PENSION CRISIS

The Core of the Sovereign Debt Crisis

What Lies Ahead

Armstrong Economics

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I. The Pension Crisis

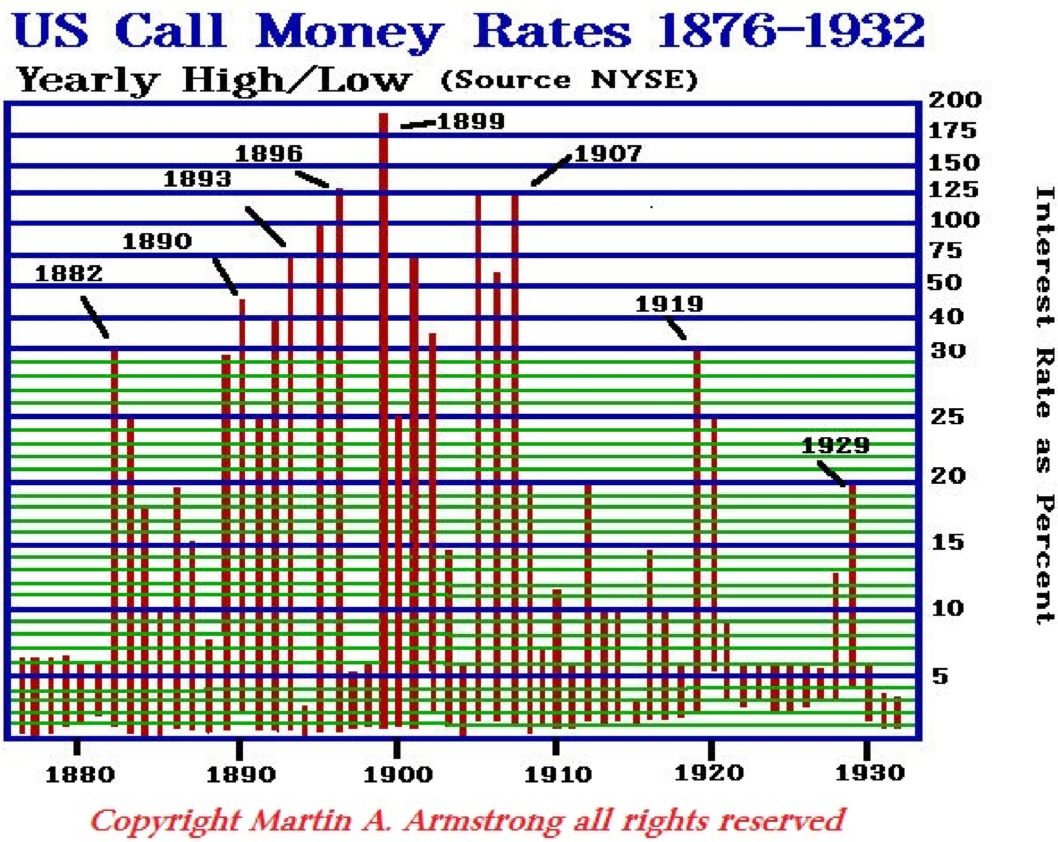
The next great crisis brewing is none other than the pension crisis. Historically, families and marriage provided the security needed to support the elderly prior to the proliferation of pensions. As the population became more industrialized, private annuities rose in popularity with pensions resembling disability insurance. With the rise of socialism, first in Europe with Karl Marx and in the United States coincinciding with the Great Depression, pensions not only grew in popularity, but replaced the family as support for the elderly. Unfunded pensions combined with poor demographics in which the elderly comprise a greater portion of the global population are leading to a situation that could cause the collapse of governments globally.

At the time when pensions were implemented, only 5-8% of the global population was over-65. However, estimates state that by the year 2030, over 20% of the population from developed countries will be over-65. Furthermore, pensions have made generous promises with income replacement rates averaging over 50% for members of the Organization for Economic Co-operation and Development (OECD). Meanwhile, pension assets have distorted the bond market. According to the OECD, pension assets total almost $25 trillion for the OECD nations. A strong bond market with record-low yields has allowed politicians to delay needed pension reforms. Aging demographics and high taxes are stifling economic growth. Taxes cannot be raised the 8% required to meet promised pension benefits with OECD nominal GDP growth at 4.3% for 2017.

Countries with the largest pension issues also display lower growth. According to the International Monetary Fund (IMF), the Euro Area GDP is projected to grow 1.4% in 2017, while the Japanese economy is expected to grow at 0.1%. These low growth rates inhibit the ability of governments to raise taxes. The economic decline in several countries following recent tax increases illustrates the inability of governments to raise taxes sufficiently to meet promises.

Low interest rates are hurting the returns of fixed income securities and increasing the present value of pension funds. Larry Summers, American economist and former Secretary of the Treasury, first proposed negative interest rates to stimulate the economy. His idea was to punish savers by pushing them to hoard and not spend their life savings in the manner that politicians do with the national budgets. Each and every time there is a crisis in the economy, the only thing they do is lower interest rates. They operate under the misguided view that people will borrow if you simply lower the rates. There is zero comprehension of the basic human reaction not to spend money if they do not have confidence in the future. This is similar to how no bank will lend you money for a mortgage if they are uncertain that you will be able to afford it in the future.

Furthermore, people will not borrow if they perceive that rates will continue to decline. People typically rush out and lock in mortgages as soon as rates make their first uptick because it is only human to buy now if you believe it will cost more tomorrow. That was the driving force behind the inflationary spiral from 1976 to 1980 when people assumed everything would cost more as OPEC oil prices increased the cost of production in virtually all sectors. Likewise, Japan saw the same surge the month before the sales tax increase. Everyone ran out to buy before it would cost more tomorrow. A simple correlation would disprove the concept that lowering interest rates will stimulate the economy and inspire consumer spending. It did nothing to reverse the economic decline even during the Great Depression when rates fell from 6% to 1% as the stock market collapsed by 90%.



Moreover, those who believe they have the right to manipulate the "Great Unwashed" fail to understand how basic transactions take place between individuals. If person #1 is willing to lend you money at 25%, and person #3 is willing to pay you 30%, then there is an expected profit. However, if person #1 offers you money at 1%, and person #3 only pays 1%, then there is no profit. The elite cannot understand that it is by no means the empirical level of interest rates that matters, but the expectation of value and profit.

After running a correlation on the economy, we found that the stock market has never peaked twice with the same level of interest rates. The peak in the call money rate in 1899 was nearly 200%, and in 1929, it reached only 20%. Yet, the latter was the Great Depression, which was far worse than the Panic of 1899. This proves the point that the empirical level of interest rates means absolutely nothing. The key is always the expectation of the future—**public confidence**. If you believe the market will double in the next year, you will pay 20%. If you think the market will rally 5%, you will not pay 5%. Certainly, if you do not believe the market will even rally to make a new high, you will not buy at any price.

Those who want to rule the world, talk up the power of central bankers to try to maintain public confidence. As soon as an economic collapse begins, they always come out and say everything is just fine. This is why they preach nonsense and make promises they can never keep nor do they even try to keep. At the core, even they comprehend this is all about public confidence.

The prolonged denial of the pension crisis is darkening the horizon, given the fact that lowering interest rates is the fundamental basis from which the government seeks to manage every crisis. As we approach 2017, everything you once thought was secure for your future will unravel. Why? Governments have stolen your money for retirement by mandating that some large portion be invested in government bonds, and the funds have been consumed by governments with no private investment (such as US Social Security). Negative interest rates have undermined pension funds that are both private and public. Most funds require 8% annual returns to reach fully funded expectations. These negative rates have not merely undermined pension funds as a whole, but have also driven many into the open arms of emerging market debt to achieve higher yields. This is all connected and our greatest threat to the future.

II. Origin of Private Pensions

Pensions first emerged as annuities that were, believe it or not, private contracts for marriage. Hollywood has changed our idea of marriage by distorting its history. Historically, there were permanent and temporary marriages with different legal rights. The Catholic Church sought to regulate marriage by limiting the number of wives to one and only endorsing "permanent" marriages rather than "temporary." Perhaps our modern concepts of marriage may account for the rising divorce rate based upon expectations of an unattainable utopia.

Traditionally, marriage served as a form of a pension. The first Roman Emperor Augustus (b. 63 BC–14 AD; r. 27 BC–14 AD) enacted Family Laws, mandating that young men take a wife and not remain free-loving bachelors. Perhaps you will recall that Mark Antony was married to Augustus' sister Octavia whom he divorced to marry Cleopatra (b. 69 BC–30 BC; r. 51–30 BC). That too was seen as a crisis in property for Cleopatra's son was that of Julius Caesar (b. 100 – 44 BC; r. 46 – 44 BC), and thus a closer relative than Augustus to any inheritance. Consequently, Augustus moved against Mark Antony and Cleopatra, defeating them both. Augustus had Cleopatra's son, Caesarion, executed to end any issue of property rights to the newly created throne of Rome.

Mark Antony & Octavia

Gold Aureus

The first Roman Emperor Augustus tried to address the issue of falling birth rates to protect the Roman race. The Roman (Latin) population had declined while the population of foreign immigrants and slaves increased. Augustus saw having children as moral and essential to the long-term viability of Rome. In the case of Augustus, he used his powers as **tribune-for-life** to initiate legislation that he hoped would encourage marriage. Infanticide (the intentional killing of infants) remained legal and at a husband's discretion. However, people who remained single or married without children after they were 20 were penalized through taxation. Nevertheless, with the rising wealth of Rome came a declining Latin birth rate that reduced Rome's native population to its lowest level in history.

Between 2 BC and 4 AD, Augustus enacted Family Laws that he hoped would reduce inter-breeding between Latins and non-Latins to preserve their race and heritage. Indeed, Trajan (98-117AD) was actually the first non-Latin blooded Roman to become emperor. He was 100% Spanish. These laws also prohibited an indiscriminate emancipation of slaves and prohibited freed slaves from marrying Romans. There was also a prohibition against senators marrying freed slave women.

Marriage in Western Europe during the early Middle Ages stemmed largely from the spread of Roman culture rather than Christianity. Northern Europeans considered consummation of a marriage to be the element that truly sealed a legally binding marriage arrangement. This does not necessarily mean that only sexual intercourse formed the marriage bond. To the contrary, sexual intercourse followed by the couple living together is what actually created a marriage, not a license or ceremony. There was plenty of pre-marital sex then as well, so sexual intercourse was not the binding element—it was sex with cohabitation. Some states in the USA still recognize cohabitation today as "common law," which is not the mere act of sex.

Wedding customs prior to the 10th or 11th century are not well known. Marriage, in practical terms, was a pension or performance bond—marry me and I will take care of you. Under Anglo-Saxon English customs, marriage by purchase was common. Instead of a dowry, the man paid money for his bride. She was not sold; rather she bestowed her inheritance. The money paid went directly to the bride rather than her family. As the right of marriage included the transfer of property and titles, these rights were often traded or resold in the case of a rising market. It was all about economics—not love at first sight.


Anglo-Saxon Sceat (7th-8th Century)

The traditional view of marriage contracts involved the design to strengthen ties between ruling families, increasing the strength of dynasties, as well as providing political stability among nations. In theory, there was a reduced likelihood of countries going to war if they were connected through marriage. This idea seldom worked, yet Parliament was often involved in these marriages.

In April 1554, Parliament passed Queen Mary's Marriage Act to set the future marriage and joint reign of Queen Mary I and Philip II, the Prince of Asturias. In addition to national alliances, this marriage was about legal and property rights. Even the queen had to settle her marriage with Parliament.

However, this view of intermarriage among the royals masks the origin of the marriage contract, which was, in reality, the first annuity. A man entered into a marriage contract guaranteeing that he would take care of the woman for life, and she, in turn, understood her duties to provide heirs. It was a very black and white economic agreement and the birth of pensions. The family was then established and the children furthered the goal of economic stability by taking care of their parents in their old age.


