



# ROCKLINC

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## Global Debt, Instability and the Transfer of Wealth

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Leadership means drawing lines in the sand. If an individual wants to be a leader and isn't controversial he never stood for anything.

*"The budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed lest Rome become bankrupt. People must again learn to work, instead of living on public assistance." Cicero - 55 BC*

### A. Introduction – Short-termism

Over the past several decades the preoccupation with short-term results over against long-term impact has intensified throughout much of the developed world. We see this short-term focus in the area of finance and the capital markets, where I will spend most of my time, but we also see it in other areas of social life. Anyone who has followed the debates on family, education, health care, pensions and government social and fiscal policies in general, can draw the conclusion that short-termism, or conversely, a lack of long-term thinking, within a moral framework, has seeped into all aspects of our culture.

This should come as no surprise to the observant. Why should we expect people to think long-term and make self-sacrificing and intergenerational decisions when there is very little consensus on what is right and wrong and whether there is a basis for moral authority let alone a unified theory of knowledge? We can't even attribute an ultimate purpose to humankind! In our places of higher learning, our leading academics have the audacity to promulgate the notion that truth does not exist, despite the self-refuting nature of that very statement and their willingness to judge, in absolute terms, anything they do not agree with.

But each of you gathered here today know that a culture or community of nations that does not and cannot make moral judgments, and has jettisoned both its willingness to discern truth and its agreed answer to the question of the purpose of life, is living under the shadow of nihilism. As Christopher Dawson stated, *"A society that has no end beyond its own satisfaction is a monstrosity a cancerous growth which will ultimately destroy itself."* All false ideas have, as their end, devastating consequences.

One of the greatest blights on our global economy today is the massive and unthinkable amount of debt that has been amassed by our global financial system over the past 40 plus years. It is not an exaggeration to state that outsized selfishness and greed along with the arrogant disregard for the

most basic economic principles has placed our global economy in great risk. I plan to discuss some of this risk and how we can begin to de-risk this explosive situation.

## B. Global Debt

The current level of global debt is now in excess of \$200 trillion USD (2.5-3 times global GDP). Over the past 10 years alone we have witnessed a 150% increase in the level of global debt (this does not include unfunded liabilities/entitlements). The numbers are so large that they are difficult to fathom. To learn that the IMF, as suggested recently in Davos at the World Economic Forum, is interested in adding another \$100 trillion USD in debt (or as they call it “credit”) through their notion of fiat money called Special Drawing Rights (SDRs) defies logic. These numbers do not begin to account for the tens of trillions of derivatives and synthetic derivatives that exist, purely for speculative reasons. The financial state of the global economy is precarious.

### 1. Individual Debt

- Over the past number of decades, individual and family debt has sky rocketed. In a culture dominated by short-termism and lack of meaning and truth, it doesn't take long for the underlying values of personal gain and materialism to take control. But, as we all know, the belief that my lifestyle and accumulation of things comes first, regardless of its impact on others, including the next generation is self-destructing. For our culture, success = things. The greater the perceived success, the more things you must have, even when you can't afford them; hence the creation of massive debt.
- It is important to point out that the standard of living for the average family in the developed world has not increased materially over the past 30 years. Four important factors have put more material things in our hands, but all are short-term factors that are unsustainable. The four factors are: greater dependence on government programs, double incomes (male and female), less children and greater use of debt at lower and lower interest rates.
- Devastating Demographics. The replacement rate for a society is 2.1 children per woman. There are now very few countries in the world anywhere near 2.1. In fact, the countries with the worst debt situations outside of the US are averaging approximately 1.3 children per woman. That means that 100 grandparents will result in 38 grandkids. With the outrageous entitlement promises and massive debt outstanding, one should expect sovereign defaults. You cannot drop fertility rates without a resizing of the whole economy! China has one of the worst demographic profiles given their one child per family policy that began in 1979. By 2024, China will hit a demographic wall unseen in the history of the world. This will have an increasing impact on the global economy. Let me also add that current levels of fertility have, in history, led to societal collapse.

