Armstrong Economics

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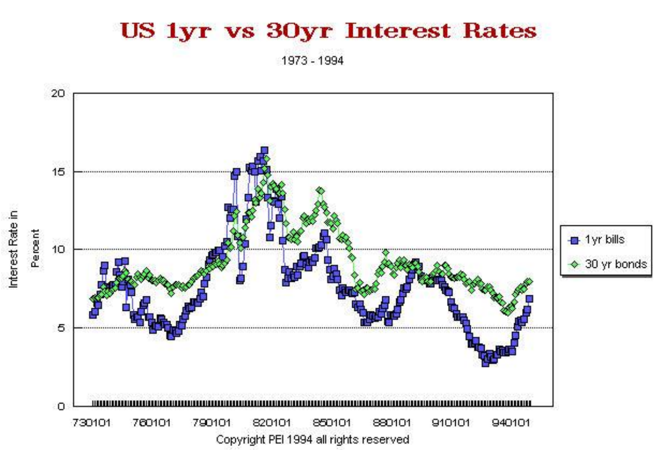
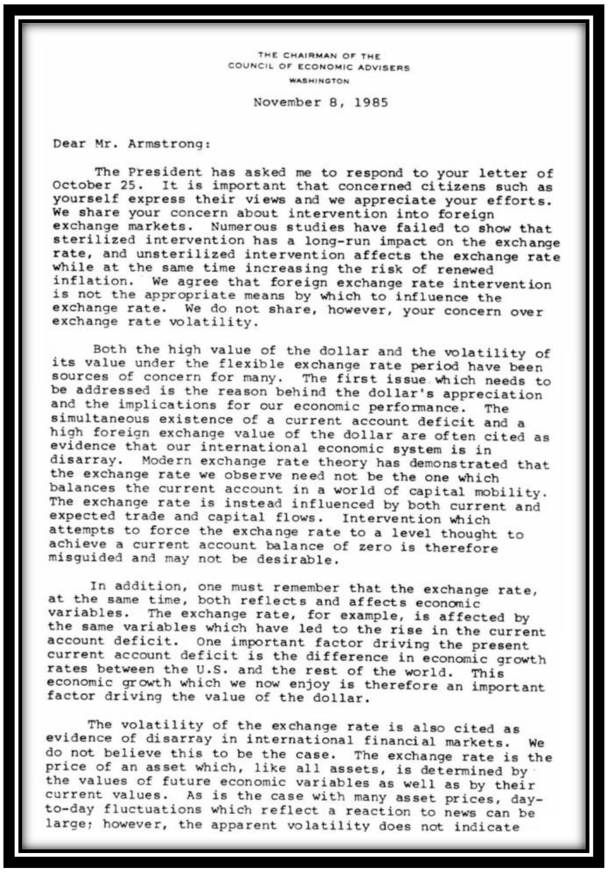
DON'T ANYBODY MOVE OR THE BLACK GUY GETS IT!

I have worked with people on Capitol Hill for some time now. I testified before the House Ways & Means Committee in 1997 on the global economy and taxation. When I was young and idealistically naïve, I met with the US Treasury during the Reagan Administration. I stupidly assumed that everyone would do the right thing and therefore if they were not doing so, then the answer must be surely they did not see at the problem correctly! When Paul Volcker raised interest rates to insane levels in 1981 to fight inflation, perhaps being a trader rather than an academic, I saw things from a far more practical perspective. I was beside myself. How could you raise interest rates to fight inflation when you yourself are the biggest borrower? It was like that crazy scene in the move ***Blazing Saddles*** where the black guy holds the gun to his own head and says if anyone moves, the black guys get it. I could not understand how there could be such stupidity in Washington, DC. So I worked out the simple math and showed the Treasury that this policy was disastrous. They would cause the National Debt to rise from $1 trillion to $8 trillion by the end of the decade. This was just insane! They looked at me as if I was nuts. They replied – ***"But we will be paying back with cheaper dollars!"*** They knew what they were doing.





THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

November 8, 1985

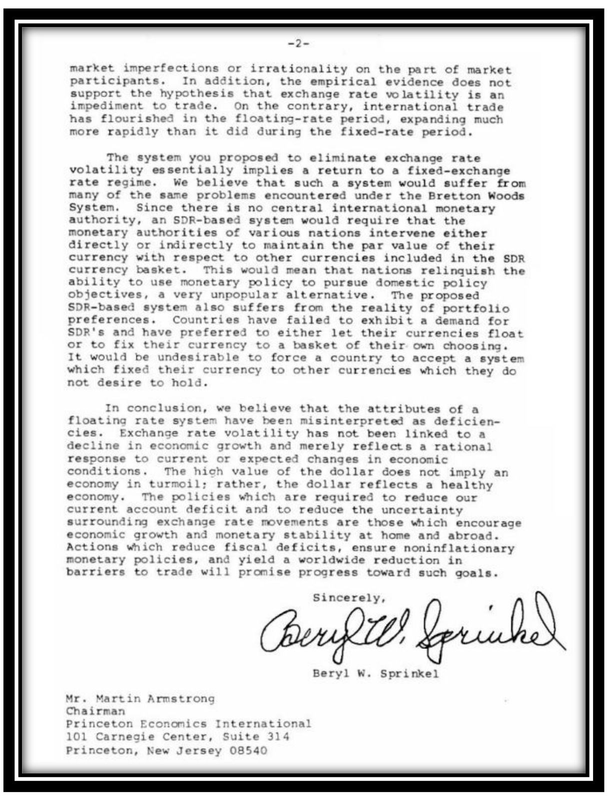
Dear Mr. Armstrong:

The President has asked me to respond to your letter of October 25. It is important that concerned citizens such as yourself express their views and we appreciate your efforts. We share your concern about intervention into foreign exchange markets. Numerous studies have failed to show that sterilized intervention has a long-run impact on the exchange rate, and unsterilized intervention affects the exchange rate while at the same time increasing the risk of renewed inflation. We agree that foreign exchange rate intervention is not the appropriate means by which to influence the exchange rate. We do not share, however, your concern over exchange rate volatility.

Both the high value of the dollar and the volatility of its value under the flexible exchange rate period have been sources of concern for many. The first issue which needs to be addressed is the reason behind the dollar's appreciation and the implications for our economic performance. The simultaneous existence of a current account deficit and a high foreign exchange value of the dollar are often cited as evidence that our international economic system is in disarray. Modern exchange rate theory has demonstrated that the exchange rate we observe need not be the one which balances the current account in a world of capital mobility. The exchange rate is instead influenced by both current and expected trade and capital flows. Intervention which attempts to force the exchange rate to a level thought to achieve a current account balance of zero is therefore misguided and may not be desirable.

In addition, one must remember that the exchange rate, at the same time, both reflects and affects economic variables. The exchange rate, for example, is affected by the same variables which have led to the rise in the current account deficit. One important factor driving the present current account deficit is the difference in economic growth rates between the U.S. and the rest of the world. This economic growth which we now enjoy is therefore an important factor driving the value of the dollar.

The volatility of the exchange rate is also cited as evidence of disarray in international financial markets. We do not believe this to be the case. The exchange rate is the price of an asset which, like all assets, is determined by the values of future economic variables as well as by their current values. As is the case with many asset prices, day-to-day fluctuations which reflect a reaction to news can be large; however, the apparent volatility does not indicate



-2-

market imperfections or irrationality on the part of market participants. In addition, the empirical evidence does not support the hypothesis that exchange rate volatility is an impediment to trade. On the contrary, international trade has flourished in the floating-rate period, expanding much more rapidly than it did during the fixed-rate period.

The system you proposed to eliminate exchange rate volatility essentially implies a return to a fixed-exchange rate regime. We believe that such a system would suffer from many of the same problems encountered under the Bretton Woods System. Since there is no central international monetary authority, an SDR-based system would require that the monetary authorities of various nations intervene either directly or indirectly to maintain the par value of their currency with respect to other currencies included in the SDR currency basket. This would mean that nations relinquish the ability to use monetary policy to pursue domestic policy objectives, a very unpopular alternative. The proposed SDR-based system also suffers from the reality of portfolio preferences. Countries have failed to exhibit a demand for SDR's and have preferred to either let their currencies float or to fix their currency to a basket of their own choosing. It would be undesirable to force a country to accept a system which fixed their currency to other currencies which they do not desire to hold.

In conclusion, we believe that the attributes of a floating rate system have been misinterpreted as deficiencies. Exchange rate volatility has not been linked to a decline in economic growth and merely reflects a rational response to current or expected changes in economic conditions. The high value of the dollar does not imply an economy in turmoil; rather, the dollar reflects a healthy economy. The policies which are required to reduce our current account deficit and to reduce the uncertainty surrounding exchange rate movements are those which encourage economic growth and monetary stability at home and abroad. Actions which reduce fiscal deficits, ensure noninflationary monetary policies, and yield a worldwide reduction in barriers to trade will promise progress toward such goals.

