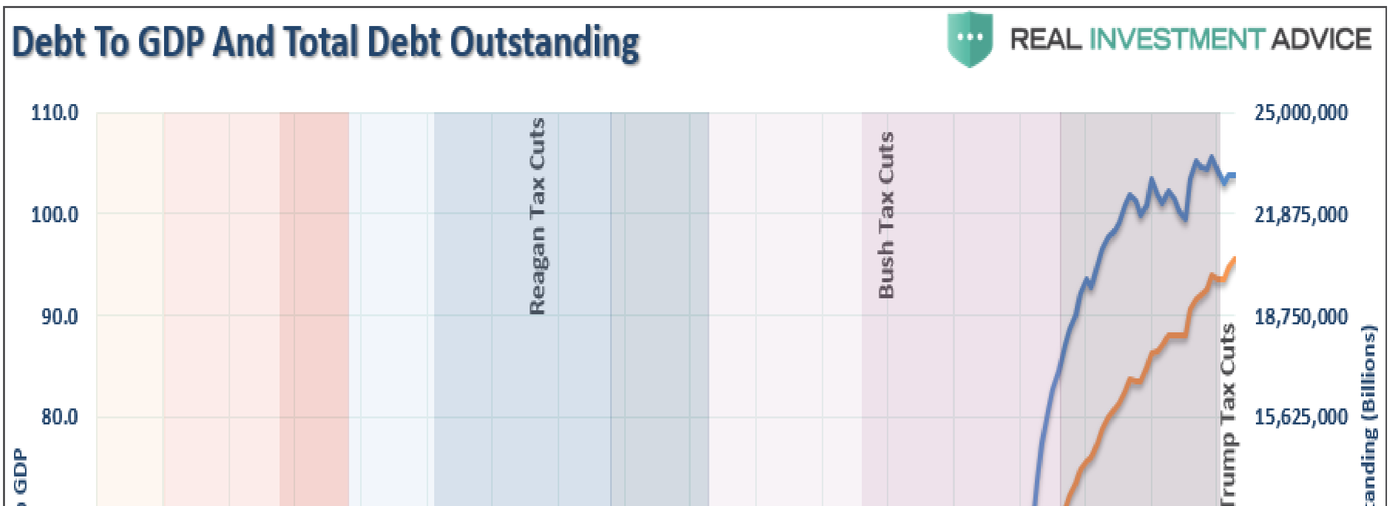
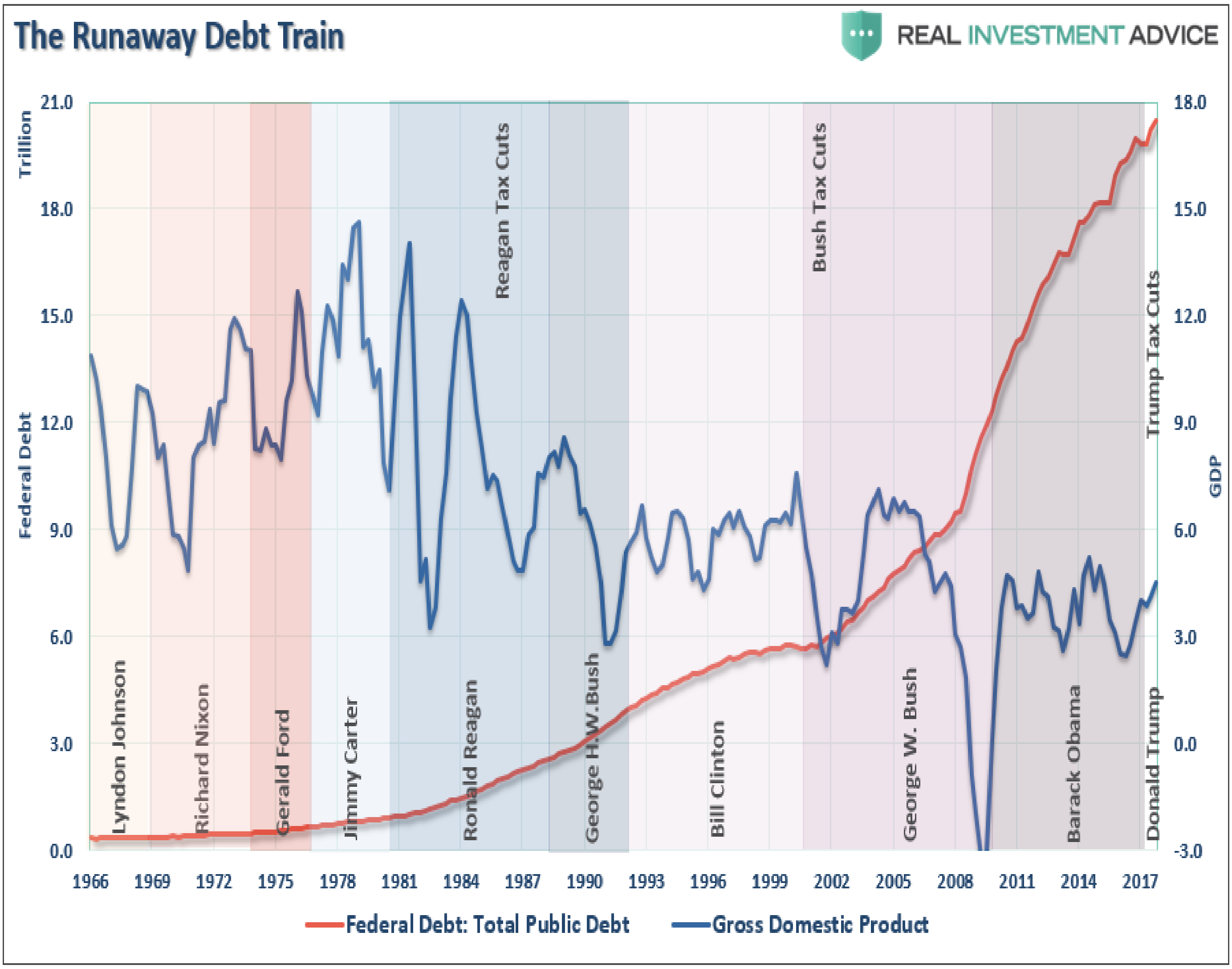
Over the weekend, I was digging through some old posts and ran across a speech given by Dr. Woody Brock in 2012. Dr. Brock, is an economist who holds 5-degrees in Math and Economics. He is also the author of *"American Gridlock"* which is must read for anyone investing money in the markets. The speech is as important today, as it was in 2012. There is a huge debate over *"Austerity"* versus *"Spending."* While conservatives in government talk a *"good game"* about cutting spending, budgeting and debt reduction, the exact opposite has been the case over the past several Administrations both *"conservative"* and *"liberal"* alike.



