

Debt

The financial problems I foresee in the future have everything to do with debt.

Many people hear or read about financial disaster predictions and think that it can't affect them because they don't invest. This is a very big mistake if you have any debt. Debt is an investment. My theory of the coming crash is based on debt.

The problem people don't recognize is that they will not have the ability to pay off their debt when a crisis of magnitude hits. One reason people don't realize this fact, is that they've never experienced a financial crisis in their lifetime. That's exactly the problem with these types of crisis'; they only come every 85 years or so. That time frame is basically a lifetime, so everyone only experiences it once and they are at all different age locations. There are a few who experience it twice. Once in childhood and once in elderhood. By the time a person reaches elderhood they can't possibly fathom that it's going to happen again. "Everything's different now," they state. But, everything isn't different as research surely shows. In today's society those people are the Silent Generation, b1925-1943.

Another factor about debt that never comes to mind is that debt is precisely the reason the depression deepened after the 1929 crash. Many people think it was the stock market crash that caused the great depression. It wasn't the *spark* that ignited the depression it was a catalyst.

The reason the economy slipped into depression was bank failures. The first failure didn't happen until December of 1930 and the economy really wasn't that bad up until December 1930. However, when the Brooklyn, New York, Bank of the United States failed, in December of 1930, it started an unprecedented cascade of failures.

In 1929, there were 24,970 commercial banks. In 1933, there were only 14,207. The number of banks in the Federal Reserve System fell from 8,707, in 1929 to 5,606, in 1933.

That's a 27.5 percent failure rate. However, the non-member banks were the hardest hit. There were 16,263, in 1929 and 8,601, by 1933. That's a 45 percent failure rate.

Between 1929 and 1933 there were 9,765 bank failures. Most occurring after December 1930. But why did they fail?

The answer is simple. People couldn't pay their mortgages because they were either laid-off or their wages were cut. They couldn't keep up the mortgage payments and they were soon evicted, as the banks took ownership of the homes. However, the banks couldn't sell the properties because there were no buyers. The bank failures caused the depression.

The history books tell you that the brokerage houses were the cause because they were letting people borrow money to trade the market. These people would only have to put up

10 cents on the dollar. Then when the market crashed and the brokerage houses asked for the loans to be paid, no one could pay so the brokerage houses liquidated their positions. And that's what the history books say caused the depression. Not!

What the books don't say is that from 1919 to 1929 there was an unprecedented amount of lending going on that had nothing to do with the stock market. Specifically, people were buying *all* the new inventions that were created in the 20s, on time-payments.

Electricity enabled a zillion new products to hit the market including radio, refrigerators, ovens, dryers, washers, fans, etc. Many industries copied Henry Ford's 'borrow on time' finance scheme. That scheme was a major contributing factor to the depression, along with the mortgages not borrowing to buy stocks. The numbers aren't even comparable.

Any person today would say, "Things are different now. They have mechanisms in place that won't allow the 1930s to repeat".

Well, I'm here to tell you that's simply wrong and if you believe it you're misinformed. What the average person doesn't see, written in the press, is that this country is over 50 trillion in debt. The average person reads that we are 7 trillion in debt, which is the *National Debt*. Yes, that figure is accurate. But, what about mortgage debt, credit card debt, state debt, under funded pensions, under funded social security, under funded Medicare, corporate debt, GSE debt, and the US Governments 'off the books' debt?

Add them up and sums to over 50 trillion which is 5-times the 2005 Gross Domestic Product (GDP). The interest payments alone are estimated at 2.5 trillion dollars a year. That's 25% of the GDP. If the GDP goes down by the same amount it did in the 1930s, 29%, the debt service will become 35% of GDP. That amount doesn't include the new debt issued between now (2005) and 2010. If you add that new debt into our equation then we are talking about 45% of the GDP, going to pay debt service. That's economically impossible to sustain.

If this scenario pans out the government would have no choice but to devalue the debt via the US dollar. The result would mean millions of people out of work and I guarantee the rest of the world would make a run on the Euro and Swiss currency. If that happens, the 1930s are going to look like a picnic.

Worse, the US Dollar is a fiat currency backed by nothing. If you think your bank account is safe because of the FDIC you're sorely mistaken. The FDIC money comes from the member banks of the Federal Reserve, not the government. The Fed just acts as an agent to collect the money from the banks to pay-off the people who lost money from a bank failure. When those bank members fail who is going to pay you? Not the government. They'll be dealing with two major problems concerning debt; the national debt and the biggest reason we'll all be up a creek, the so called 'Government Sponsored Agencies' who issue mortgages. Both debts are 14 trillion combined.

Did you know that the average person put down 18% on a new mortgage in 1983? Today it's less than 3% because of these government-sponsored agencies (GSE). And, they're creating new derivatives every day to make it easier to borrow. A few of these agencies are in the news lately, under the names *Fannie Mae* and *Freddie Mac*. Why are they in the news? They've been lying about their earnings. And, these two entities make Enron look like a five-and-dime. No one is being held accountable and the failure of these entities alone would cause a depression.

Now, what happens if we have a crisis and people can't pay their mortgages? Those agencies will fail and no one has the money to bail them out. There are no contingency plans in place. Think about it, you're dealing with the US government and in their 229-year history they've always waited for a crisis to happen before acting.

Take care,
jim goulding
www.jamesgoulding.com
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