Sincerely,

Beryl W. Sprinkel

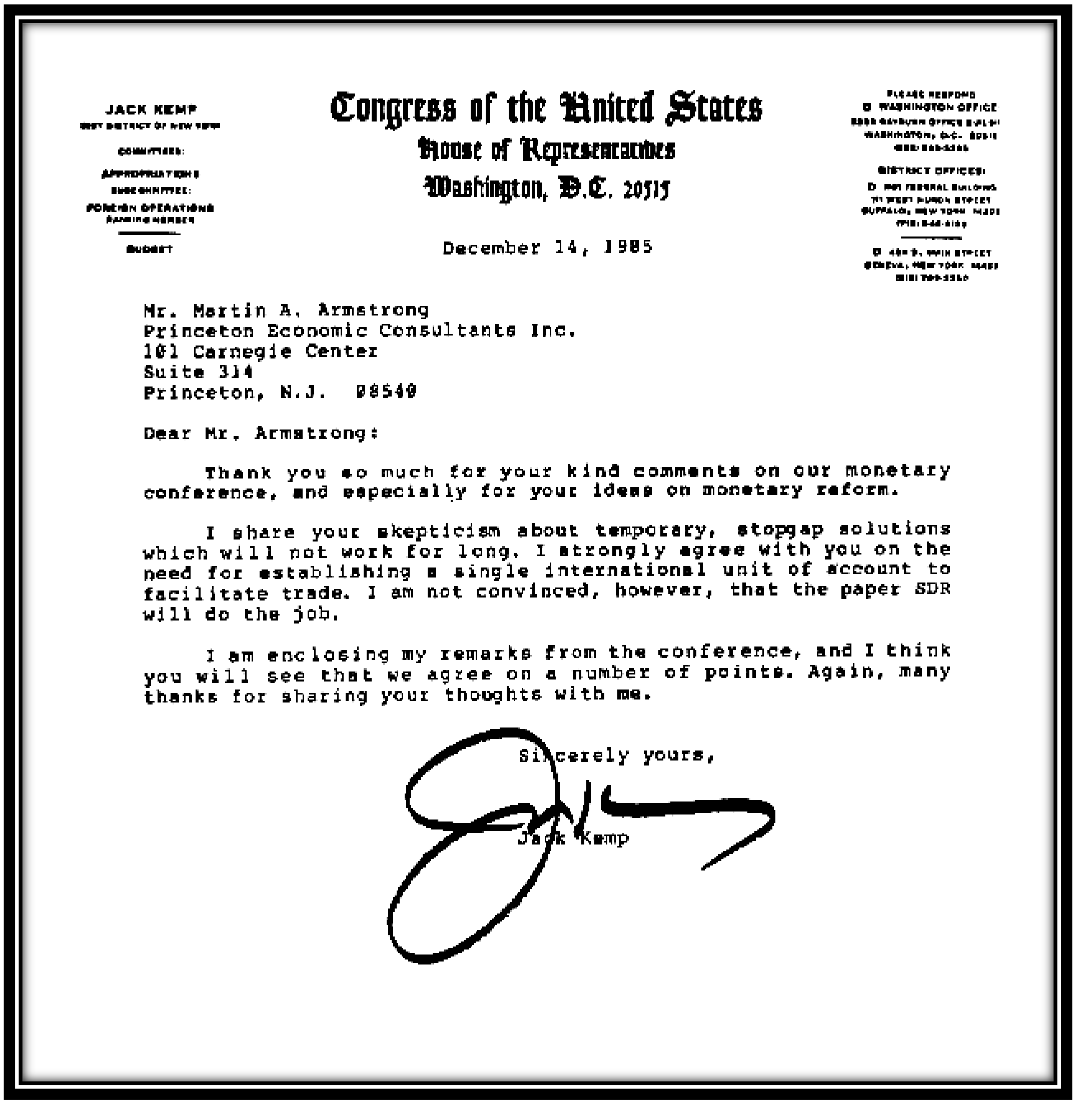
Beryl W. Sprinkel

Mr. Martin Armstrong
Chairman
Princeton Economics International
101 Carnegie Center, Suite 314
Princeton, New Jersey 08540

The trade statistics are calculated based upon the old gold standard of ***Bretton Woods***. If money was of a fixed value, then the shortcut to calculating trade was just to monitor the money going back and forth. When the floating exchange rate system emerged as a bargaining chip in 1971, there was no formal conference and nobody sat down and revised the entire world monetary system. When they came up with the brilliant idea of manipulating the dollar down by 40% to reverse the trade deficit forming the G5 (Now G20) at the Plaza Accord, again the concept was just insane.

