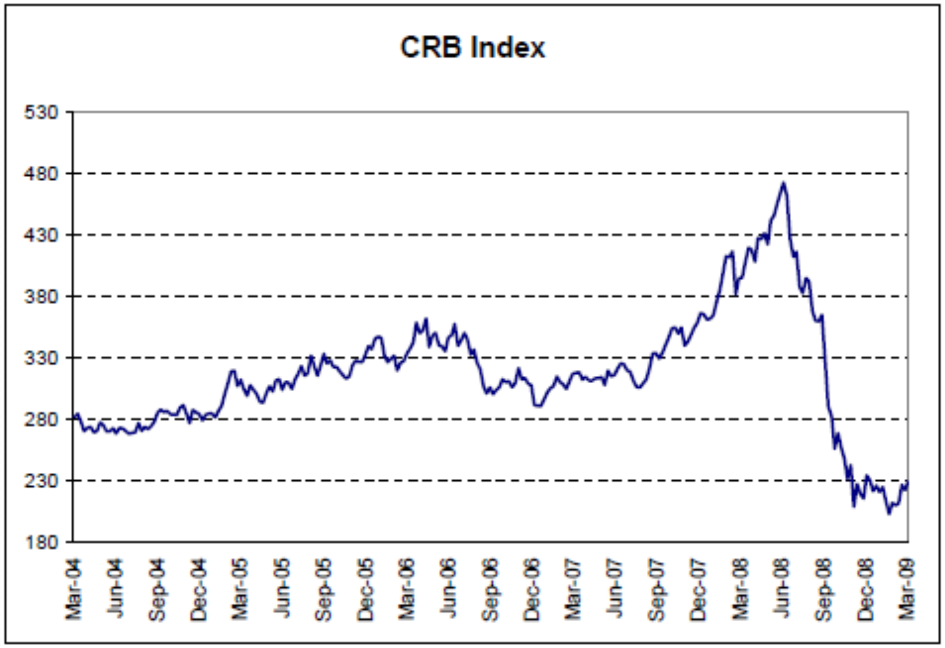
Why did Aggregate Demand Fall?

- The end of the sub prime expansion in 2006.
- The wind down of the one time fiscal adjustment in q2 08.
- The Mike Masters inventory liquidation of July 08.
- A shift in the propensity to spend due to the pro cyclical nature of credit worthiness (aka, the banks stopped lending).