## 2. Sovereign Debt - Extreme Leverage, Extreme Instability, Extreme Risk, Extreme Dishonesty

### (i) Keynesian Economics

- We are approaching the Keynesian end point. More government spending supported by more debt is now producing virtually no net increase in GDP.
- Governments are not capable, nor should they be expected, to moderate business cycles. Governments know how to grow and expand not contract. Governments also tend to manipulate and undermine the private sector as they expand their presence in the economy. With every business slowdown in recent history governments have simply added more and more debt.
- Keynesianism, which has to be paid for, has led to massive wealth confiscation by producing the worst tax of all, inflation due to the expansion of the money supply beyond the productive capacity of the economy.

### (ii) Entitlements

- Pension obligations, healthcare promises and other social welfare commitments are out of control.

Governments within the developed economies have taken on responsibilities they cannot afford. The unfunded liabilities on the books, or should I say off the books of governments, is staggering and completely dishonest. Most governments continue to lie to their citizens concerning their ongoing ability to fund their generous entitlements. The game is now up! There is no more kicking the can to the invisible next generation. Entitlements in the future, in order to have any credibility, must be fully funded. Expect means tests and later retirement ages in the future.

### (iii) ZIRP (Zero Interest Rate Policy)

- Addiction to low rates has placed us in a position where we cannot afford higher rates.
- Misallocation of capital forces savers to make more speculative decisions that are not optimal.
- Bond bubble of historic proportions now exists. We face years of low to negative performance in many fixed income investments.
- Balance sheets of Financial Institutions are going to be stressed to the maximum, placing capital at risk. Too much bank capital is represented by overvalued sovereign debt.
- Underfunding of pensions and inability of pension assets to pay in real dollars their obligations due to lower rates and overpriced fixed income securities.
- Stealing from the savers to pay the irresponsible and debtors, an economy cannot function, nor grow its wealth, living in an environment of manipulated interest rates where the yield curve is fiction.

(iv) Debt Monetization

- The expansion of the money supply, well beyond the productive increase in the economy, is theft and demonstrates the absolute bankruptcy of modern economic thinking. Borrowing and printing money in order to inject cash into the economy, bail out banks, brokers and consumers is a short-sighted and “easy decision” for a population that has not yet learned that short-sighted and easy strategies are the route to long-term ruin. Even with the recent financial scare, we have not changed our ways; the toxic triplets of fiat currency, activist central banks and regulatory bungling are still well entrenched. Current debt monetization emanates partially from governments that are bereft of leadership, refuse to live within their means and continue to run large deficits.

3. Sovereign Defaults have Arrived

- Implicit - the artificial lowering and manipulation of the yield curve has produced negative real rates of return. With increasing levels of inflation seen throughout the world, countries with large debts that are able to keep their rates well below inflation are implicitly defaulting (US, UK, EU, and Japan).
- Explicit - restructuring the existing debt, which includes: changing debt duration, changing the level of interest rates and/or the amount of outstanding debt. This will affect smaller countries that cannot print or devalue their currency, examples include, Greece, Portugal, Ireland. If these countries do not write down their debt and start fresh they will be weakened for years to come. Putting countries in “debtors’ prison” is not a good long-term solution and will lead to tremendous social upheaval.
- We should expect a combination of both implicit and explicit defaults coupled with increasing austerity measures. Government dishonesty cannot continue to cover up the debt mess.
  - For example, the European stress tests applied to their banks were a charade. The ECB did not require any write-downs on the sovereign debt held in the capital of the banks despite the obvious impairments on much of this debt. A 50% write-down on the debt of the various countries already within the EU rescue plan would reduce the capital in many of the European Banks by 25-150%!
  - The US Treasury is dishonest when it does not include the debt of the GSE’s (Fannie Mae and Freddie Mac) in their outstanding obligations, despite pressure from global financial organizations and credit rating agencies to come clean.