The Act for the Marriage of Queen Mary of England to Philip of Spain
Queen Mary's Marriage Act (1 Mar. Sess. 3 c. 2) passed by Parliament in April 1554

During the feudal period, lords allocated property to their vassals in exchange for annual payments. The possession of land and titles were inheritable; thus the consent of a lord was required for marriages to ensure that the new vassal would be loyal to the lord. The lord was also responsible for the wellbeing of his vassals. The responsibility of unbetrothed children at the time of a man's death fell to the lord, thus it was common for children to be betrothed in infancy to ensure the parents' wishes were known. As documented by Ranulf de Glanvill (c. 1112-1190), Chief Justiciar of England during the reign of King Henry II, any father who arranged a marriage for his heir without his lord's permission was subjected to the confiscation of his land by the lord.

Ranulf de Glanvill (c. 1112-1190)

At the time, women of all levels paid fines to marry the man of their own choosing or for the right to remain single. In fact, a 93-year-old countess bribed Henry II for the privilege not to re-marry. Age was irrelevant. A 70-year-old man would be married to a 16-year-old girl just as a 93-year-old woman would be married to a 30-year-old man.

When the Countess of Warwick remarried without a license, her lands were confiscated. Since marriage conferred the transfer of property, the lord's consent ensured no property would be assigned to another without compensation. Property always preceded love.


MEROVINGIAN-Pseudo-Imperial Coinage (c 500-580AD) AU Gold Tremissis

As marriage conferred the transfer of property, the right to marry was often sold. For example, King John (b. 1166; r. 1199-1216) sold his first wife to a good friend when he sought to marry another woman. The assumptions about these arranged marriages vary greatly, but the predominant mistake made by modern readers is the assumption that women were suppressed and traded like cattle. We must understand the period within its own context and reject applying current standards to those of the past. Clearly, strict control over women and their marriages was acceptable even to families who loved their daughters. Why? This was, in reality, a pension system to ensure her and her offspring would be provided for under contract. It was all about property rights.


King John
(b: 1166; 1199-1216)

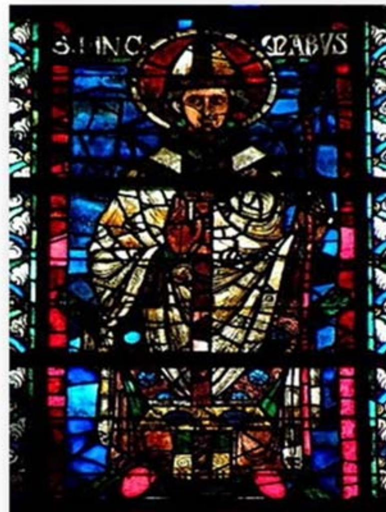
Nineth century Frankish law recognized two distinct forms of marriage: **Muntehe** and **Friedelehe.** The distinction was all about property. Muntehe was the formal "permanent" marriage and involved the transfer of property from one family to another. Friedelehe was an official marriage, but it was often "temporary," did not require the transfer of property, and did not actually have an expiration date. Offspring of a Friedelehe were legitimate and recognized as heirs if there were no heirs from a Muntehe marriage. Yet, the relationship was considered that the bride was lent rather than given.

Charlemagne, Charles the Great, only allowed his daughters to enter Friedelehe unions. The more binding Muntehe marriage would have transferred the right to the throne, while the Friedelehe protected that right.


Charlemagne *(Charles the Great)*
(742–814AD)

Additionally, the consent of the bride's father/family was of higher importance than the couple's consent. Under Anglo-Saxon law, as was the case under French law of the Merovingians, abducting a woman was a punishable offense. In 596 AD, the Merovingian king issued a decree that stipulated the death penalty for anyone guilty of abduction by force. Even in cases where the woman agreed to marriage after the fact, if parental approval was not forthcoming the couple was sentenced to exile or even death. Clearly, mere sex did not constitute a marriage—it required parental consent to protect family assets.

Only as the power and influence of the Roman Catholic Church began to spread throughout Europe do we find opposition to any form of marriage or union that was not binding for life. The Catholic Church sought to regulate marriage during the 12th century in France. Despite Abraham having two wives, the Church argued against a man having more than one recognized partner, which created a conflict with accepted norms at the time.



Archbishop of Rheims, Hincmar (845-882)

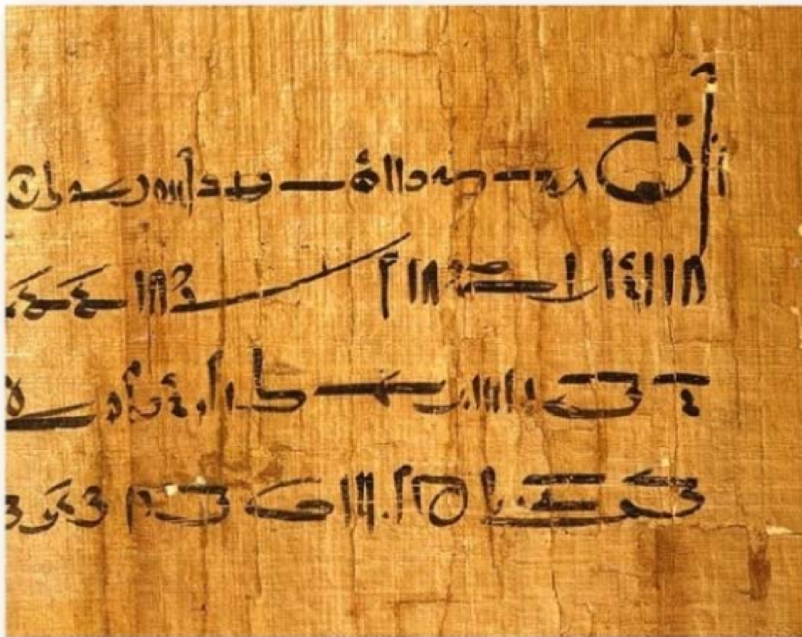
The Archbishop of Rheims, Hincmar (b. 806–882 AD), attempted to resolve these conflicting views of marriage in his *Treatise de Divortio*. Hincmar held that legitimate marriage had to meet four conditions:

1) The partners had to be of equal and free rank and must give their consent
2) The woman must be given by her father and dowered
3) The marriage must be honored publicly
4) The union was completed by sexual consummation[1]

Hincmar recognized both the Roman tradition of consent and the Germanic tradition requiring consummation. Marriage emerged as a contract for women's pensions. Religiously, this became a sacrament based upon mutual consent and sexual union. Hincmar's views have essentially prevailed throughout the history of marriage in Western Europe, which still governs our modern understanding of marriage today.

[1] Georges Duby, *The Knight, the Lady and the Priest: the Making of Modern Marriage in Medieval France* (New York: Pantheon Books, 1983), 41.

III. The Birth of Annuities



Annuities are the oldest form of debt. Government issued them for they never had to pay back the principle. This is a wedding annuity, written in the Demotic Egyptian language, which provides information on how a husband was to provide for the wife. This script was used in Egypt from about 500 BC to 500 AD

Courtesy of the Oriental Institute Museum

Annuities were one of the first forms of debt. Once you lent the money, you received an annual return, thereby allowing governments to borrow without ever repaying the debt. Annuities have been available for more than 2,000 years. It is one of the oldest, most enduring financial tools invented by man. The origin was clearly the marriage contract where the agreement was to take care of someone for life. Annuities were thus not loans with an expectation of repaying the capital, but relinquishing title to the capital in return for an annual payment. Throughout the centuries, the annuity has been the financial key to the development of our modern world despites its ups and downs.

3.1 Annuities in Ancient Rome

In ancient Rome, there was a well-established market for speculators in a variety of financial instruments from shares of stock to a fully developed maritime insurance market that dates back at least to the days of Athens, circa 400 BC. However, the Romans also traded what was commonly known as *annua*. Translated from the jargon of the time, *annua* meant "annual stipend" or "annual payout," which still applies to the annuity today. The Roman *annua* remains as the cornerstone for the financial security of industrial and government retirement programs, families, estates, and individuals.

***Gnaeus Domitius Annius Ulpianus* (c. 170 – 228)**

A Roman annuity buyer paid a lump sum in return for a fixed payment every year for his natural life. You at least did not expect to get your capital paid back as in a loan. Later on, annuities were modified to allow payments for a specific period of years called a term.

Table #3

Domitius Ulpianus (v. 170-228AD)
Life Expectancy Calculation

Age of Life Interest Holder	Life Expectancy
0 – 19	30
20 – 24	28
25 – 29	25
30 – 34	22
35 – 39	20
40	19
45	14
49	10
50 – 54	9
55 – 59	7
60	5

The concept of an annuity contract also embraces the applied probability theory that emerged, not just from gambling in the Middle Ages, but also from the Roman law courts and the Roman concept of life interest. The pension crisis in Rome by the 3rd century AD necessitated the creation of mortality tables, otherwise known as the "life table."

Historians believe an ancient Roman Jurist, Gnaeus Domitius Annius Ulpianus, who was also the chief adviser and Praefectus Praetorio to Severus Alexander, created the first annuity in Western culture. We know that Ulpianus helped create the first version of today's actuarial table, which tried to calculate the probability of human life expectancy at the time. Records show that

Ulpianus and his life table calculated the eventual value of an estate on behalf of the beneficiaries of the deceased who purchased the annuity for his survivors. Since he was an advisor to the emperor, it appears that he was very concerned about the unfunded liabilities of the Roman empire regarding pensions.

After the fall of Rome, we have the European Dark Ages where there was little much of anything but serfdom. Of course, this was a sort of pension system, whereby you worked for your landlord and he provided you with a house to live in and allowed you to retain a portion of the crops to sustain yourself and your family. This was a trade of labor for a secure future. In effect, this was a sort of institutionalized pension system. Additionally, there were no wages until the Black Death during the 14th century, which reduced the labor force by nearly 50% in Western Europe.

3.2 Annuities in the Middle Ages

The Middle Ages were plagued by revolution and war. The unrest not only prevented innovation and progress, but also strained the finances of the leaders. To maintain power, leaders had large budgets to fund the armies who protected the people. During this period, the expense of war led to the widespread adoption of creative financing vehicles. War took many lives, but it also led to the development of exchanges and capital markets. One of the most popular instruments to re-emerge was the ancient Roman invention of an annuity.

Annuities existed between private parties where property was sold for an annuity that would last for the lifetime of the seller. If someone owned a farm but was too old to work the land, he would sell the property for an annuity whereby he was assured to have a pension until his death

During the Middle Ages, the first public annuity reemerged in Valencia, Spain, in 1366. The annuity was the financial powerhouse that allowed the crown to defend its borders and expand and colonize the world without ever having to repay the debt. Statues bound in Parliamentary volumes date back to the reign of King Richard III, confirming the importance that annuities played in the role of government financing during the Middle Ages.

The annuity presented the risk of life expectancy. The issuer became obligated to pay the annuity holder until death whereby their heirs did not benefit in general. There are stories like that of Jeanne Calment (b. 1875–1997 AD) who sold her apartment in 1875 for a private annuity from a man named Arles. He died and his heirs had to continue to pay the annuity until 1997 when she died at the age of 122. This led many to give sums of money to their offspring at a young age as a way of securing huge profits from the city-states, which no doubt contributed to the greater tendency to default with time. The longevity risk of annuities is what inspired the bond market to supersede the annuity market by defining risk for government. Clearly, the risk of issuing an annuity that the state is obligated to pay would be mitigated by shifting to long-term bonds where the bondholder then has the risk of inflation.

The actual annuity contract proceeds began to fund a variety of government programs, including construction projects. Annuities were even being used to provide an annual allowance for England's royal family. From the 17th to 19th centuries, annuity proceeds had funded many of the historic construction projects including buildings and monuments that still survive to this day. These annuities also financed government administrative operations and the retirement income of select government officials.

The Tax Rebellion of 1381 - Wat Tyler (1341-6/15/1381)

For example, during 18th century England, Parliament enacted an intricate host of hundreds of annuity-related laws that defined the sale of annuities and the efforts they would help fund. Annuities even provided an annual allowance for England's royal family. Naturally, annuities also funded wars and became deeply interwoven into the administration of government. Politicians saw them as less confrontational than taxes, especially after the tax rebellions of Wat Tyler in 1381 and William [Jack] Cade. In fact, from the Wat Tyler tax rebellion, England witnessed a persistent increase in the trend of peasant uprisings between 1381 and 1685. Annuities were the alternative to taxes.