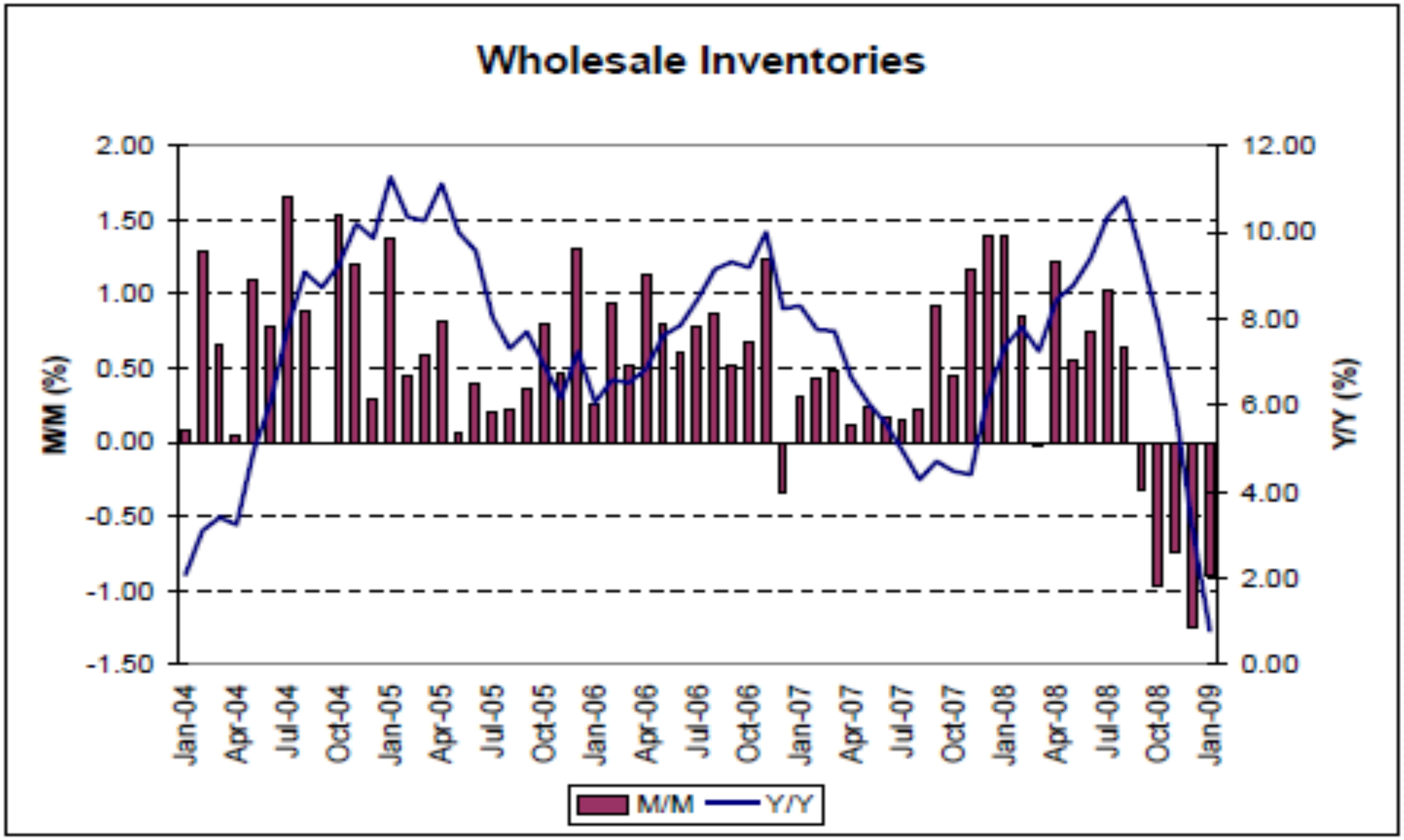
Aggregate Demand has been Weakening Since the 03 Fiscal Package



Commodity Inventory Liquidation



Business Inventory Liquidation



The Financial Sector and Aggregate Demand

- Financial Sector losses per se do not materially reduce aggregate demand.
- The financial sector is necessarily pro cyclical.
- The financial sector opportunistically expands with the real economy.

THE FINANCIAL SECTOR IS A LOT MORE TROUBLE THAN IT'S WORTH!

Nominal Aggregate Demand is EASY to Restore!

- The damage was all nominal.
- The housing market was destroyed, but not the houses.
- Car sales collapsed because of funding, not labor or material shortages.
- There is no famine, pestilence, or widespread destruction by earthquakes or meteor strikes.
- The US is not on a gold standard!

This is a Data Entry Crisis!

- The federal government can immediately restore aggregate demand by making the correct entries on its spreadsheet we call the monetary system.
- It could not do this on a gold standard!
- Unfortunately, the administration does not understand how its monetary system works.
- That includes the President, Treasury Secretary, Fed Chairman, and all their immediate advisors.

My Proposals for Restoring Aggregate Demand back in August

- A full payroll tax holiday where the Treasury makes all payments for employees and employers to the trust funds.
- $300 billion of revenue sharing for the states on a per capita basis.
- Federal funding for an $8/hr job for anyone willing and able to work that includes federal health care benefits.
- These are all 'data entry' adjustments.
- This is not a viable option on a gold standard!