Since currencies floated, the “trade deficit” that was really the Current Account no longer represented actual tangible goods, but the same goods now fluctuated in price and a rise in the deficit would no longer imply you actually important more goods for the currency simply changed. Again I wrote to the White House pleading with them not to act in such a stupid brain-dead manner. You could no more isolate only trade, and would reverse investment flows as well. The White House replay was a two page letter saying how nobody effectively understood what I was talking about.

The only politician to grasp what I was talking about at the time was Jack Kemp. While I was trying to come up with a solution that at the time involved the IMF, Jack disagreed with that and over time I began to understand that this was an issue of political power. Creating a reserve currency out of SDRs *(something others are floating today)* will never work because it required a nation to yield sovereignty to the IMF over its economy. As time passed, I had to learn not just the real world solutions, but how to merge them with the political world. This was something that I learned only by having to deal in both worlds on a more regular basis. A bridge of understanding had to be constructed between reality and what would fly on a political basis.



JACK KEMP

COMMITTEES:

APPROPRIATIONS

SUBCOMMITTEE:

FOREIGN OPERATIONS

BUDGET

Congress of the United States
House of Representatives
Washington, D.C. 20515

PLEASE RESPOND
WASHINGTON OFFICE

DISTRICT OFFICES:

December 14, 1985

Mr. Martin A. Armstrong
Princeton Economic Consultants Inc.
101 Carnegie Center
Suite 314
Princeton, N.J. 08540

Dear Mr. Armstrong:

Thank you so much for your kind comments on our monetary conference, and especially for your ideas on monetary reform.

I share your skepticism about temporary, stopgap solutions which will not work for long. I strongly agree with you on the need for establishing a single international unit of account to facilitate trade. I am not convinced, however, that the paper SDR will do the job.

I am enclosing my remarks from the conference, and I think you will see that we agree on a number of points. Again, many thanks for sharing your thoughts with me.

Sincerely yours,

Jack Kemp

I found Jack Kemp to have been an exception to the rule. The same I could say for Bill Archer who was Chairman of the House Ways & Means Committee in the 1990s. Otherwise, most of those in power unfortunately have no real world experience or understanding. Likewise, those in the real world do not fully understand Washington. I had to learn this lesson myself. Why so many in public services are attracted to positions of power but are clueless is a real world context is truly a paradox. We should have a requirement that **ONLY** people with experience at the **END** of their career should go to Washington. There are also people who write newsletters that have never played in the big leagues yet pretend to tell people what to do. It is like going to a virgin for advice of sex. There are plenty of people with real experience. Make it attractive for them to donate the last few years of their career to help the nation. When I was invited by the Central Bank of China in 1997 to fly to Beijing to discuss the ***Asian Currency Crisis*** of 1997, that they knew was the result of market manipulations, I was asked by the people in the US Treasury what was my impression. I told them it was amazing. They **ONLY** hired people with real world experience who work on trading desks – not administrative management.

Princeton
Economics
International Ltd

May 20, 1997

Mr. Robert Rubin
Secretary of Treasury
US Department of Treasury
Washington, DC

Dear Mr. Rubin:

The current conflicting statements out of the US and Japan over the value of the yen and Japanese trade surplus have obviously unleashed untold volatility within the foreign exchange markets that are endangering the stability of the entire global economy and capital flows.

I must point out that the US government has still not taken into account that the trade numbers as reported reflect only currency net movement and not actual units of goods and services. The methodology of trade statistics is a throw back to pre-1971 gold standard days when the value of money did not change. Subsequently, trade could then be easily monitored by merely following cash flows. Today, the floating exchange rate system has rendered all international statistics worthless and dangerous when used for political economic purposes. Comments relative to the US/Japan trade account reflect the sharp decline of the yen and not a substantial rise in actual exports of goods to the US.

We have investigated this matter very carefully and the true net sales of goods to the US from Japan have declined, despite the fact that the surplus in yen terms has risen 150% over the past year. If actual exports to the US had risen, then Japan's economy would be booming instead of the current dismal performance. Corporate profits would rise instead of decline, and above all, unemployment would decline instead of rising as is the current case in Japan.

We were one of the firms requested to help investigate the 1987 Crash by President Reagan. The conclusion of that investigation was clear. The Crash of 1987 was caused by a 40% swing in the value of the dollar over the previous 2 year period. That volatility forced investors to withdraw from the US market due to the view of the dollar, not their view of our assets.