The irony is that increases in debt lead to further increases in debt as economic growth must be funded with further debt. As this money is used for servicing debt, entitlements, and welfare, instead of productive endeavors, there is no question that high debt-to-GDP ratios reduce economic prosperity over time. In turn, the Government tries to fix the *"economic problem"* by adding on more *"debt."* [The Lowest Common Denominator](#) provides more information on the accumulation of debt and its consequences.

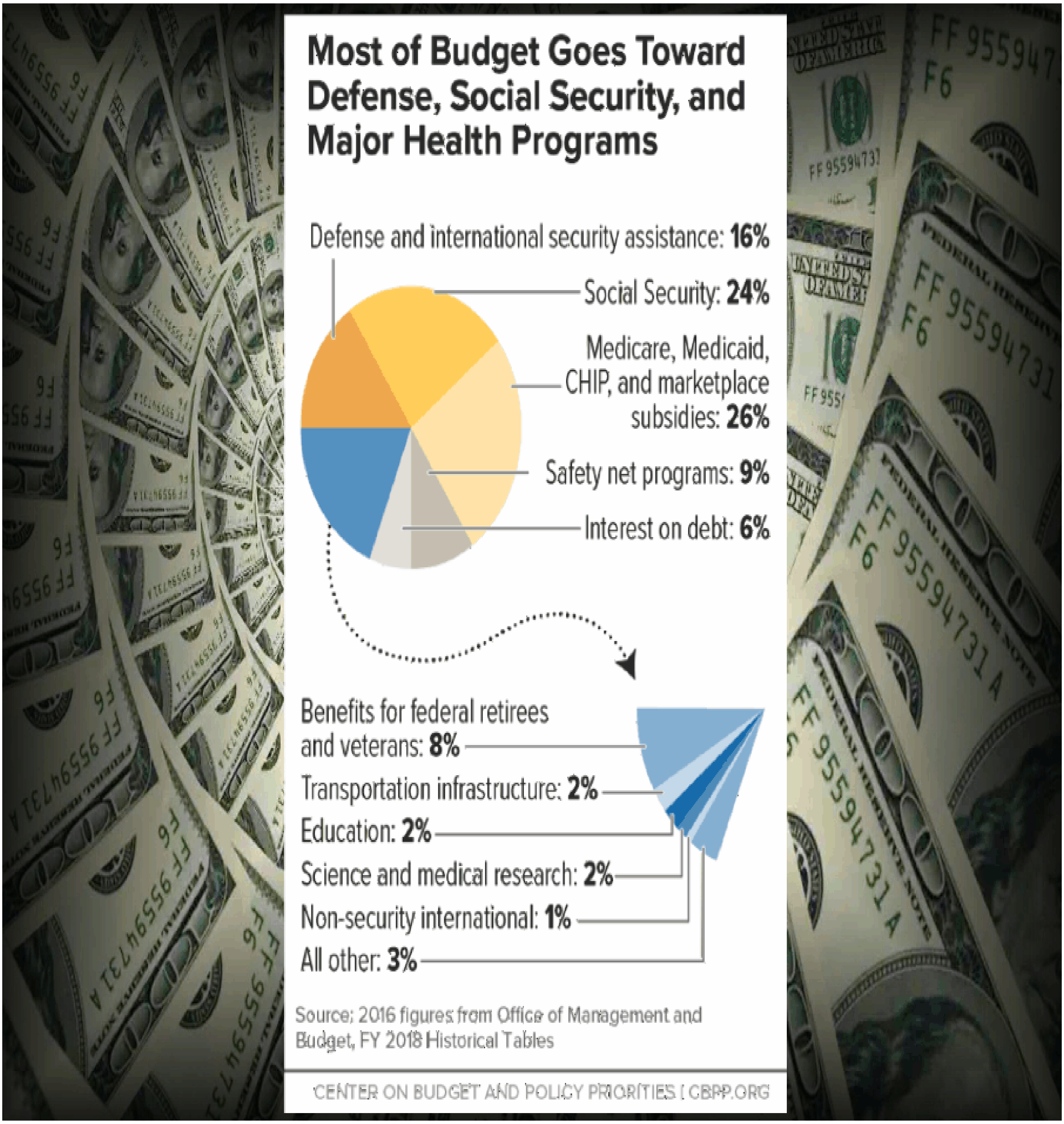


However, the word *"deficit"* has no real meaning. Dr. Brock used the following example of two different countries.

> ***Country A** spends $4 Trillion with receipts of $3 Trillion. This leaves Country A with a $1 Trillion deficit. In order to make up the difference between the spending and the income, the Treasury must issue $1 Trillion in new debt. That new debt is used to cover the excess expenditures, but generates no income leaving a future hole that must be filled. **Country B** spends $4 Trillion and receives $3 Trillion income. However, the $1 Trillion of excess, which was financed by debt, was invested into projects, infrastructure, that produced a positive rate of return. There is no deficit as the rate of return on the investment funds the "deficit" over time.*

There is no disagreement about the need for government spending. The disagreement is with the abuse, and waste, of it. According to Keynesian theory, some microeconomic-level actions, if taken collectively by a large proportion of individuals and firms, can lead to inefficient aggregate macroeconomic outcomes, where the economy operates below its potential output and growth rate *(i.e. a recession).* Keynes contended that ?***a general glut would occur when aggregate demand for goods was insufficient, leading to an economic downturn resulting in losses of potential***