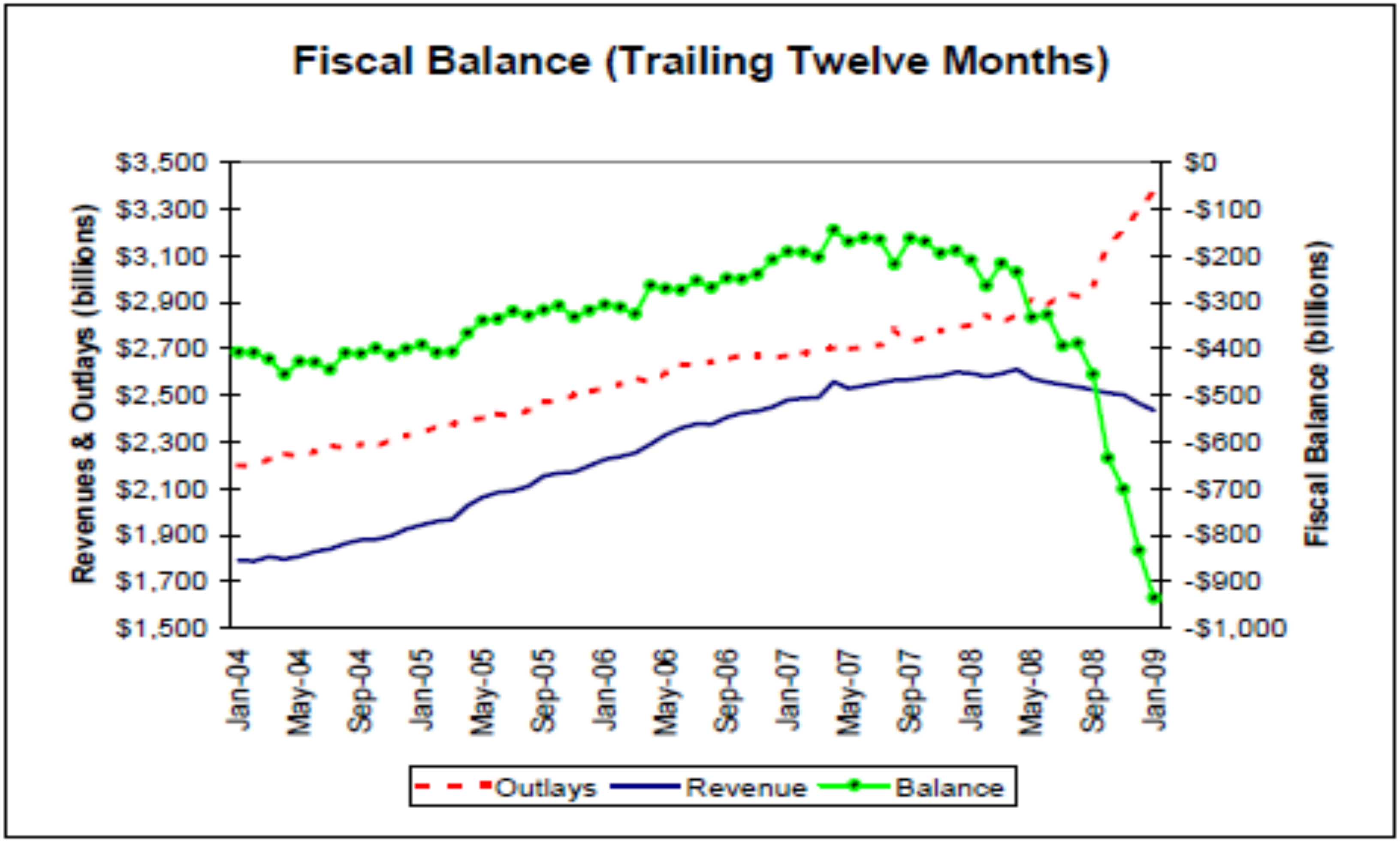
Caveat!

- Restoring aggregate demand will also empower the Saudis to set ever higher prices for crude oil unless our demand for motor fuel is cut in half.
- Saudi price hikes will again cause our real terms of trade and standard of living to deteriorate.
- THIS IS NOT A DATA ENTRY PROBLEM!