## C. Instability

### 1. Developed Economies

- Standards of Living on the Decline

The decline in the standard of living has been masked for some time by double incomes, a rapid increase in debt and a dramatic decrease in fertility rates. The reality is that our living beyond our means is now catching up with us. Nations cannot dis-save and offshore manufacturing and continue to expect their standard of living to increase. In depleting our capital base, we have now come to the point where the level of income from our reduced capital must fall. Leveraging our decreasing capital base further at record low interest rates is folly. Reflating our economy, as we are engaging in now, will take a huge swath out of the middle class who will be forced to pick up the tab. This will lead to further class tensions in the years ahead and also tensions with the developing countries that are now manufacturing many of the goods being purchased in the developed world.

### 2. Developing Economies

- There is a growing desire among those in the developing world to increase their standard of living. Yet, for most, they are not experiencing more wealth despite living in countries that are financing the debt of the developed economies. Reflation for the benefit of the developed nations is creating substantial inflation in basic, essential and scarce commodities. Food and energy inflation is and will continue to place a major burden on the citizens of developing economies.
- “Facebook” and other unique technologies provide the linkage for more and more people (who share common interests, concerns or enemies) to unite and have a voice for the first time. The cost of running a dictatorship in our world has risen dramatically in the face of greater transparency.
- Instability in many developing countries is rooted in their institutions and religious systems that do not support the freedom and dignity of all citizens within the rule of law.
- It is critical that developing nations allocate capital into investments that generate a return on invested capital. There is the temptation to “create growth” but, unless money is invested in projects that generate adequate returns, wealth is not created in a sustainable manner.

## D. Transfer of Wealth – Increasing Concentration

### 1. The Economics of Reflation and the Speculator

The primary strategy of the major central banks in dealing with the debt crisis is to attempt a reflation of the global economy. This is seen most directly in the rapid expansion of the money supply, the record low interest rates and massive government deficits. Inflation is always the end result of too much money chasing too few goods beyond what is needed for productive enterprises. Inflation will often strike in different areas at different economic

moments. Currently, instead of propping up the real estate market, which is the desired area of focus, the excess money is ending up predominately in the financial markets and in the hands of the speculator class!

This attempted reflation is currently aiding two classes of people, the big banks that want interest rates as low as possible to increase their spread and subsidize their bad loans and the speculators who use the cheap money to leverage into financial assets and commodities. If you are not a big bank or a person who can buy a great deal of stocks and commodities, you are becoming poorer. As Marc Faber stated recently, *“Current monetary policies are murdering the middle-class”*.

## 2. The Ownership of Scarce Resources

The game is now on! How can you protect and grow your capital today given the insurmountable wall of debt, lack of government integrity and demographic challenges? Follow the smart money, and what is that? Answer: Convert your increasingly worthless paper assets and currencies into hard, essential and scarce assets! In practical terms, buy energy (oil, gas, coal, uranium), food and water, key infrastructure (rails, pipelines, utilities), real estate, base materials and precious metals. Thankfully, the government has a harder time destroying the value of these essential resources with their promises and printing presses. Therefore, buy assets that will re-price and maintain your long-term purchasing power so when the debt crisis is over and the cards have been collected, you've maintained and grown your ownership stake in the economy!

**The most important scarcity to invest in is a civil society characterized by a high level of intellectual and moral capital. This is becoming the greatest scarcity of all when you look at the nations around the world.**

## E. Towards a Solution – Necessary Ingredients

### 1. Competition - personal, family, businesses and nations.

We need to encourage and reward competition. We need competition on many levels, or as some would say, within the various spheres of life. This must begin at the individual level. Every culture should be committed to maximizing the diversity of gifts and abilities God has sovereignly placed in each person. We should celebrate and reward differences in outcome because of the differences in the input!