Venetia Anastasia Stanley Digby (1600–1633)

Annuities have been an ongoing component of English life and law from the Middle Ages of Anglo-Saxon England to modern-day living in London. Annuities were often pensions even for mistresses. The famous Venetia Anastasia Stanley Digby was the third daughter of Sir Edward Stanley. Venetia was an enticing beauty who used her looks to her advantage. She moved to London alone during her very early teens, and was quite promiscuous, acquiring such a reputation as a teenager. She is reported to have become the mistress of Richard Sackville, Earl of Dorset, who died in 1624. Venetia is said to have had several children and he provided for her by granting her an annuity of £500 upon his death. Venetia eventually married the scientist Kenelm Digby (b. 1603–1665 AD), who filed a lawsuit when her annuity was not paid and won. Clearly, annuities were the foundation of pensions.

IV. The Return of Pensions Post-Dark Age

Great London Fire of 1666

Pension schemes reemerged during the 17th century, and they were rooted in the concept of annuities sold by insurance companies. Until the 17th century, insurance was relatively unknown. Two back-to-back events—the Great Plague of 1665 and the Great Fire of 1666—exposed the need for insurance as companies after individuals faced massive losses. Charles II faced a great health crisis known as the Great Plague of London in 1965, shortly after the restoration of the Monarchy in 1660. The death toll at one point reached a peak of 7,000. Charles, along with his family and court, fled London in July to Salisbury. Parliament actually met in Oxford during this time. The disease continued to spread rapidly and the health officials were incompetent to do much about it.

On September 2, 1666, the Great Fire of 1666 began and destroyed much of the city of London (Old Section). The fire began accidentally in the house of the king's baker on Pudding Lane. The flames spread quickly, driven by fierce winds. Gunpowder was used to blow up houses in the path of the fire in an effort to stop it from spreading. The fire raged throughout London for four days and destroyed 13,000 homes, civil buildings including the Royal Exchange, and 87 churches including St. Paul's Cathedral. Charles II and his brother James even joined and directed the fire-fighting effort. The public blamed Catholic conspirators as the Romans blamed the Christians for the fire of Rome during the time of Nero. What emerged from the ashes of the Great Fire of London was fire insurance.

The idea of insurance quickly spread to other areas. The late 1600s saw the birth of marine and life insurance. Insurance became common during this period in history and joint-partnerships evolved into corporations. Mutual insurance emerged from associations known as trade guilds during the Middle Ages.

There was a small coffeehouse on Tower Street in London in 1688 that emerged as a gathering place for those engaging in the idea of underwriting insurance. This coffeehouse is where merchants, rising bankers, and marine seafarers would meet to transact business deals. This coffeehouse became a popular place for insurance underwriters and its name was Lloyds's of London, which emerged as the premiere name in insurance. Lloyd's coffeehouse became the popular meeting place for those engaging in insurance on ships for the payment of premiums. In 1696, Edward Lloyd (b. 1648–1713 AD) published *Lloyd's News*, covering news concerning shipping movements. This was the forerunner of *Lloyd's List*, first published in 1734. With time, these underwriters at Lloyd's coffeehouse formed their own association and in 1774, they moved into the Royal Exchange. In 1928, Lloyd's moved to its own place on Leadenhall Street. Lloyd's finally became a formal corporation in 1871. It had remained restricted by choice to marine insurance. However, in 1911, it altered its focus to engage in insurance of all types.

Lloyd's Coffeehouse

Lloyd’s of London has remained a form of syndicate where more than 25,000 individuals accept unlimited risk personally. Syndicate members who do not underwrite personally are known as “names” and remain personally responsible for transactions by their underwriting agents.

4.1 Life Insurance

Alexander Webster
(1708–1784)

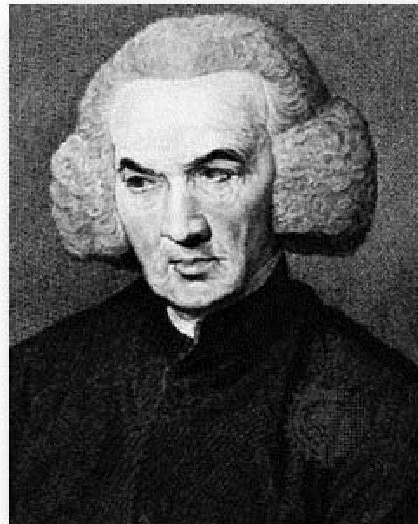
The first official attempt to create a pension post-Roman Empire was in Britain and it took the form of life insurance, which also existed in ancient times. The idea of life expectancy and population growth were stirring at this point in time. After 1660, these issues were addressed in a variety of religious concerns. Under the Law of Queen Ann, if a minister died, his wife and children would receive only a stipend of half the salary during the year of the minister's death. The idea of life insurance emerged from a minister by the name of Robert Wallace and his friend Alexander Webster. Colin Maclaurin (b. 1698–1746 AD) Professor of Mathematics at Edinburgh, who made important contributions to geometry and algebra, later joined them.

Life insurance evolved from demography and mathematics. Thomas Robert Malthus' theories of the political economy and demography were highly influential in the creation of life insurance. Malthus popularized the economic theory of rent.

Thomas Bayes
(c. 1701–1761)

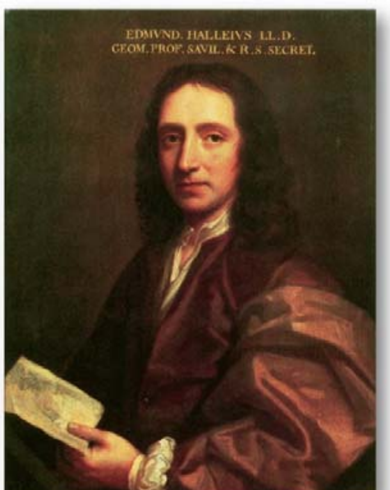
The math behind life insurance was largely based upon the work of English mathematician and Presbyterian minister, Thomas Bayes (c. 1701 – 7 April 1761). His work, *Essay Towards Solving a Problem in the Doctrine of Chances*, was published after his death in 1764, posthumously by Richard Price (1723 – 1791), the noted British moral philosopher, preacher, and a political pamphleteer. Bayes' theorem was highly influential in its day regarding debt and pensions, coming up with an understanding of probability, which was often used for gambling. Gambling was a profitable and practical sport that funded serious work in mathematics. Bayes had concluded, "The probability of any event is the ratio between the value at which an expectation depending on the happening of the event ought to be computed, and the chance of the thing expected upon its happening."[2]

During the 17th and 18th centuries, life expectancy in England was about 35–40 years. A life insurance scheme for ministers and university professors emerged. It was not a fund based upon premiums, but the money collected was invested and the profits from that investment would provide an income for the family.



Richard Price
(1723–1791)

Wallace gathered and tabulated the available information about pastors' widows and orphans from all the presbyteries in Scotland from 1722–1741. He gathered data that showed there were around 930 living ministers at all times, and that over the prior 20 years, 27 ministers died annually, 18 left behind widows, five had children with no widow, and two left widows with children from a previous marriage under the age of 16. They then calculated that the maximum number of widows living at one time was 279, which was then modified using an interest rate of 4%, and the life tables of Edmund Halley (b. 1656–1742 AD) who published them in 1693.



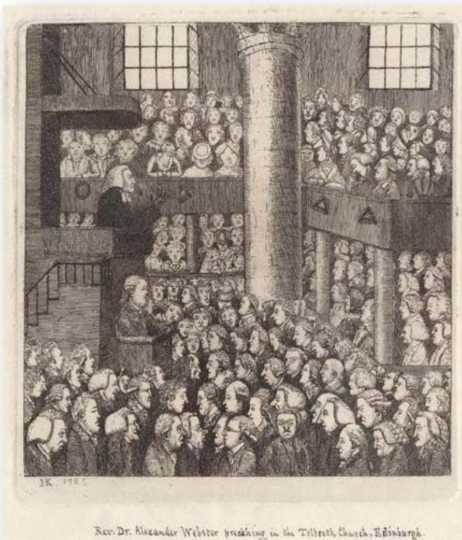
Edmund Halley
(1656-1742)

Halley, of course, is far more famous for discovering Halley's Comet and his funding of the work of his friend Sir Isaac Newton (b. 1642–1727 AD). Nevertheless, Halley had calculated mortality using data from Prussia. On this foundation, they calculated a premium setting with four levels of coverage. The idea was to create an annuity for the family of ministers. This became the first insurance fund of its kind. Their calculations were incredibly accurate.

Wallace and Webster estimated exactly how much premium each pastor would need to contribute to create a fund that would make it possible to (a) take

[2] Thomas Bayes and Richard Price. *Essay Towards Solving a Problem in the Doctrine of Chances* (London: C. Davis, Printer to the Royal Society of London, 1763).

care of the widows, as well as (b) to invest prudently to make the fund grow. Their calculations, predictions, and investment decisions turned out to be so exact that their system was followed by all the insurance companies that came after them. From this Scottish Ministers' Widows' Fund, the model spread quickly around the English-speaking world. This model has served as the foundation for many later such funds throughout history. The famous Scottish Widows that was eventually taken over by Lloyds Bank in 1999.



Alexander Webster
(1708–1784)

Wallace published *A Dissertation on the Numbers of Mankind in Ancient and Modern Times* in 1753. Wallace's thesis was that the ancient world was more populated than the modern world and he included seven suggestions to increase population growth. The book was read before the Philosophical Society, and population was a deeply debated issue in Scotland during the time.

Alexander Webster published a defense of the Methodist movement in 1742. Webster gave fiery sermons that drew people to church who did not normally go. Webster also published the details of the methodology behind the pensions for the widows of ministers including the calculations, setting forth the principles on which his scheme was based in about 1742 or 1748.

In 1754, Webster published his *Zeal for the Civil and Religious Interests of Mankind Commended,* describing modern finance as a mix of scientific and biblical interests. Webster's work was so influential that in 1755, he was commissioned to obtain data for the first census of Scotland.

Why was the widows and orphans fund successful? Simply because the fund was never mismanaged or looted by corrupt politicians and bureaucrats. The fund was entirely private. On May 12, 1743, Wallace was elected the Moderator of the General Assembly of the Church of Scotland. The assembly approved his scheme, which enabled him to submit it to the Lord-Advocate in London who framed it into a legislative measure and superintended its safe progress into an act. The Scottish Church cultivated a grassroots democracy where church members were held accountable (unlike politicians). Wallace was elected to run the fund, not because of his connections to a politician. He developed the mathematical calculations that served as the fund foundation.