Prologue on Aggregate Demand

- Left alone, GDP deteriorated causing the automatic stabilizers to rapidly increase the federal deficit to over 6% of GDP by January 09.
- This 'ugly' deficit spending stemmed the tide.
- The proactive fiscal adjustments are now kicking in.
- There is no policy to immediately cut imported motor fuel consumption.

Automatic Stabilizers to the Rescue



Obstacles to Restoring Aggregate Demand

- Belief in ‘monetary policy’
- Deficit Myths
- Belief that credit flow must be restored before the economy can recover

Monetary Policy

- The belief that monetary policy 'works' delays fiscal responses.
- Monetary Policy does not restore demand- it just rearranges financial assets.
- Monetary policy is about price (interest rates), not quantities.
- Interest rates are a weak macro force at best.
- While monetary policy can not restore aggregate demand, there are modifications that can be done to keep policy from being disruptive and counter productive.

Proposals for the Banking System

The liability side of banking is not the place for market discipline.

Therefore regulation is directed towards assets and capital.

THESE AND THE FOLLOWING PROPOSALS ARE NOT WORKABLE ON A GOLD STANDARD!

Proposals for the Fed to Replace Current Initiatives

Lend unsecured to member banks in unlimited quantities:

1. The FDIC already insures bank deposits.
2. Demanding collateral is disruptive.
3. Eliminates interbank markets

Proposals for the Banking System in Place of Current Initiatives

- Banks only originate assets to hold.
- Banks not permitted to transact in the secondary markets.
- Banks lend on credit analysis.
- Banks mark to FDIC approved credit models.
- Banks not allowed to lend against financial assets.
- Ban the use of LIBOR by banks.

Proposals for the Banking System in Place of the Geithner Plan

- Sell FDIC insured credit default insurance to member banks targeted at ‘toxic assets’ rather than implementing the Geithner plan.
- This plan creates a ‘sheltered bad bank’ within the ‘good bank’ for a fee.
- The FDIC already is the ‘bad bank’

Proposal for Interest Rate Policy
(NOT FOR A GOLD STANDARD!)

- My preference is to set all risk free rates at zero, permanently.
- This minimizes cost pressures on output, including investment.
- It also minimizes rentier incomes, thereby encouraging higher labor force participation and increased real output.

Proposals for Government Purchases of Financial Assets

- Move the TARP and other new Treasury financial asset purchases to the Fed.
- All financial asset transactions are the realm of the Fed, not the Treasury.
- It’s about price (interest rates) and not quantity.

Proposals for the Treasury

- Cease all issuance of Treasury securities.
- Cease all Treasury purchases of financial assets.

Proposals for Congress for Trade and Energy Issues

- Unilaterally drop all import restrictions.
  (BUT NOT WITH A GOLD STANDARD!)

- Exports are real costs, imports are real benefits.

- Implement a policy to immediately cut imported motor fuel consumption in half.