Herbert Hoover also wrote in his memoirs about how confidence in the foreign exchange markets collapsed in 1931. He stated that capital acted like a loose cannon on the deck of a ship in the middle of a torrent. Capital rushed from one currency to another so rapidly

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Mr. Robert Rubin
Secretary of Treasury
May 20, 1997
Page Two

that government was unable to form a committee fast enough to investigate what was taking place, no less prevent it from happening.

Our historical computer models are warning that unless the volatility in foreign exhange markets is reduced, we are endangering the stability of the entire global economy once again. If such statements do not seek to constructively reduce volatility instead of fuel it, you will see short-term interest rates in the US explode and your extremely short-term funding of the US national debt will seriously disrupt our entire economic future.

We have been in contact with our institutional clients in Japan. Their purchase of US government securities has risen from 7% to 33% of our entire US national debt. The majority are now telling us they can no longer endure this type of volatility in the currency markets and if the dollar/yen falls below 110, you will see massive liquidation of US government assets.

If you are not extremely careful with this issue of foreign exchange and trade surpluses, vague statements will cause the Crash of 1997 within a matter of months. If the dollar/yen does not stabilize, and soon, the current administration will go down in history next to that of Herbert Hoover.

Sincerely,

Martin A. Armstrong
Chairman of the Board
Princeton Economic Institute

cc: President William Clinton
Congressman Bill Archer
Senator Trent Lott

However, real world experience that does not include down in the trenches trading, is still worthless. In the case of Robert Rubin being former head of Goldman Sachs does not ensure that there will be any practical knowledge that will follow with the job. Once again in 1997 there were the same stupid comments emerging from the US Treasury that they wanted to see a lower dollar to help the US trade numbers. Once again I wrote to Secretary Rubin warning not to make the same mistakes of 1987. This time, the reply was from today's Secretary of the Treasury Timothy Geithner.

Mr. Geithner simply denied that there was a policy to talk the dollar down and claimed that the ***"recognition that the fundamental sources of a strong and stable currency are sound monetary and fiscal policies that foster healthy, non-inflationary growth, and sustainable current account positions."*** This is obviously not following their own advice today.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 4, 1997

Mr. Martin A. Armstrong
Princeton Economics International
210 Carnegie Center, 4th. Floor
Princeton, N.J. 08540

Dear Mr. Armstrong:

Thank you for your letter to Secretary Rubin of May 20. It is always useful to be reminded of history.

Our exchange rate policy is based on the recognition that the fundamental sources of a strong and stable currency are sound monetary and fiscal policies that foster healthy, non-inflationary growth, and sustainable current account positions. We work closely with our G-7 partners and other major countries to promote these policies.

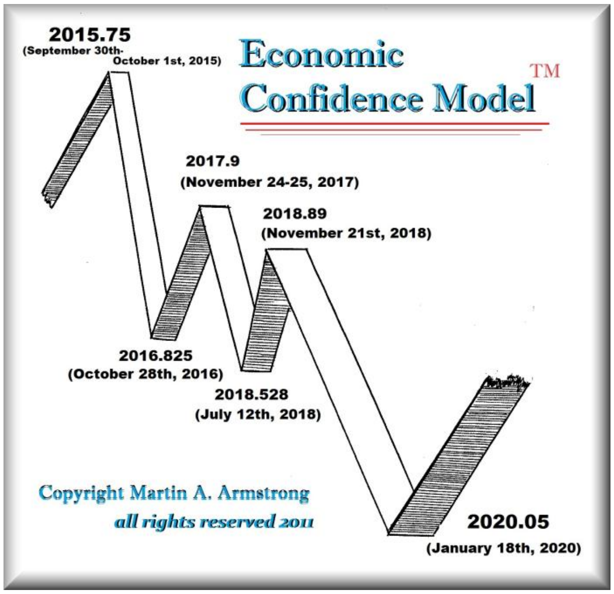
Sincerely,

Timothy F. Geithner
Senior Deputy Assistant Secretary
(International Affairs)

As I said, there can also be the problem of those in the real world being ignorant of how government truly functions as well. I have straddled both worlds and try to relay what I have learned from a unique position I have had for decades. This is why there has been a major effort by those in New York to shut me up at all costs, because what I have to say will kill the golden goose that fuels the corruption in New York City. Government is **NEVER** rational or logical in its thinking process. This is exploited by New York banks on a regular basis. Installing bankers as the head of the US Treasury is far better than the head of the Fed. This gives them cabinet status and direct links into Congress as well as the White House.