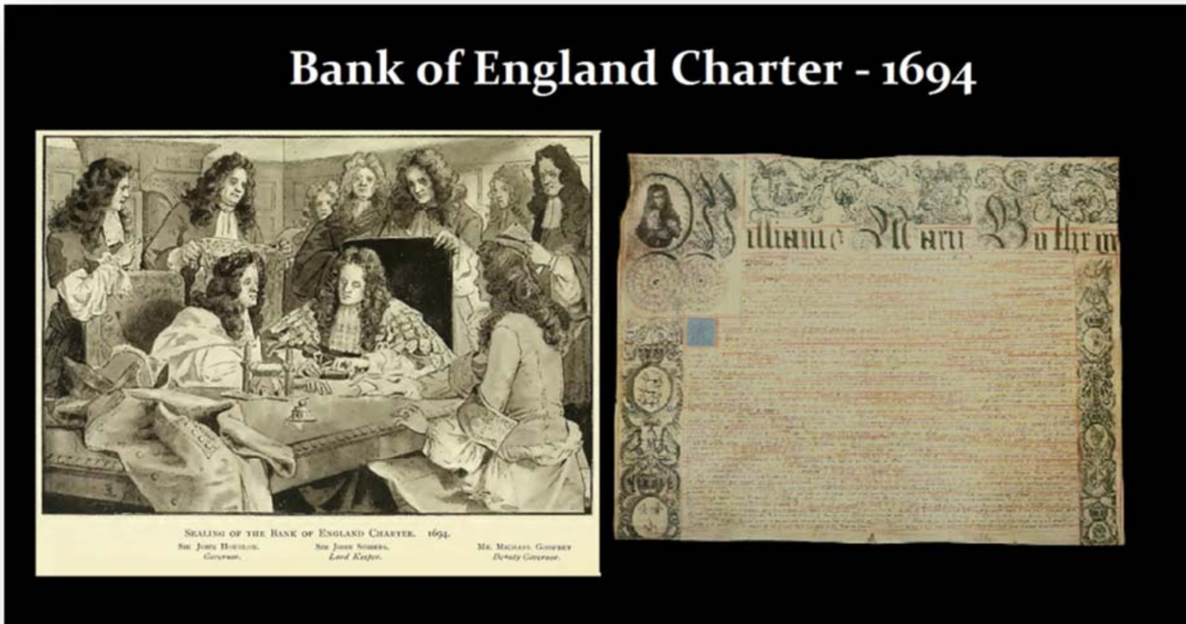
The Widows' Fund became a capitalistic or free-market enterprise. If private men created Social Security instead of politicians, then they would have actually invested money and remained solvent rather than creating a slush fund for government. This is why governments collapse. Governments are simply run by people who love power. They possess the power to write law and decide who shall be prosecuted, yet they are exempt from the same laws that govern all other men.

4.2 The Bank of England and Growth of Annuities

The British national debt grew tremendously following the expense of the Thirty Years' War and battles in the colonies. After England's brutal defeat by the French Navy in the Battle of Beachy Head in 1690, the monarchy desperately needed to rebuild the British navy. No public funds were available and the British were already in debt by £30 million. The credit of William III's government was so low in London that it was impossible for it to borrow the £1,200,000. It was this economic decline and the collapse in public confidence that led to the establishment of the Bank of England. The Bank of England was born out of funding the war with France. It was all about financing the government.

William III of Orange
(1650; English King 1688-1702)

The Scotsman Sir William Paterson led the move by the merchants to create the Bank of England. While parliament initially rejected Patterson's idea, it merely took the shortage of money to turn the tide, leading to the establishiment of the Bank of England three years later. In 1694, the first Earl of Halifax, Charles Montagu, proposed a loan of £1.2m to the government. Financing was so tight that there was a service charge of £4,000 on top the 8% interest rate charges. Montagu's plan was based off Paterson's initial proposal.

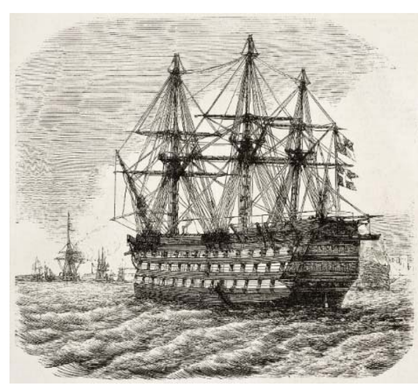


Parliament granted the Royal Charter through the passage of the Tonnage Act of 1694. The charter awarded to The Governor and Company of the Bank of England included exclusive rights to handle government finances, lending the government money and then lending against these government notes.

Old Lady of Threadneedle Street (Bank of England)
Pursued by William Pitt to persuade her to Issue Banknotes

The Bank of England would become known as the "Old Lady of Threadneedle Street." This royal charter established a monopoly, as was the case in Sweden, affording the bank tremendous advantages. It was clear from the outset that the Bank of England was created to fund the government.

The financing of the Bank of England was essentially the first preferred share prefaced on the concept of an annuity, which promised annual payments into perpetuity. These preferred shares were a hybrid between a bond with a fixed payout and an equity stake in the Bank of England. Early Bank of England certificates indeed used the word “annuity” at the top of each document issued to the purchaser. The demand for annuities was strong in England and helped to fund the government and Navy.

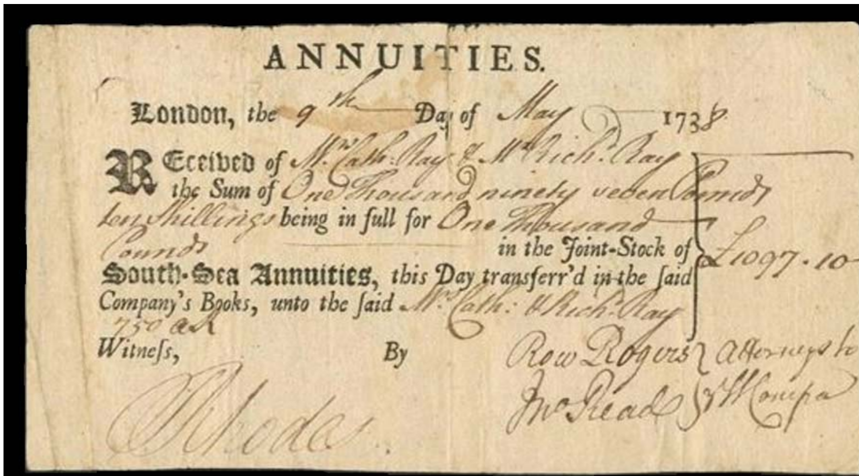


1694 Banknote of Bank of England

In later years, Bank of England certificates replaced the term “shares” with the more familiar term “annuity,” further refining annuity products and features, as providers do today. Because interest rates changed routinely with economic conditions, annuities changed repeatedly with the times as well. The evolutionary process of the annuities over the 100-year period between 1780 and 1880 saw a growth of different types of annuities including: consolidated annuities, Navy annuities, reduced annuities, and the notorious, albeit short-lived, new annuities. As the colonies grew and related conflict grew expenses, the promotion and sale of annuities flourished as a result with Parliament ever dependent upon such a win-win money-raising instrument. The ever-growing variety of annuities and rates of interest caused a good deal of confusion.

It was during February 1719 when it was explained to the House of Commons that they could swap the national debt by converting the annuities issued after the 1710 lottery into South Sea stock. The pitch was attractive. By act of Parliament, the South Sea company was granted the right to issue £1,150 of new stock for every £100 per annum of annuity the public would surrendered. The government would pay 5% per annum on the stock created, which would reduce their debt expenses by 50%. The conversion was voluntary, not mandatory, and amounted to £2.5 million in new stock if the public had converted all outstanding issues. The South Sea Company was to make an additional new loan to the government pro-rata up to £750,000, again at 5%.

The South Sea Company formally presented the offer to the public during July 1719. Curiously, it had been in March when there was an attempt to restore the Old Pretender, James Edward Stuart, to the throne of Britain. A small landing party took place in Scotland. They were soundly defeated at the Battle of Glen Shiel on June 10. This is when a rumor spread that the Old


ANNUITIES.

London, the 9th Day of May 1738

Received of Mr. Cath: Ray & Mr. Rich: Ray the Sum of One Thousand ninety seven Pounds ten Shillings being in full for One Thousand Pounds in the Joint-Stock of South-Sea Annuities, this Day transferr'd in the said Company's Books, unto the said Mr. Cath: Rich: Ray

£1097.10

Witness, By Row Rogers Attorneys to Jno Read

1738 South Sea Company, Annuities, Inscribed stock certificate for transfer of £1000

Pretender had been captured. This created a wave of optimism and that manifested in the share price of the South Sea Company rising from £100 to £114. Annuitants were still paid out at the same money value of shares, and the South Sea Company was keeping all the profit from the price advance. It was during this boom that two-thirds of all outstanding annuities were swapped or exchanged.

As early as 1751, Parliament enacted a radical consolidation of securities into one, single issue. This instrument carried a fixed 3% annual rate, which lawmakers dubbed the “consolidated annuity.” Others dubbed it the “perpetual bond” or “consol,” which had no maturity date and was redeemable at any time deemed appropriate by the British government.

Consolidated annuities became very popular. They were widely respected as a solid retirement instrument that provided guaranteed income for elderly citizens. The consolidated annuity became so popular, in fact, that during the late 19th century, and well into the early 20th century, this instrument represented more than half of England’s national debt! Aristocrats and wealthy merchants used annuities to protect themselves from descending into poverty due to investment or gambling losses, thus protecting the family name and reputation.

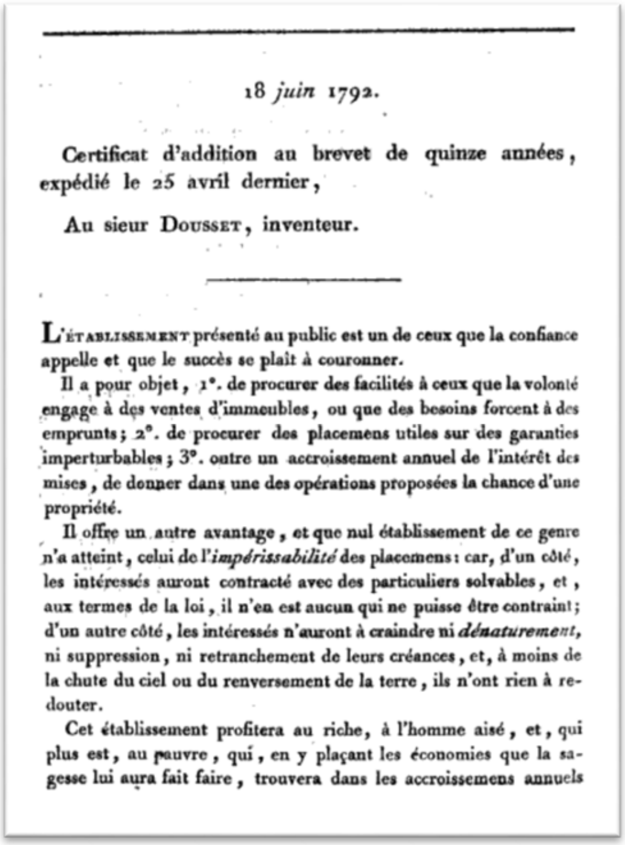
In contrast to England, annuities were slower to rise to popularity in the United States given its rural economy. The first known American annuity producer was the Corporation for the Relief of Poor and Distressed Presbyterian Ministers and Distressed Widows and Children of Ministers whose mission was to protect survivors of deceased ministers. As the War of 1812 began, The Pennsylvania Company for Insurance on Lives and Granting Annuities began offering annuities to the general public, although the demand was low was given the agrarian economy. Large extended families lived on family farms and ranches. The elderly continued to do small chores on the farm while the extended family cared for them. Eventually, the industrial revolution combined with the migration to cities drove the demand for annuities, as workers could not continue to perform industrial jobs as they aged.

V. Tontines The Original Group Annuity

Tontine Coffee House of Wall Street
Origin of New York Stock Exchange

The tontine was one of the first forms of a group annuity. The tontine was similar to a single-premium life annuity in which the buyer pays an initial lump sum, and in return is promised a growing stipend for life. Tontines attractiveness were due to the growing payout. As each holder died, the remaining pool of cash was distributed to the remaining holders, which allowed large payouts for the last survivors. In essence, the value of each share devolved to the other participants rather than the shareholder's heirs as in life insurance. The combination of retirement security with the possibility of high windfall payouts for the last survivors made tontines quite a popular financing scheme for the crown who was burdened by large war expenses and had limited taxing ability.

The name “tontine” comes from Italian financier, Lorenzo de Tonti, who pitched a tontine scheme to the French government in the 17th century as a way for King Louis XIV of France to raise money.



18 *juin* 1792.

Certificat d'addition au brevet de quinze années, expédié le 25 avril dernier,

Au sieur Dousset, inventeur.

L'établissement présenté au public est un de ceux que la confiance appelle et que le succès se plaît à couronner.

Il a pour objet, 1°. de procurer des facilités à ceux que la volonté engage à des ventes d'immeubles, ou que des besoins forcent à des emprunts; 2°. de procurer des placemens utiles sur des garanties imperturbables; 3°. outre un accroissement annuel de l'intérêt des mises, de donner dans une des opérations proposées la chance d'une propriété.