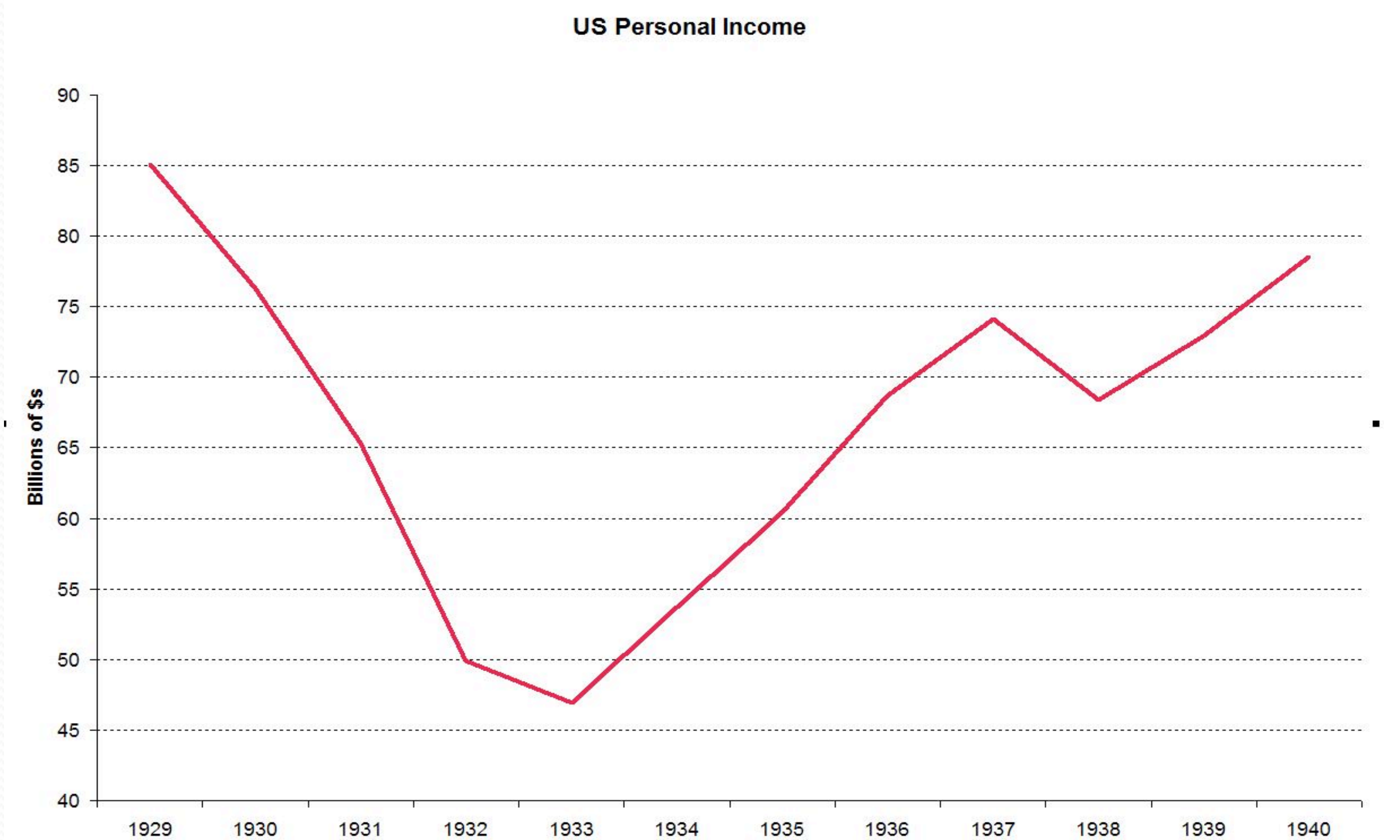
Deficit Myths for Non-Convertible Currencies

- Deficits reduce savings.
- Deficits are dependent on buyers of the debt.
- Deficits leave real debts to our children.
- Deficits make us dependent on foreigners.
- Deficit spending only shifts funds from one agent to another.
- Deficits are unsustainable.
- We can’t go it alone.