Warren Buffett, in a recent interview with CNBC, suggested that he could balance the budget right away. He said:

> ***"I could end the deficit in 5 minutes. You just pass a law that says that anytime there is a deficit of more than 3% of GDP, all sitting members of Congress are ineligible for re-election."***



While this is a noble suggestion, we are past the point of no return. ***Balancing the Budget*** will no longer save the day. The entire monetary system is so screwed-up there will be little hope of avoiding a major economic catastrophe in 2015.75-2020.05. ***Balancing the Budget*** will fail because the interest expenditures will continue to rise. As they do, they will then force spending cuts in all social and tangible areas as the money will have to be directed at interest expenditures. Thus, what will happen is total expenditure will be consumed by interest to keep the debt rolling. Of course, this would be an impossible result for that would mean government employment would shrink and played out to the ultimate conclusion, what will happen is there would be nobody left in government to sign the checks. Government would have to become all machines as in the **Matrix** or the **Terminator** movie series. There would be major social unrest long before that would happen so the true scope would be a bell curve rather than a linear projection. Meaning, at some point the great unwashed who receive checks from government to remain quiet will rise up and tear the cities apart as the plunder the stores to get what they would view as their rightful property.

While there are people arguing for the introduction of what they would call the ***Congressional Reform Act of 2012***, it would have to be introduced by people whose self-interest would be directly affected. It is true that most other amendments were done with incredible speed. However, none of them curtailed political individual power. The proposals are:

> ***1. No Tenure / No Pension. A Congressman/woman collects a salary while in office and receives no pay when they're out of office.***
>
> ***2. Congress (past, present & future) participates in Social Security. All funds in the Congressional retirement fund move to the Social Security system immediately. All future funds flow into the Social Security system, and Congress participates with the American people. It may not be used for any other purpose.***
>
> ***3. Congress can purchase their own retirement plan, just as all Americans do.***
>
> ***4. Congress will no longer vote themselves a pay raise. Congressional pay will rise by the lower of CPI or 3%.***
>
> ***5. Congress loses their current health care system and participates in the same health care system as the American people.***
>
> ***6. Congress must equally abide by all laws they impose on the American people.***
>
> ***7. All contracts with past and present Congressmen/women are void effective 12/1/12. The American people did not make this contract with Congressmen/women.***

It is true that Congress made all these contracts for themselves and nobody will introduce something like this. The best we can hope for is **<u>term limits</u>** whereby nobody should be allowed to remain in office but for **<u>ONE</u>** term. However, even that will be impossible to get passed absent a revolution. It is true that serving in Congress should be an honor rather than a career. Yet good luck on making that point.

I have fought the corruption in New York that is going to bring us to the brink of world war. Congress **<u>REFUSES</u>** to even investigate the New York court system that is a joke because they know it only rules in favor of government. You have to be insane to have **<u>ANY</u>** money in New York after MF Global. The only way to break the back of this corruption is to move funds out of New York, refuse to do business with anyone doing business in New York, and that will hurt the ability of government to borrow and roll this debt on a perpetual basis. Until they cannot keep the debt game rolling, there will **<u>NEVER</u>** be any reform.

So we have to be practical. Until government is put in check by the free markets, the joke is on us and will continue to be so. Feel free to send this to everyone you can around the world. We need to educate people about government and its own self-interest that is opposed to the interest of the people or what is even fair, just, and right.

Armstrong Economics

Forecasting the World

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Armstrong Economics

Forecasting the World

Welcome to Armstrong Economics where we are bringing the global economy down to an integrated understandable single entity. Forecasting the World economy and thus markets becomes possible only when you see the global capital flows and comprehend how they interact to produce real bull markets when capital in concentrating on a global scale into one nation focused into one sector. As long as a market is rising ONLY in terms of a local currency, then foreign capital will be sellers against domestic buyers and thus there will be no sustainable trend.

We are striving to bring reason from a practical hands-on perspective, not theory. Only real experience is the teacher and here we had under contract more than 50% of the value of the entire US National Debt in corporate advisory as early as 1989. Theories of what is money and the impact of interest rates have done far more damage to understanding the world we face than reveal the hidden truth behind the global trends.

This site offers much free research as a public service to further the understand of the general public and to expose the antiquated economic theories that are still taught in school today, yet are from the Bretton Woods era of fixed exchange rates that have not existed since 1971.

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