Il offre un autre avantage, et que nul établissement de ce genre n'a atteint, celui de l'*impérissabilité* des placemens: car, d'un côté, les intéressés auront contracté avec des particuliers solvables, et, aux termes de la loi, il n'en est aucun qui ne puisse être contraint; d'un autre côté, les intéressés n'auront à craindre ni *dénaturement*, ni suppression, ni retranchement de leurs créances, et, à moins de la chute du ciel ou du renversement de la terre, ils n'ont rien à redouter.

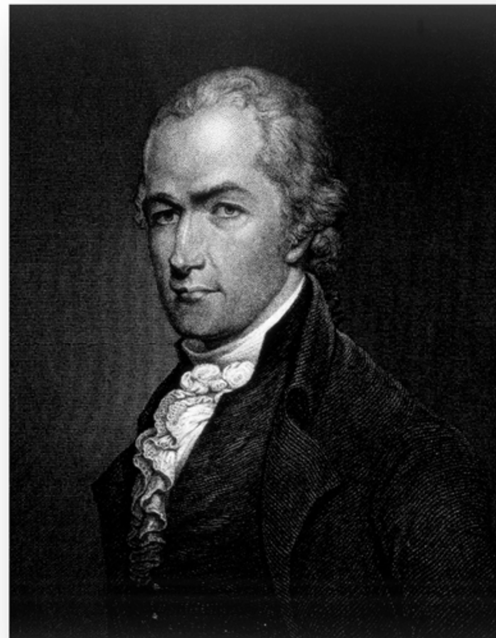
Cet établissement profitera au riche, à l'homme aisé, et, qui plus est, au pauvre, qui, en y plaçant les économies que la sagesse lui aura fait faire, trouvera dans les accroissemens annuels

Tontines were less expensive to administer, and so their payouts were much higher. The costs of annuity administration stem, in part, from paying the insurance company to shoulder all the risk. To provide assurance that it can make good on all its annuity contracts, the insurer has to set aside large cash reserves for longevity and market risks. Investors share the longevity and market risk in tontines, thus reducing the administrative expense.

Tontines appealed to the gambling spirit, as those lucky enough to outlive the others would be rewarded with a large payout. The tontine paid more over time as other participants died. Although unknown today, tontines go back at least half a millennium. Similar to states moving to legalize gambling, the same took place during the 16th century as governments began to compete for those eager to buy annuities, and hence the ***tontine*** was one way of beating the competition. Annuities were appearing in Holland, England, and most other European nations rather than bonds. The crown was constantly looking for revenue to pay for on-going battles with neighboring countries, and the tontine was like Manna from heaven with no requirement to repay the capital. When the last nominee or annuitant died, the principal reverted to the treasury, thus providing the crown with windfalls.

The idea did not catch at first, but became widespread throughout Europe decades later as rulers sought new financing mechanisms to finance the wars. Tontines were slow to gain popularity in England where investors preferred annuities. Only after many years of war against France, England reportedly created the first known as the ***State Tontine*** of 1693.

In France, the tontine became a Ponzi scheme where nominees had to wait until sufficient numbers died before receiving payments while the state received annual payments leading it to fall out of favor in Europe relatively quickly. With the French government closing down, the tontine scheme was effectively banned and more sophisticated forms of annuity programs were developed.



Alexander Hamilton proposed a tontine in the 18th century to pay down the national debt after the Revolutionary War. While the federal government chose other financing schemes, local communities occasionally used tontines to raise money for large projects. Several buildings and roads along the east coast were financed through tontines.

As Americans left their farms for cities, the demand for retirement products rose. Factory workers could no longer work into old age, and as families started to disperse, the elderly did not want to be a burden on their children. Before Social Security, IRAs, corporate pensions, and 401(k)s, tontines provided retirement and paid more than other investment options. To meet demand, the large insurance companies were quick to develop a hybrid insurance product with a tontine payout. At their peak, tontines represented nearly two-thirds of the American insurance market, holding about 7.5% of national wealth. It is estimated that by 1905, there were nine million active tontine policies in a nation of only 18 million households. Tontines became so popular that historians credit them for single-handedly underwriting the ascendance of the American insurance industry.

The downfall of the tontine in America was equally dramatic. The insurance-based tontines resembled an insurance policy with a tontine kicker rather than a true tontine with the forfeiture of benefits if a single payment was missed. Annual payments were often deferred for the first 10-20 years, thus creating large balances sitting on the books of insurance companies. Agents and directors embezzled these cash balances while bribes were paid to newspapers, judges, and legislators. Shortly after the turn of the century, the lavish lifestyle created a boardroom crisis at Equitable, the nations largest insurer, and ended with a Senate investigative panel. In 1906, New York State launched a major investigation into the insurance market that resulted in the banning of tontines. The demise of the tontine in the US led the rise of the corporate pension. Although the investigation was centered on corporate grafts and corruption, tontines remain outlawed and their name is synonymous with greed and corruption.

VI. Modern Pensions

Modern public pensions began as a way to entice military enlistment and were limited, resembling disability plans rather than retirement income. In the United States, the first pensions were offered by individual colonies to men who defended the communities from Native Americans. During the American Revolution, the Continental Congress offered pensions consisting of half-pay to officers, soldiers, and sailors who were disabled in service and incapable of earning a living. To attract and retain officers, half-pay for seven years was offered to officers who served until the end of the war with soldiers receiving a one-time payment. Seven years of half-pay was later extended to widows and orphans. As prosperity increased, coverage for the American Revolution Pensions increased and extended pensions to invalid veterans.

Britain and several European countries offered pensions to officers and troops in the 16th century. The first modern civilian pension was for an official working for the London Port Authority who received half his pay for the rest of his life funded through the salary from the pay of his replacement.

General public retirement pensions have their roots tied to socialism. In 1889, German Chancellor Otto von Bismark introduced modern retirement pensions to pre-empt a growing Marxist movement in Germany. Bismarck offered pensions to anyone over the age of 70 when the average age expectancy was only 45. It was not until 1916 when the retirement age was lowered to 65.

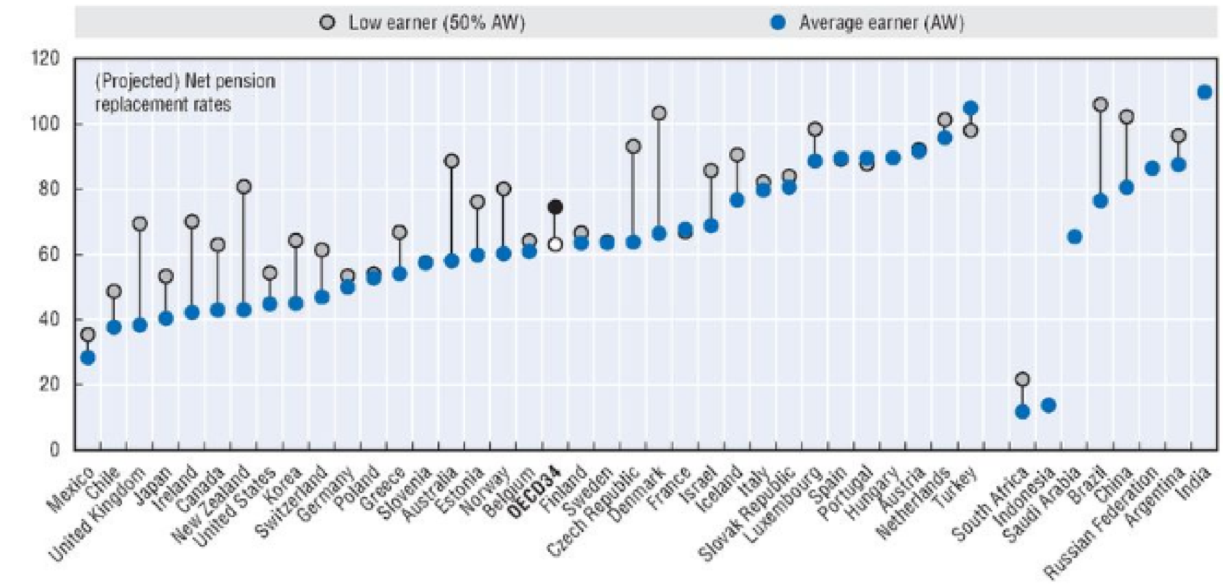
Lincoln Motor Company - 1922 Towncar

In 1911 in the United States, Massachusetts established the first retirement pension plan for general government employees with retirement ages starting from 62, 65, or 70 depending upon the job profile. Pensions were capped at a 60% of the average salary over the last ten years of service. The original plan resembled a cash balance plan that required workers to contribute. The state purchased an annuity equal to twice the accumulated value (with interest) of the employee's contribution, thus the state did not take the longevity risk.

One of the first old age pensions was established in 1908 by the United Kingdom to protect the elderly from poverty. UK's Old Age Pension was offered to people over 70 years of age based upon income. More comprehensive public pensions were offered in the UK in 1946, including guardians, orphans, widows, unemployment, and general retirement.

The United States created Social Security in 1935, and added Medicare in 1965. Social Security started, not due to the demand for retirement income, but rather to convince the elderly to retire, thus providing more jobs to the youth during the Great Depression. Industrial companies were happy to have seniors retire as they had higher sick leave and were slower. Retirement remained unpopular through the 1950s until Madison Avenue transformed idle time into playtime for seniors.

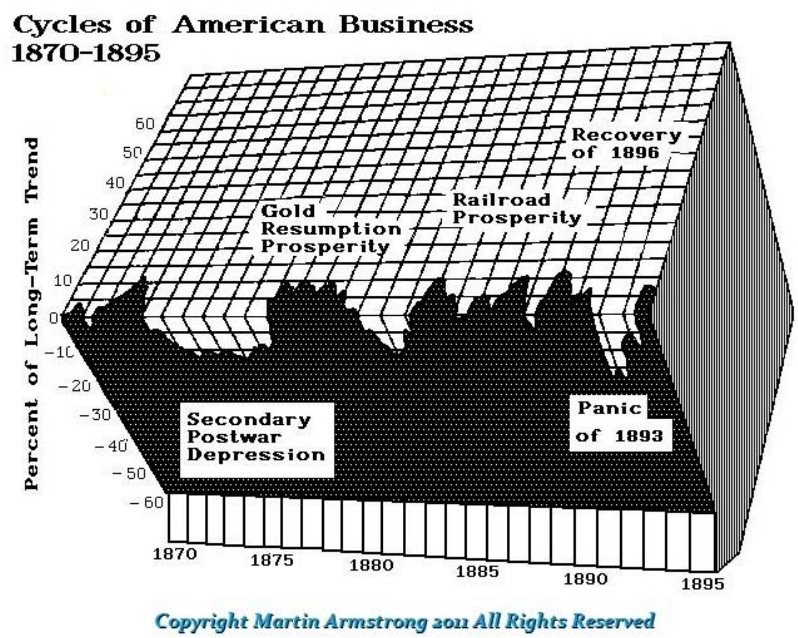
Figure 1.7. **Future net replacement rates for low and average income earners in OECD and G20 countries**



1 Source: OECD (2015), Pensions at a Glance 2015: OECD and G20 indicators, OECD Publishing, Paris.

As government spending fell following World War I and World War II, politicians expanded entitlement programs with current pensions offering replacement rates of up to 100% and retirement ages that have not kept up with longevity trends. These generous benefits have squeezed governments and workers alike with contribution rates as high as 45%. These are typically pay-as-you-go schemes. With retirees becoming an increasing share of the population, government budgets are being tested.

VII. Private Pensions



It was not until the early part of the 20th century when the concept of the group annuity or pension took hold and the corporate pension was born. The goal of the original corporate pension aimed to replace 50-60% of a retired worker's former salary. During the Great Depression, the demand for annuities and pensions grew as Americans valued stability and fiscal security as banks failed. Insurance companies were seen as stable institutions that could make the promised payouts. A new emphasis was put on saving for a "rainy day."