output due to unnecessarily high unemployment, which results from the defensive (or reactive) decisions of the producers.? In other words, when there is a lack of demand from consumers due to high unemployment, the contraction in demand would force producers to take defensive actions to reduce output. In such a situation, **Keynesian economics states that government policies could be used to increase aggregate demand, thus increasing economic activity and reducing unemployment and deflation. Investment by government injects income, which results in more spending in the general economy, which in turn stimulates more production and investment involving still more income and spending and so forth.** The initial stimulation starts a cascade of events, whose total increase in economic activity is a multiple of the original investment. Keynes? was correct in his theory. In order for government *"deficit"* spending to be effective, the *?payback?* from investments being made through debt must yield a higher rate of return than the debt used to fund it. The problem, as noted by Dr. Brock, is that government spending has shifted away from productive investments, like the Hoover Dam, that create jobs *(infrastructure and development)* to primarily social welfare, defense and debt service which has a negative rate of return. According to the Center On Budget & Policy Priorities, **nearly 75% of every tax dollar goes to non-productive spending.**



In other words, the U.S. is ***"Country A."*** As Dr. Brock aptly stated in his speech:

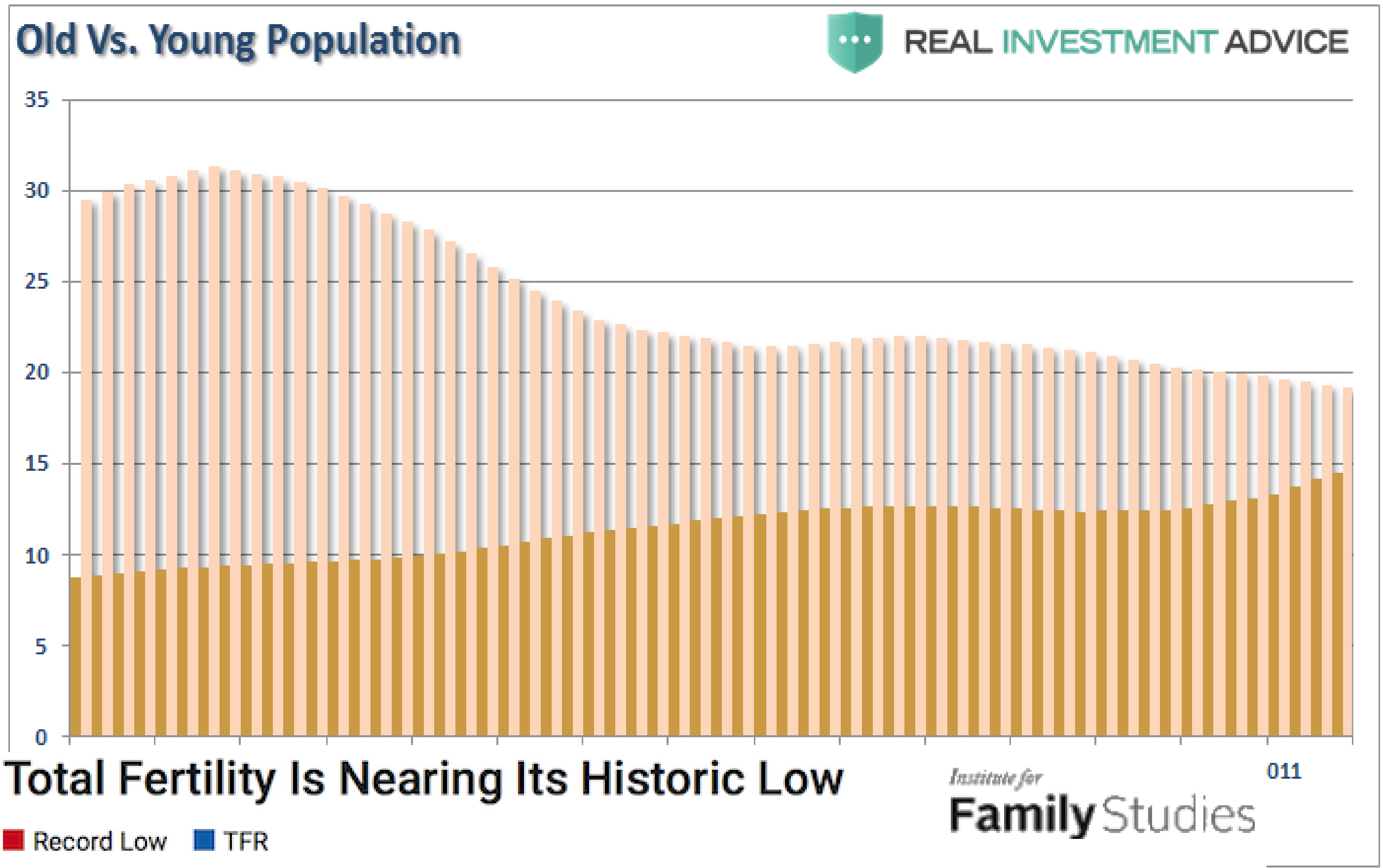
> *"Today we are borrowing our children's future with debt. We are witnessing the 'hosing' of the young.'"*