The family is the most important unit in any society. Strong families lead to strong cultures and strong economies. The primary institution for the training of values and ethics and the building of character is in the home. It is not in the public school systems that have slowly become propaganda agents for the State whose curriculums are completely at odds with producing the next generation of leaders and citizens of moral character. Darwinism is not a foundation upon which a society can build ethics, values, meaning, purpose or truth.

We must have a diversity of businesses, charities and organizations competing to produce the goods and services needed by the population. Only healthy competition rewards the entrepreneur, keeps people working hard and leads to maximum efficiency and innovation. Lastly, we need strong and numerous nation-states in order to safeguard human freedom and limit the tendency of all cultures to hand too much power over to the State which will, over time, always produce tyranny and oppression. National cooperation amongst States, yes; but minimal supranational entities that are removed from the people they are supposed to represent.

**We must strongly resist the tendency to believe that all our problems can only be solved by global entities that would control and regulate nations. History clearly tells us that this would be an absolute disaster and risk destroying human freedom and dignity across the whole globe. Nation states help provide their own checks and balances.**

## 2. Property Rights

The rule of law as a means of protecting private owners and peacefully resolving disputes between them is essential to long-term wealth creation. A system of strong property rights also underpins the most stable form of representative government. Property rights emanate from a belief that the person is significant and not subservient to the State. No society or culture has produced much of value and dignity apart from protecting the rights of individual, both male and female, black and white. Collectivist systems that strip the individual of freedom and dignity produce little of value for the purported masses.

## 3. Collateralize Currency - Overhaul Monetary System

We must reject fiat currency and the control the government has over the money supply. We must return to a sound money policy, with much less debt, more collateral and fully funded entitlements. Our focus on GDP without looking at the components of GDP and ignoring the balance sheet of the respective countries must change. GDP in and of itself only measures spending and not necessarily the prosperity of a nation. Incurring permanent debt to encourage less than optimal spending is folly. It would be far better to both lower GDP and our debt in order to produce a healthier and more sustainable balance.

Part of the solution is not new; simply limit the ability of governments to spend money they do not have. Deficits must stop, debt must come down, and equity and savings must go up! Our economic policies and monetary theories have been an absolute disaster! We all realize that the purchasing power of the USD (the reserve currency of the world) has over the past 100 years eroded by more than 97%; this is unacceptable.

#### 4. Science and Technology

It is essential that we continue to invest in ways to increase our productivity in all sectors. From harvesting the earth in a sustainable manner and producing larger quantities of food for a growing population to utilizing more efficiently scarce resources such as water and energy, we need to encourage the ongoing investigation and understanding of the natural world.

This will require massive investments in the future. These investments will only be made by a culture that believes in the future, produces the future and delays gratification for the future. It also can only result from a culture that believes that the creation is rich and bountiful and as human beings we have the right and responsibility to develop the resources as the pinnacle of the creation.

#### 5. Work Ethic and Value System

Economics is really a metaphysical science rather than a mathematical one, in which the spiritual values and attitudes are more important than physical assets, and the morality and virtue of the populace are as foundational as the money supply. Warren Brookes states it well when he said “products, after all, are the assembly of qualities, and their value derives directly from the innate character and ideals of those who create them and the workmanship of those who produce them. Things are, in their final analysis, the expression of thoughts. Quality products derive from quality thoughts, shoddy products from shoddy thought.”

An economy is the sum of the spiritual and mental qualities of its people. Economic output will only be as strong as the values of the society. Without the refining influence of moral standards such as honesty, trust, integrity, and loyalty, the marketplace will quickly deteriorate. A society - particularly a free market society that does not have strong values - will end up producing less and less value. A nation, whose values are in decline, will eventually witness a decline in its economy. Can economic strength be cultivated in the soil of spiritual poverty and short-termism?

**We face tremendous challenges that must be addressed immediately and with a long-term focus. This requires honest and diligent leadership. It also requires the cooperation of as many nation-states as possible. The stakes are very high. Will we be those leaders?**