Baseball legend, Babe Ruth's story helped highlight the benefits of annuities to society. Babe Ruth survived the 1929 stock market crash through the proceeds of his annuity while other celebrities ended up in the breadline.

Annuities in the late 1930s and early 1940s were comparatively simple, offering a fixed return during accumulation periods and guaranteed safety and return on principle. The annuitant could choose a fixed, lifetime income or payments over a set number of years. The annuity was then considered a solid tool for tax and guaranteed-income planning. It allowed for capital appreciation, preservation, and asset protection, which made it an ideal estate-planning instrument with the value-added aspect of providing creditor protection in many states.

In response to the American appetite for risk, the variable annuity was introduced in 1952. The variable annuity offered a guarantee of principal, yet allowed capital to be invested in more speculative vehicles, thus offering greater risk and reward.

The variable annuity was a precursor to the mutual fund, which emerged in the 1960s. During the 1980s, annuities lost market share to 401ks that were invested in mutual funds. The 401ks offered lower fees and more control over assets as high fees, hefty surrender charges, and transaction costs burdened annuities.

Annuities are experiencing a resurgence following recent market swings as investors are seeking the low risk, asset preservation features of annuities. The combined sale of fixed and variable annuities reached $98.5 billion in 1985, growing to $155 billion in 1999, and now top $200 billion. Few workers have access to pensions and investors have little confidence in global financial markets, which has caused them to invest in real estate and collectibles. Meanwhile the focus has shifted to the large fees carried by 401ks, specifically targeting date funds. Given the large lobbying efforts of the insurance companies, Congress has continued to favor annuities. The Tax Reform Act of 1986 reduced the ability of Individual Retirement Accounts to defer tax liabilities for investors, thus strengthening the tax-deferred appeal of the annuity. In return, funds invested by insurance funds are regulated by the government.

VIII. The Welfare State

The Socialist and Communist parties have actually proven to be the worst possible form of government under the pretense of a welfare state, for they have both destroyed the citizens' character and relieved them of their self-survival instinct by pretending that government is doing that job for them. What has proven to be far worse was the claim that government would be there from birth to death, which reduced population growth by eliminating the need to have children. Historically, a couple had numerous children to ensure their own retirement since the children took care of them in their old age. Under socialism and communism, children are relieved of such family responsibilities. Family size has shrunk since the pre-Depression days. Even Japan's population has been declining. This has had a profound impact on the welfare state created by governments whom expect to fund this through taxation.

Welfare schemes are Ponzi schemes under socialism whereby there is no investment, and instead the current workforce pays for retired workers through taxation. In 1920, Charles Ponzi was viewed as the shrewd miracle man of Boston's Hanover Street district. Ponzi had promised his clients a 50% profit in 45 days. At times, police had to control the crowds who often fought while in line outside of his office. On busy days, it took 14 policemen to keep the crowds in order.

Charles Ponzi
(1882–1949)

Ponzi's famous scheme was to buy postal reply coupons in countries where foreign currencies had depreciated against the dollar. Under postal agreements, you could buy a reply coupon and send it to a friend, who in turn would take that coupon and redeem it for U.S. postage equivalent on a fixed basis to pay for the "reply." While the scheme had its critics, everyone had to admit that it was possible to profit in such a way because of the rise in the value of the dollar. The critics could only question whether someone could buy enough coupons to create a business venture in that manner. It was a foreign exchange scheme that was sound in its proposition.

The fraud came when Ponzi failed to do what he said he would. Ponzi merely took money from the second customer and handed it to the first, thereby creating satisfied customers to go around and honestly brag about how much they had made. This is the essence of a Ponzi scheme: there is no actual investment. Just as Ponzi discovered, sooner or later, cash flow cannot keep up with the payments and hence the scheme collapsed when there was not enough new money coming in to pay old money.

When the Ponzi scheme collapsed, there were runs on banks and several of Boston's trust companies, which caused them to fail since borrowers had leveraged themselves and could not pay back their loans. As 1931 began, the creditors of his scheme finally received their checks in the mail, which represented 0.5% of their original investment made prior to his arrest in 1920. They called Ponzi the "duper extraordinaire" and "master and personification of the quick buck."

Ponzi will forever be remembered for his scheme that had no rational basis whatsoever, whereas if he had invested and lost, that would be an entirely different issue. Nonetheless, government, always exempt from the criminal law itself, created the welfare state on the very same structure of Charles Ponzi. The entire welfare system is based on Ponzi rather than the Wallace-Webster fund that actually invested money. The problem with government is that it becomes so corrupt, exonerating itself from the rule of law, that they could never create a legitimate fund for they just cannot keep their hands out of everyone's pocket. They disagree over investments because they all want the money for their own self-interest, and thus nothing is ever possible except a Ponzi scheme.

Governments of Europe and America have followed Ponzi rather than Wallace-Webster. This gigantic social experiment has crumbled into dust because politicians and bureaucrats are exempt from the rule of law and fear nothing if their schemes fail. This is now putting everything within our social structure at risk, as people will be very upset when they discover the Ponzi scheme has collapsed. No one is truly prepared for retirement in a wholly new world. Work ethics and family structures that existed since the dawn of time have been altered by socialism. The sudden shock will confront society in a more profound way than when the Berlin Wall fell and Germany had to absorb the citizens who did not know how to work under communism. This modern economic miracle with a secular its "entitlement culture" has dangerously pushed society to the breaking point.

A fascinating aspect of former communist countries is that people do not rely upon or trust the government. Consequently, the older generations do not trust government and therefore rely upon them less for their future survival. The people of these former communist states always have a back-up plan that often includes being able to grow their own food. In the modern West, people expect the government to take care of them, making this trend especially damaging from a social-economic perspective.

The rising unemployment among the youth has created a diminished workforce that people expected would support the previous generation. We are now faced with a massive interclass and intergenerational conflict that political movements merely attempt to solve by class warfare. These trends are also creating conflicts that challenge ethical and cultural norms and are giving rise to nationalism, racism, and finger pointing to cast the blame for broken dreams. While expanding populations, such as the postwar American baby boom, fueled global prosperity with skilled workers and eager consumers, low fertility rates have resulted in an aging demographic with lackluster growth. Rising pension and healthcare expenses compound the effects of slow economic growth. While the data clearly indicates the need to raise retirement ages, politicians lack the incentive to do so. Raising retirement rates is highly unpopular and strong bond market with low rates.

The whole idea of the pension system and Social Security is turning to dust and crumbling to the ground for structural reasons. Pensions were by no means a modern invention, yet the original modern pensions were targeted the disabled with the goal of replacing 50% of income versus the generous payouts of many public pensions today. In addition, modern pensions, after all, were designed to be self-sustaining investments that would allow employers to attract and retain a loyal and dedicated workforce. There was a time not so long ago when politicians, business leaders, the press, and investors all paid little mind to the issue of pension solvency. However, there are two major traps for pensions surviving. Of course, there is the risk of administration in the failure to properly manage the funds when there is no real investing. However, there is a second trap that everyone seems to have overlooked. If we dare to glimpse beyond the present, we will see a force that is far more potent than anyone ever expected—the distortion of the bond market.

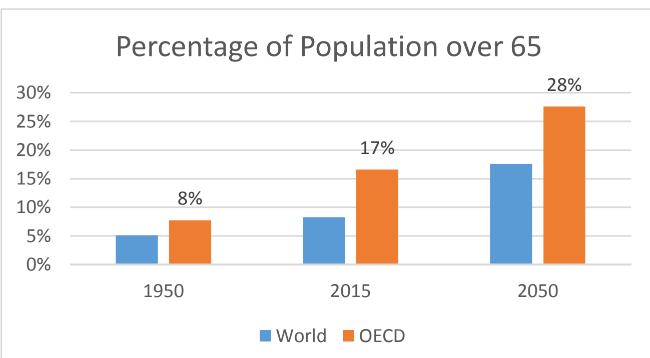
IX. The Demographics Snowball

Demographic trends of an aging global population are increasing pressures on the government budgets and pensions. Increased life expectancy and falling birth rates are causing the elderly to be a growing percentage of the population. Not only are pension liabilities coming due, but there are less people in the workforce per retiree to pay for those benefits.

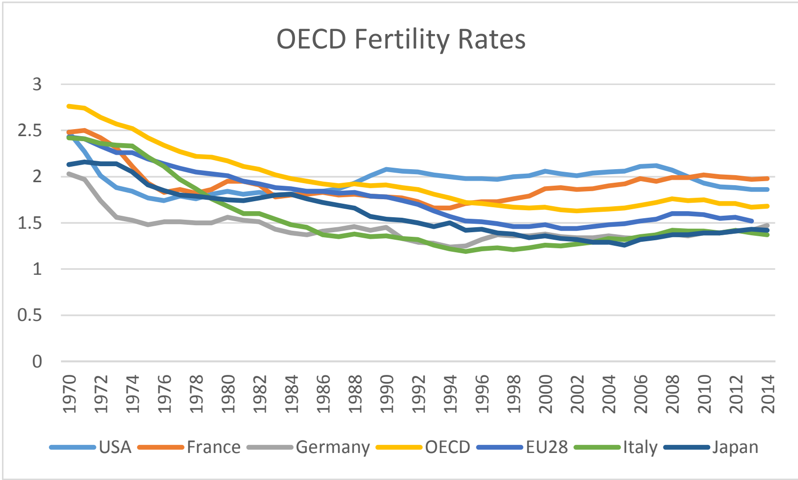
Life Expectancy at Birth
(based on the child mortality rate)

Era	(years)
Upper Paleolithic	33
Neolithic	20
Bronze & Iron Age	26
Classical Greece	28
Classical Rome	20–30
Pre-Columbian N th Am	25–30
Medieval Islamic Caliphate	35+
Medieval Britain	30
Early Modern Britain	25–40
Early 20th Century	31
World Average 2010	67.2

The share of individuals over 65 years of age will increase from 8% in 2015 to 18% by 2050. In OECD countries, the percentage of population will increase from 17% in 2015 to 28% in 2050, which will put an enormous strain on budgets of pay-as-you-go plans as well as underfunded plans. Public pension spending across OECD countries represents 8% of GDP on average. About half of the OECD countries have undertaken pension reform, mainly by increasing contributions, raising retirement ages, increasing incentives to work thus enlarging the contribution base and reducing payments. Meanwhile government debt has ballooned from 55% of GDP in 2007 to 88% in 2014 in OECD countries, adding the risk of rising interest expenses when bond yields rise.



Increased life expectancy has increased pension liabilities, adding further stress to the system. This increase has been led by technological advancements in medicine that have also caused sharp increases in senior healthcare by further increasing government obligations. In many countries, the age for qualification was set at 65. Life expectancy in the US was 59.7 years during the 1930s when Social Security was implemented, whereas the Social Security actuarial table now projects male life expectancy at 75.9 years and female at 80.81 years. The governments made promises and imposed taxes, yet have not adjusted contributions and retirement ages for shifting demographics. Global longevity risk is estimated to be between $15 to $25 trillion with each year adding 3-4% to the present value of the liabilities. To help pension funds cope with this longevity risk, a market in swaps, hedges, and bonds has emerged that actually introduces additional risks akin to those of the complex mortgage securities at the heart of the 2008 financial crisis.