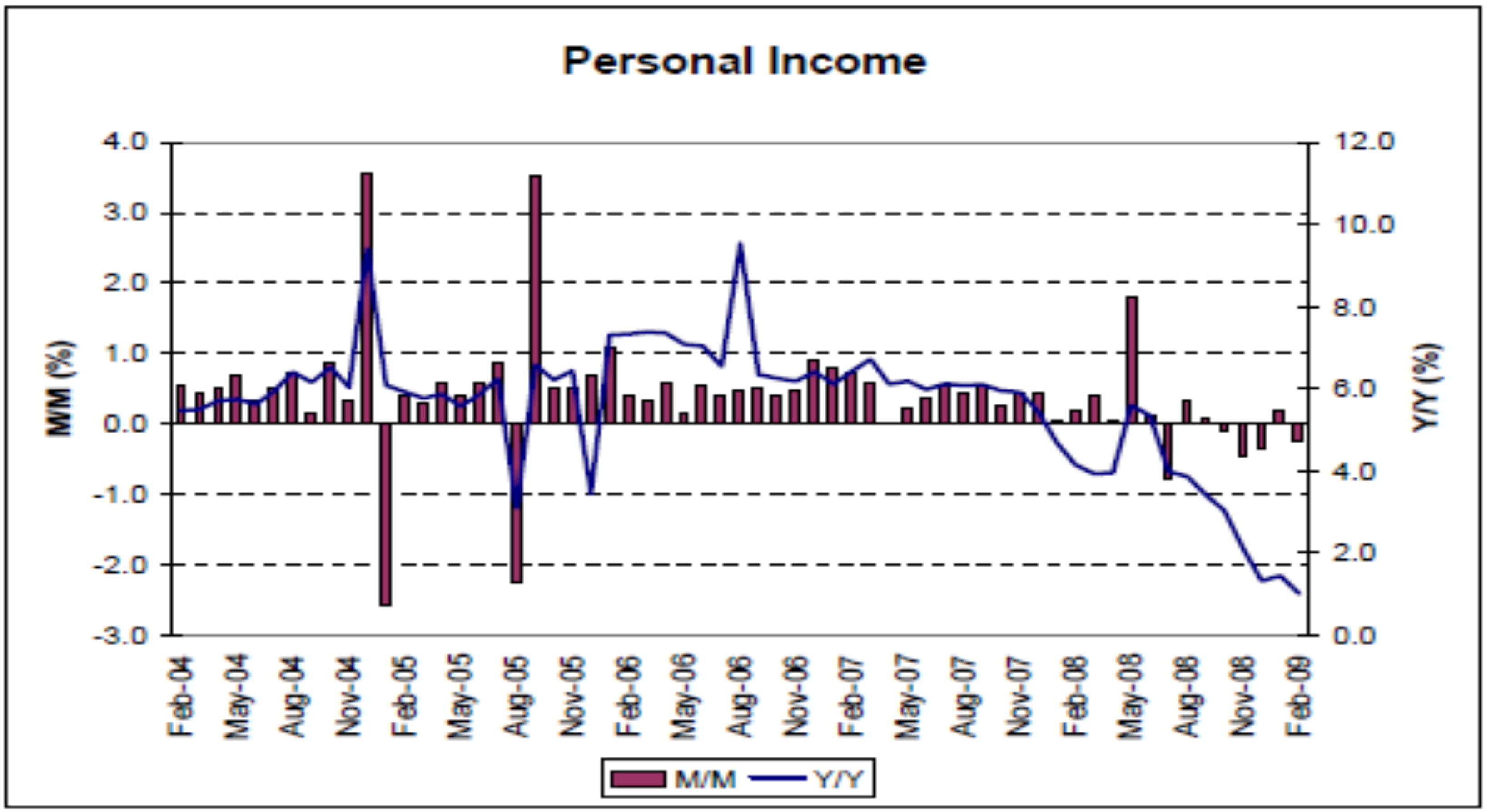
Deficit Facts with Non Convertible Currency

- Deficits add to savings.
- Federal spending is not revenue constrained.
- Goods and services can't be sent back in time.
- We don't need China to buy our debt.
- There is no nominal limit to deficit spending.
- WE ARE FAR BETTER OFF GOING IT ALONE!