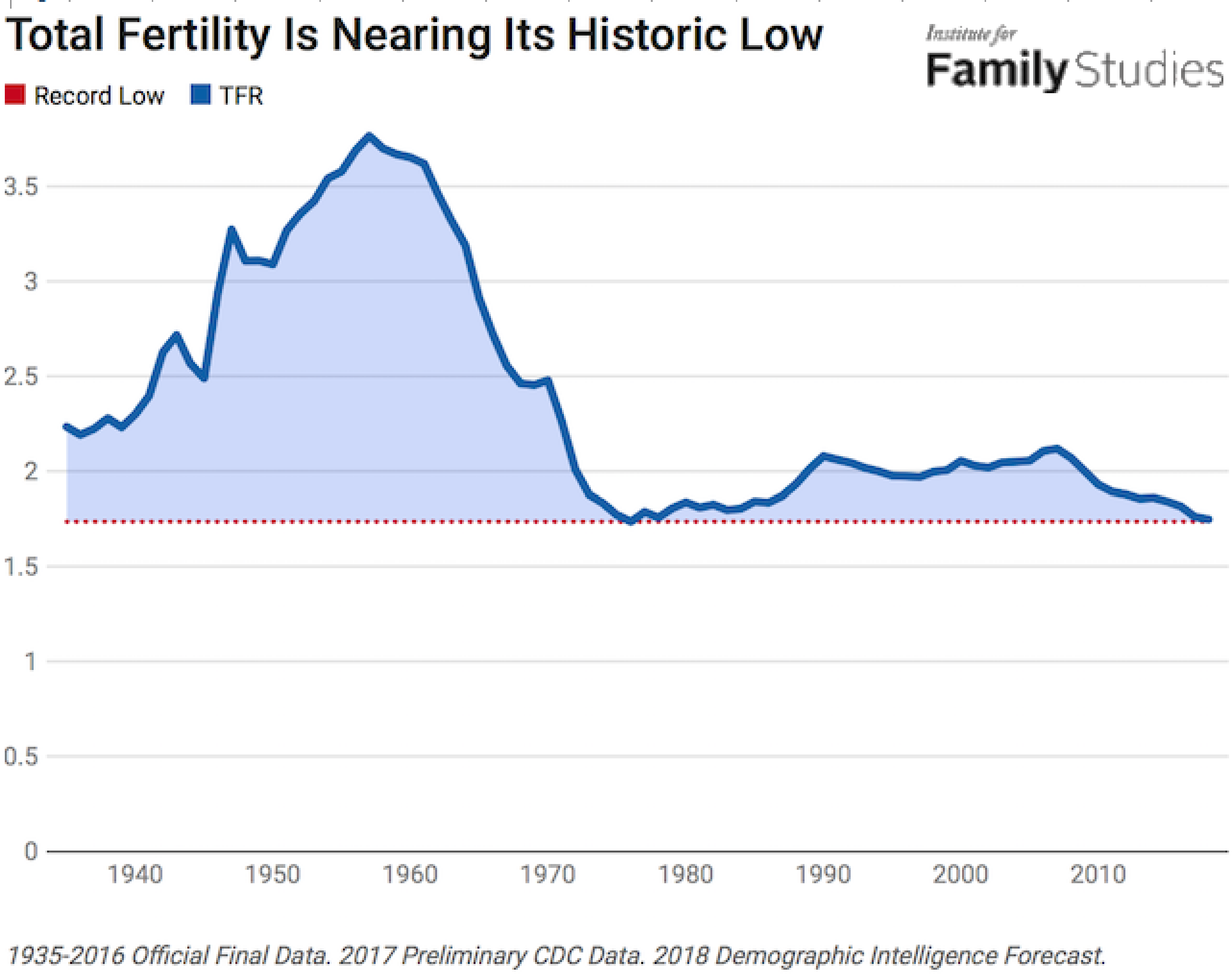
Whistling Past The Graveyard

The U.S. has the labor, resources, and capital for a resurgence of a *"Marshall Plan."* The development of infrastructure has high rates of return on each dollar spent. **Instead, the government has spent, and continues to spend, trillions bailing out banks, boosting welfare support, supporting Wall Street and reducing corporate tax rates which have a negative rate of return.** In the meantime, the aging of the population continues to exacerbate the underfunded problems of Social Security, Medicare, and Medicaid which is roughly $70 trillion and growing. It is simply a function of demographics and math. As Dr. Brock noted:

"Mathematics and Sex create performance anxiety in men - because you can't fake the outcome of either."

Two recent studies show the problem clearly. Demographics is an easy problem to see and mathematically calculate. **The ratio of workers per retiree, as retirees are living longer *(increasing the relative number of retirees)*, and lower birth rates *(decreasing the relative number of workers),* present a massive headwind to economic solvency.**





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fertility rates low, the future *"support-ratio"* will continue to be a problem. The second, and more immediate, problem is the vastly underfunded savings of the *"baby boomer"* generation heading into retirement. To wit:

> *" Anxiety over retirement and how to support oneself after calling it a career is impacting many Americans.* ***A recent poll found that one in three adults has less than $5,000 in retirement savings."***

This is simple math. Currently, 75.4 million Baby Boomers in America?about 26% of the U.S. population?have reached or will reach retirement age between 2011 and 2030. **A vast majority of them are *"under saved"* and primarily unhealthy.** This combination ensures the demand on the health care system, along with Medicaid and Medicare, will increase at a rate faster than it can supply. Bankruptcy, without substantive changes, is inevitable. The **Affordable Care Act is a prime example of wrongly directed resources.** While the goal of *"affordable health care for everyone"* is noble, the legislation only acted to massively increase the costs of healthcare, and the demand on the system, without improving the delivery and supply of the care itself. **The shift of demand, without an equal shift in the supply, ensures that the entire system eventually bankrupts itself.** Of course, it isn't just the social welfare and healthcare system that is effectively *"broken,"* but the economic model itself.