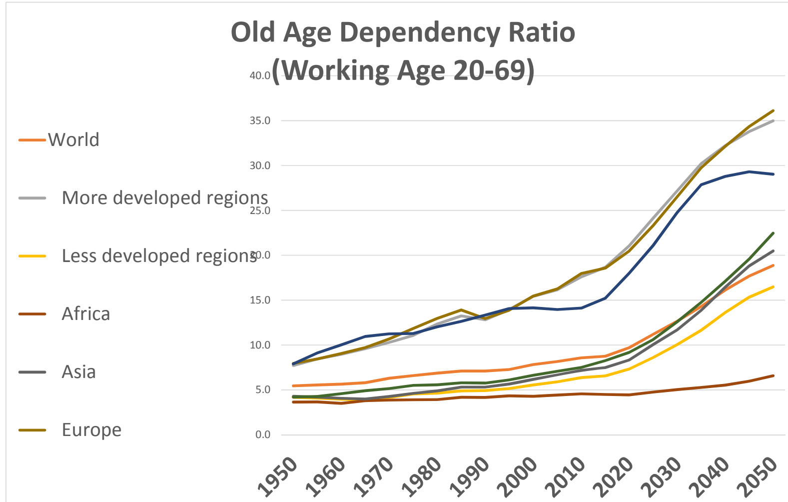
Declining birthrates compound the burden of a rapidly aging population. There has always been a historical inverse correlation between birthrates and economic advancement. This is not a modern development as it extends back in time to all empires from the birth of civilization. From ancient times, the more successful a society becomes, the less children they produce. As the people become wealthier, they no longer need that economic security of a family to take care of them in their old age. As society has become more dependent upon government for retirement, marriages have become temporary as couple seek love over financial security. Couples are marrying later in life, divorcing more, or even cohabitating without taking vows. These trends combined with modern birth control are contributing to falling fertility rates.

During the 20th century, falling fertility rates collapsed in the West and the East. Between 1800 and 1900, family size declined from 7.0 to 3.5 children in the United States as young couples left their agrarian life for industrialized cities. Thanks to the Great Depression, by 1933, the average family size declined to 2.3 children. Despite declining child mortality due to medical advances, the average child per woman has declined from the early 1900s to 1.7 in 2014 in the OECD. Fertility rates in Europe are troublingly low, averaging 1.5 children, which is far below the replacement rate of 2.1.

Part of the reason for the lower fertility rates is that couples in more affluent societies tend to get married later in life. The average age of marriage for women in the US has risen from 23 in the 1950s to over 26.5 in 2011, leading to a smaller family size. Modern contraception and reproductive health care systems have also allowed couples to have more control over family size. Furthermore, as taxes have risen sharply post-1950 to pay for Social Security and Medicare, women lost the right to stay home and raise their children, which forced families to evolve into two-wage earners. The fiscal strain on families has increased as the cost of daycare has skyrocketed to consume most of the income of the second wage earner.

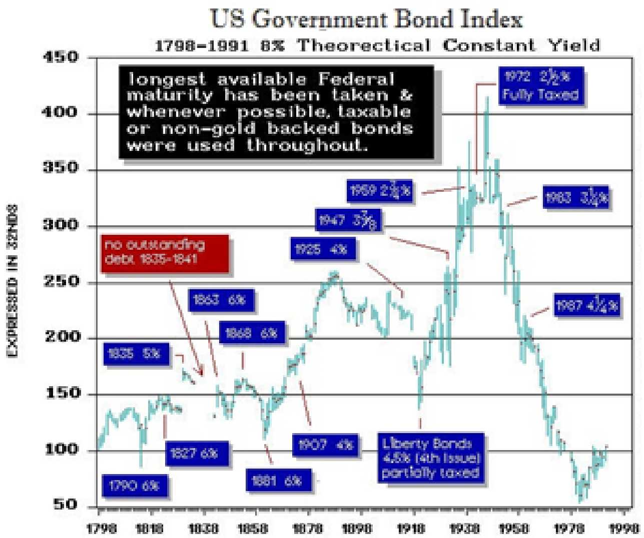
Fertility rates in Asia have fallen severely falling from an average of 5.8 in the 1960s to 2.1 in 2014. Burdened with feeding a rising population, the Chinese implemented a one-child policy in 1979. The devastating ramifications of this policy are starting to emerge as China's working-age population will shrink over the next two decades. Furthermore, the one male child usually goes off to the cities, leaving parents without support in their old age. China has enacted a law requiring children to make frequent visits to their parents or face fines. The law also allows parents to sue their children for failure to provide mental and financial support. Some elders are forced to offer their estates to girls from South East Asia who come to China and care for them in their old age. In coming years, the decline in the working population will be enough to strip more than two percentage points from China's annual economic growth.

Lower birth rates combined with increased life expectancy are causing the age-dependency ratios to climb to unsustainable levels, reducing the ability of Social Security and all pension funds to remain solvent because there are fewer people to work to pay for the older generations. The global working-age population has peaked at 7.2 billion and is now slowly declining; generating a rapidly rising population of non-working retired seniors. The old-age dependency ratio, the age ratio of the elderly as a share of the working age, is projected to reach 41.4% by 2030 from only 13.6% in 1950 in more developed nations. Even if retirement ages are raised to 70, the old-age dependency ratio is projected to reach 27.2% by 2030 and 35.0 by 2050. The OECD projects the increase in health and long-term care alone will consume between 3.5% and 6% of GDP.



Compounding the effects of the rising dependency ratio, the age of socialism has altered society with governments replacing the family structure to provide stability in old age. While children have been relieved of the social burden to care for their parents they have been left with high taxes to pay for these entitlements, which strain economic growth. The replacement of the family with government has been destabilizing to society as a whole with families dependent upon the state that may yet result in a massive collapse of Western civilization.

X. Distortion of the Bond Market

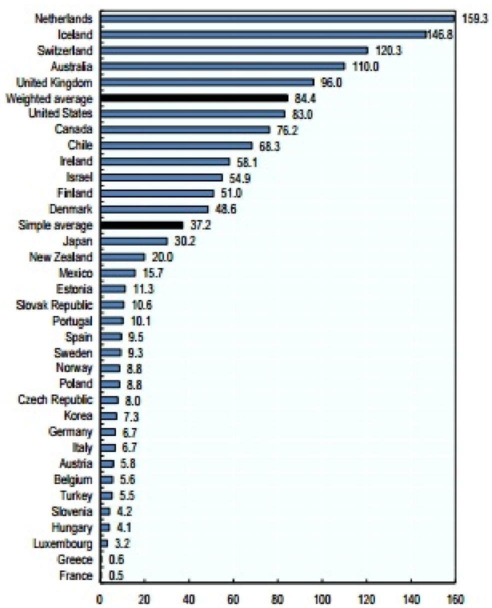


If we dare to glimpse beyond the present, we will see a force that is far more potent than anyone ever expected: the distortion of the bond market with low and even negative bond rates. The growing aged population has actually been rewriting the rules for both markets and economies as assets peak and growth rates collapse.

Along with an aging population, pension assets are approaching the size of the sovereign debt market. In 2014, pension assets in OECD countries equaled 84.4% versus debt to GDP of 68.3% in 2013. This shift in demand and a large supply of capital has caused the dramatic decline in long-term interest rates overall, and has contributed to the change in trend since 1981. This is creating frequent brushes with deflation as too much capital seeks long-term bonds for stability. This is now driving pension capital into more speculative investment vehicles seeking a return. Meanwhile, low bond rates are reducing investment returns needed to pay pension benefits and are causing funding ratios to fall.

Figure 3. Importance of pension funds relative to the size of the economy in the OECD, 2014

As a percentage of GDP

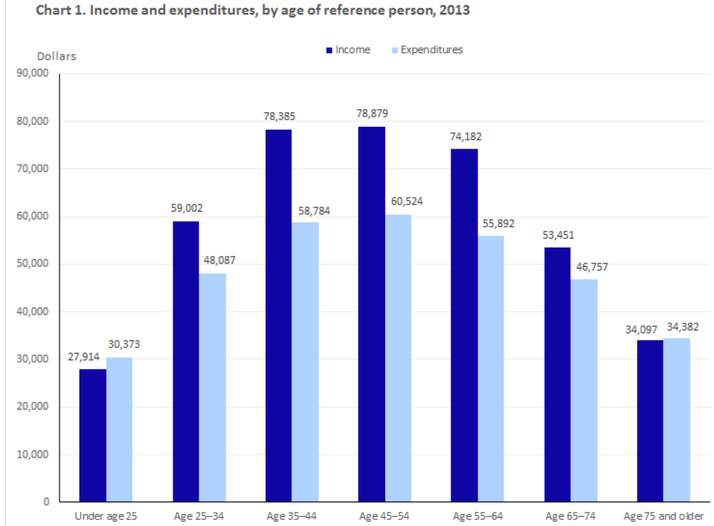


2 Source: OECD Global Pension Statistics, Pension Markets in Focus, 2015

Adding to the distortion, central bankers desperate to stimulate the economy have implemented negative interest rates in Europe and Japan. Central bankers' traditional tools are proving grossly ineffective as the older population who tends to spend less money dominate the economy. Spending peaks during the ages of 45-54 according to data from the US Bureau of Labor Statistics. Quantitative Easing programs to stimulate growth are merely compounding the trend in motion that now threatens to collapse pensions and totally bankrupt many municipalities. These trends have caused the sharp, consistent decline in long-term rates causing them to collapse from the 8% average, which was long considered the norm, to almost zero. While politicians hope that governments will be able to inflate their way out of debt, there will be no inflation as long as rates remain low. This has created an entirely new force within economics and the illusion that government could simply borrow into oblivion without any impact or consequence.

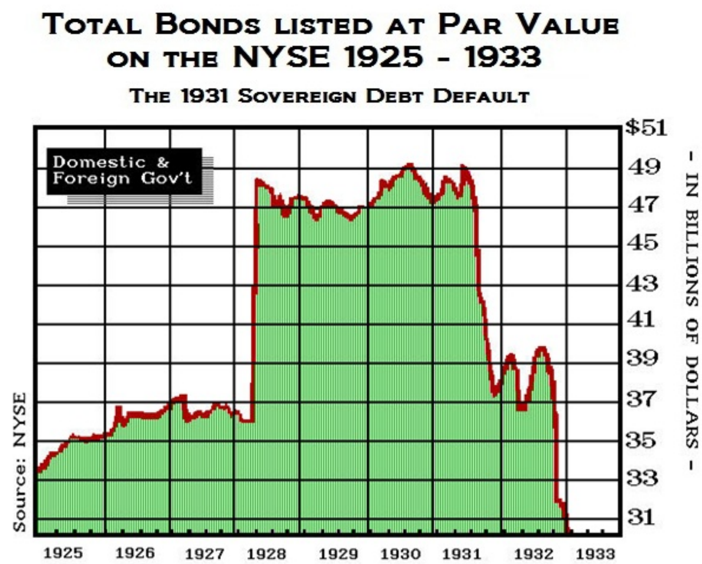
The aftershocks of QE1-QE3 have rippled through the pension funds and wiped out the expected income in the very market where the demand was the greatest—the long-end. It is now beginning to dawn on both regulators and economists that global aging and socialism have produced massive promises for pensions and threatens to unleash a financial crisis that may undermine everything. Chronically weak economic growth has been the result of government competing with the private sector for capital to fund their chronic debts. This has set the stage for a far more volatile international economy as we look ahead and the risk of the next financial crisis will be felt directly in the solvency of pension funds.

Chart 1. Income and expenditures, by age of reference person, 2013



Source: U.S. Bureau of Labor Statistics.

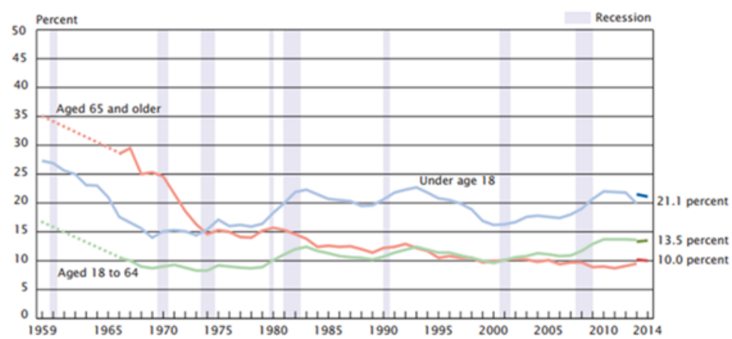
Investors continue to view sovereign bonds as the safety trade in general by assuming that government pays its debt and thus it is less risky than private debt. A look at corporate defaults of blue chip companies finds exactly the opposite trend. No blue chip company has defaulted, and even in bankruptcy you get something back whereas government defaults result in total loss. The spread between public and private debt dropped by more than 50% as FDR came to power in 1933. The USA did not default during the Great Depression, resulting in deflation as the dollar rose to record highs, but in 1931, there was a massive wave of global government defaults, which for the most part permanently wiped out capital formation.