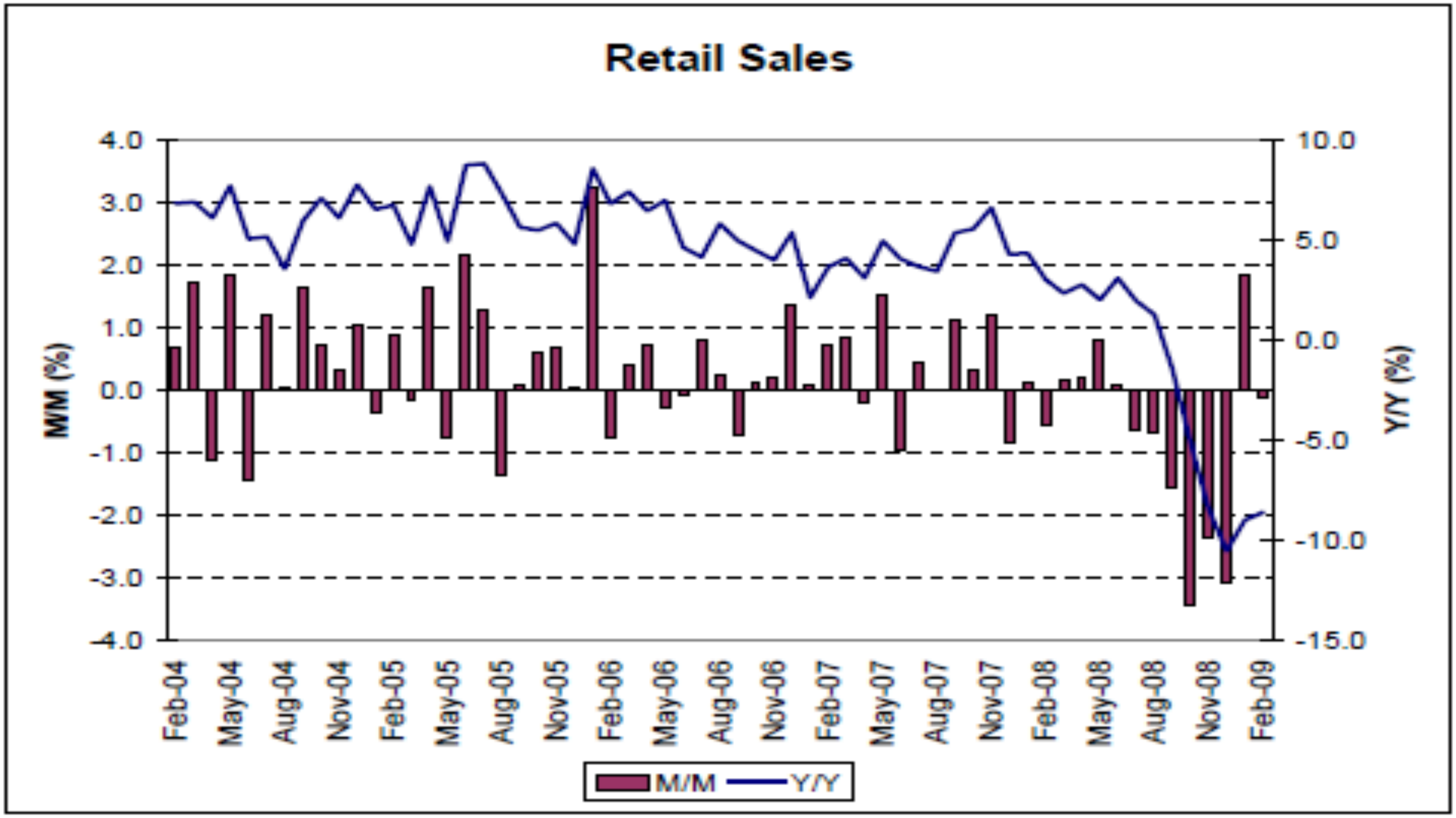
Personal Income During Our Last Gold Standard Depression