The Real Crisis

The real crisis that is to come will be during the next economic recession. While the decline in asset prices, which are normally associated with recessions, will have the majority of its impact at the upper end of the income scale, it will be the job losses through the economy that will further damage and already ill-equipped population in their prime saving and retirement years. With consumers again heavily leveraged with subprime auto loans, mortgages, and student debt, the reduction in employment will further damage what remains of personal savings and consumption ability. That downturn will increase the strain on an already burdened government welfare system as an insufficient number of individuals paying into the scheme is being absorbed by a swelling pool of aging baby-boomers. At some point, the realization of the *"real American crisis"* will be realized. It isn?t a crash in the financial markets that is the real problem, but the ongoing structural shift in the economy that is depressing the living standards of the average American family. There has indeed been a redistribution of wealth in America since the turn of the century. **Unfortunately, it has been in the wrong direction as the U.S. has created its own class of royalty and serfdom.** For many, retirement years will not be golden. They will simply be more years of working to make ends meet as the commercials of *?old people on sailboats,?* promoted by Wall Street, will become a point of outrage. While the media continues to focus on surging asset prices as a sign of economic health, the reality is far different. The real financial crisis in the future won?t be the *?breadlines?* of the 30?s, but rather the number of individuals collecting benefit checks and the dilemma of how to pay for it all. As Dr. Brock suggests - it is truly *"American Gridlock"* as the real crisis lies between the choices of *"austerity"* and continued government *"largesse."* One choice leads to long-term economic prosperity for all, the other doesn't.