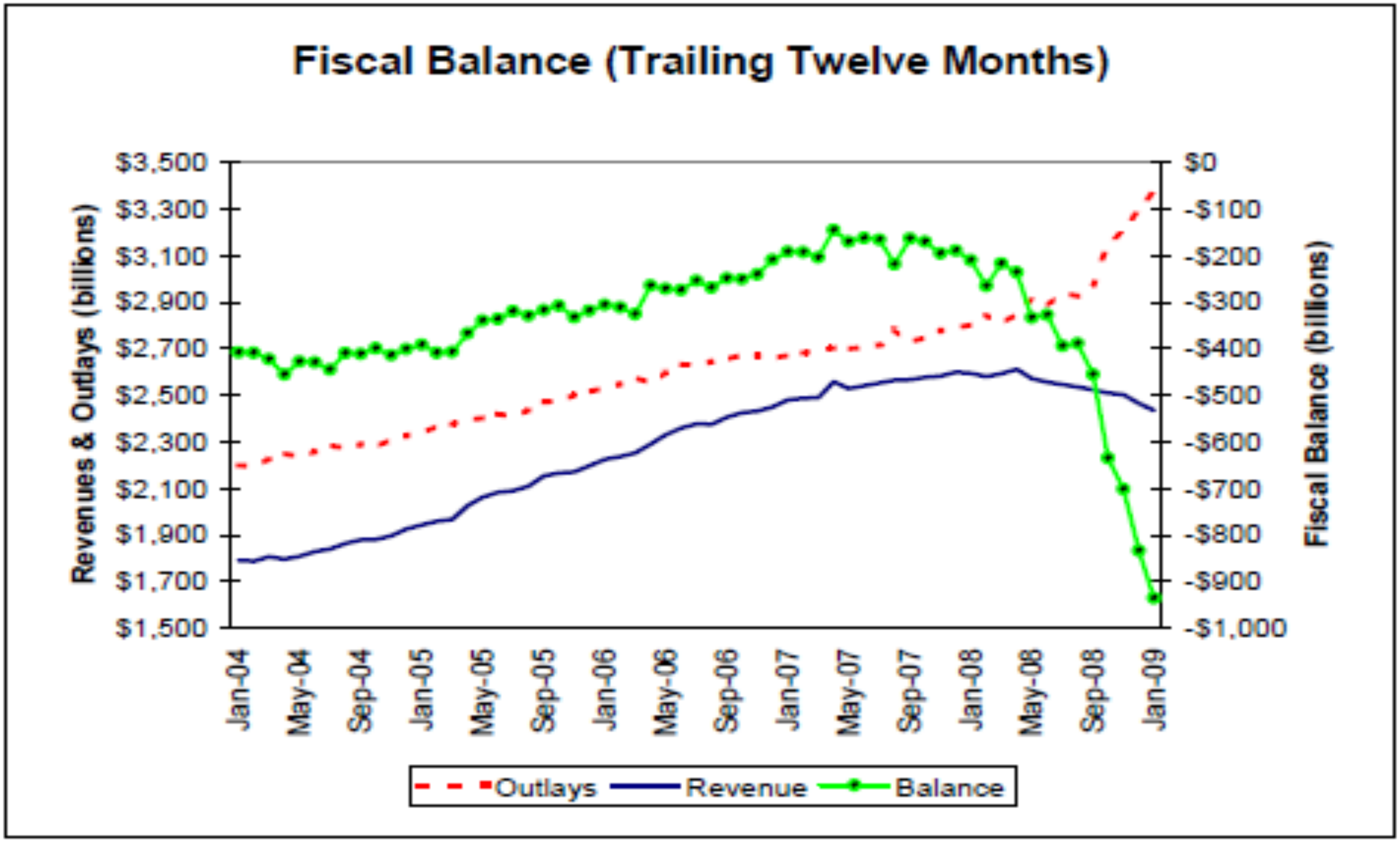
Personal Income During a Non-Convertible Currency Recession



Retail Sales



Automatic Stabilizers to the Rescue!!!



Conclusions

- The recession is over.
- The automatic stabilizers ended it the ugly way.
- Proactive fiscal adjustments currently kicking in.
- The recovery will restore the financial sector and the housing markets.
- High and lingering unemployment will contain real wages and direct real wealth towards rentiers and upper income individuals.
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