XI. The Rising Tide of Pensions

The whole idea of creating a pension system and Social Security is turning to dust and crumbling to the ground for structural reasons. Pensions were by no means a modern invention, yet the original modern pensions targeted the disabled with the goal of replacing 50% of income versus the generous payouts of many public pensions today. With few retirees and a large baby boomer workforce, politicians increased pension benefits while ignoring rising longevity projections. Pension benefits have become so generous that the poverty risk has shifted from the elderly to the youth and even the working age. Poverty rates of people aged 18 to 64 are now higher than those past the age of retirement in the United States. To compound matters, many people graduate college with large student debt that cannot be forgiven in bankruptcy.

Figure 5.
Poverty Rates by Age: 1959 to 2014



Note: The 2013 data reflect the implementation of the redesigned income questions. See Appendix D for more information. The data points are placed at the midpoints of the respective years. Data for people aged 18 to 64 and 65 and older are not available from 1960 to 1965. For information on recessions, see Appendix A. For information on confidentiality protection, sampling error, nonsampling error, and definitions, see <ftp://ftp2.census.gov/programs-surveys/cps/techdocs/cpsmar15.pdf>.
Source: U.S. Census Bureau, Current Population Survey, 1960 to 2015 Annual Social and Economic Supplements.

11.1 United States

Politicians have continued spending beyond their budgets while robbing pensions of their assets. Nations, states, and municipalities have funded basic government programs and healthcare at the expense of pension contributions and have created funding deficits. Compounding returns only magnify the deficit over time. While the US Social Security Trust was established to invest excess payroll taxes, these funds have been spent for general purposes and have left an intergovernmental ledger entry of $2.85 trillion as of September 2015.

Country	Recent Year	Total Pension Spending (% GDP)
Ukraine	2010	17.80
Italy	2009	14.90
Serbia	2010	13.70
Greece	2010	13.50
France	2009	13.30
Poland	2010	11.90
Austria	2009	11.80
Portugal	2009	11.60
Slovenia	2010	11.20
Belarus	2010	11.00
Hungary	2010	11.00
Montenegro	2011	11.00
Croatia	2010	10.60
Germany	2009	10.60
Bosnia Republika Srpska	2009	10.30
Japan	2009	10.10
Latvia	2010	10.00
Belgium	2009	9.80
Romania	2010	9.50
Bosnia and Herzegovina	2009	9.40
Bulgaria	2010	9.20
Czech Republic	2010	9.20
Finland	2009	9.10
Estonia	2010	9.00
Malta	2010	9.00

As the population ages, entitlement program costs are straining budgets. As governments paid down war debt, they expanded entitlement programs that now encompass up to 31.0% of GDP in France, including 13.8% for old age pensions and survivors. To meet promised benefits, contributions to the entitlement programs need to be increased by roughly 8% of GDP for the US and Europe.

At a time of rising government obligations, government debt has hit peak levels. Gross government debt of OECD countries has increased from 55% of GDP in 2007 to 88% in 2014, partially due to fiscal stimulus enacted during the global financial crisis. Politicians simply keep spending. Only five major countries are expected to have a balanced government budget in 2016: German, Norway, Switzerland, Singapore, and South Korea. US government debt reached 104% of GDP in 2015, the highest since the all-time high of 121.7% in 1947. This excludes unfunded liabilities of Social Security and Medicare, which the US Debt Clock estimates at over $100 trillion. Total US debt including federal, state, corporate and household debt totals almost $170 trillion, $47 trillion more than the total estimated assets of $123 trillion. Government deficits are at highs just as demographics are causing a rise in pension obligations and straining public budgets.

While the IMF and governments globally, hunt for more taxes, the policymakers fail to realize that tax rates cannot be raised without stunting growth. High taxes hinder economic growth. Even the OECD has produced studies demonstrating that the higher the tax rate, the lower the economic growth and the greater the decline in living standards.

	Contribution Rates		
	Social Security (all programs)		
	Employee	Employer	Total
Italy	8.9	36.4	45.3
Austria	17.2	25.2	42.4
France	9.8	32.4	42.2
Colombia	8.0	33.4	41.4
Netherlands	22.5	18.8	41.3
Germany	20.2	20.6	40.8
Argentina	17.0	22.7	39.7
Ukraine	2.8	36.7	39.5
Slovenia	15.7	9.6	38.0
Belgium	13.0	24.8	37.8
Spain	6.3	31.1	37.3
Croatia	20.0	17.2	37.2
Uzbekistan	2.5	34.5	37.0
Czech Republic	11.4	25.0	36.4
India	13.8	22.4	36.1
Serbia	17.9	17.9	35.8
Portugal	11.0	23.8	34.8
Slovak Republic	9.4	25.2	34.6
Singapore	20.0	15.5	34.5
Algeria	9.0	25.0	34.0
Hungary	9.5	24.0	33.5
Latvia	9.0	24.1	33.1
Romania	11.0	21.6	32.6
Mexico	2.4	28.5	30.9
Lithuania	2.5	28.3	30.8

Take Japan and Spain as examples. When Japan raised its sales tax from 5% to 8%, GDP growth fell 7% in the next quarter. As Spain raised its VAT tax from 18% to 21% in 2012, GDP contracted 3.1% while youth unemployment peaked at roughly 55% in 2013.

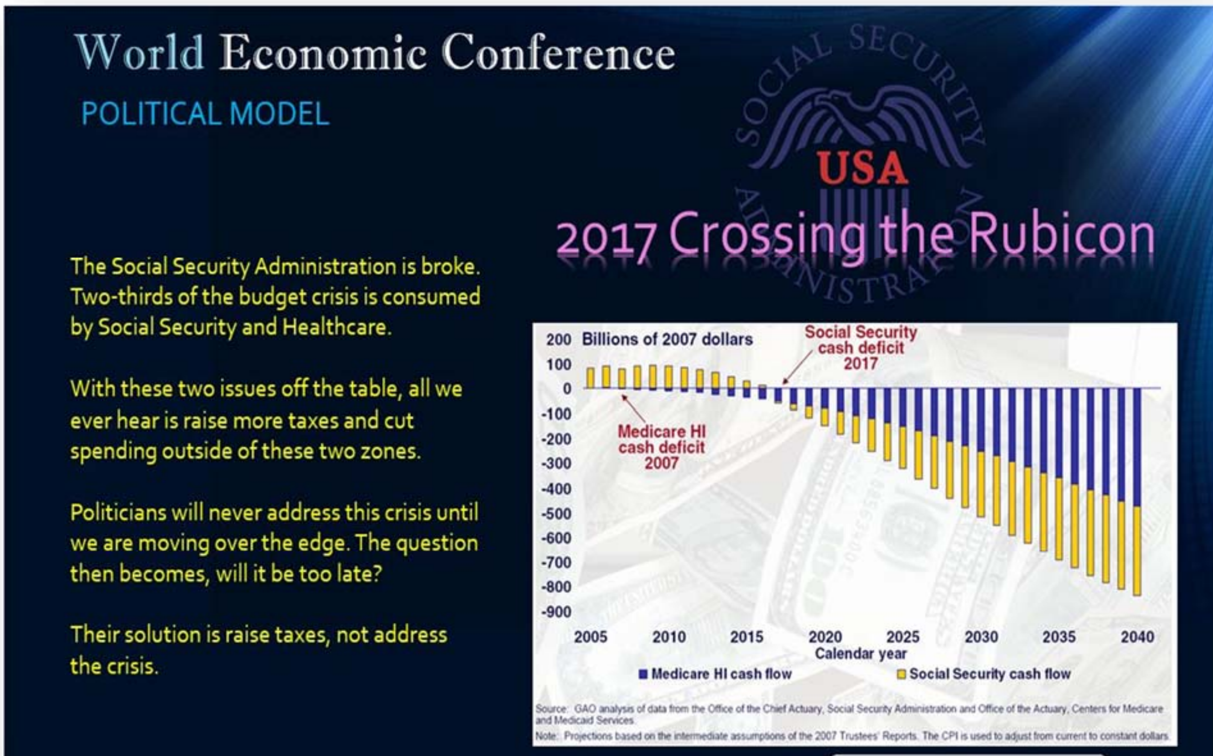
Employment taxes are already high, providing a determent for employers to hire full-time workers and encouraging the displacement of jobs with robots. People flock to opportunity as seen by the migration to Hong Kong. Within the United States, citizens are moving from high-tax states in the Northeast and California in favor of lower tax states such as Texas and Florida.

In Europe, the youth are leaving aging countries with limited opportunity such as Greece and Spain in favor of the United Kingdom. This migration compounds the problem by causing debt per capital to rise forcing further tax increases. Politicians like to blame the “rich,” yet continue fail to grasp the real cost of the entitlements.

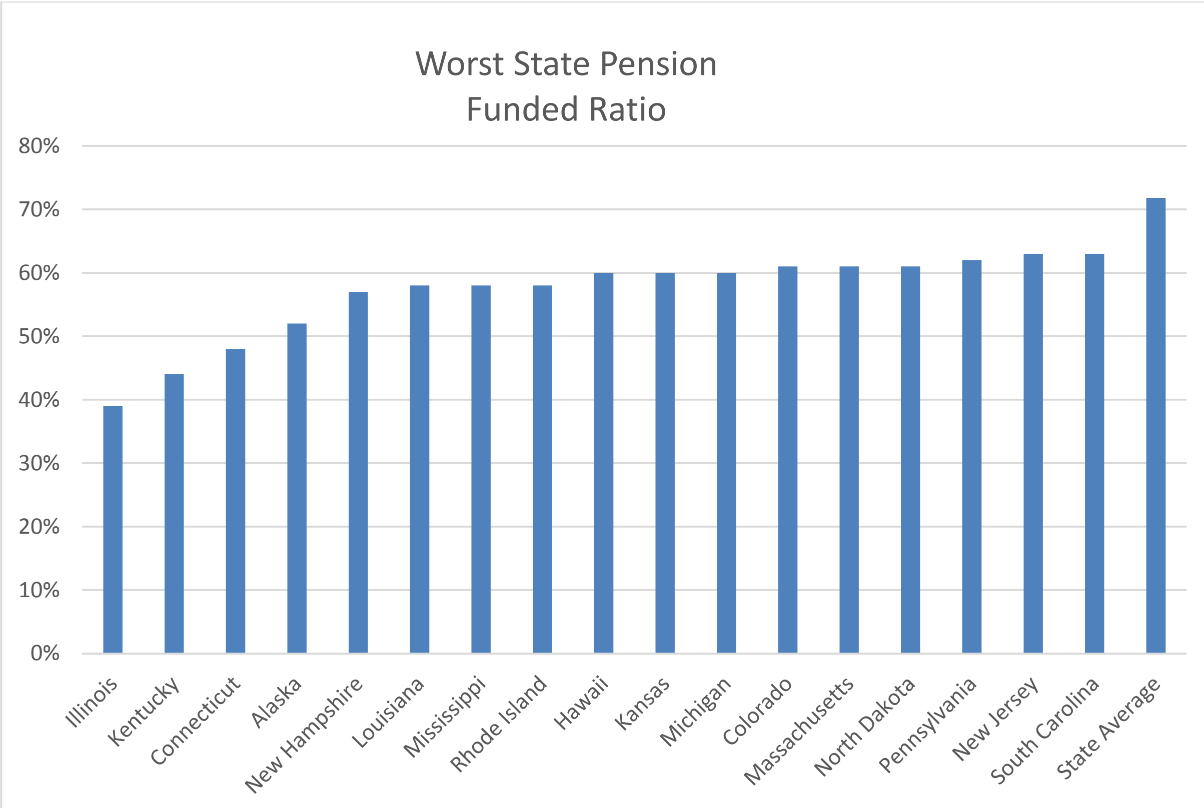
Faced with an aging population and rising taxes, economic prospects are grim. Expectations for global GDP growth are muted with the Conference Board outlook at 2.4 percent in 2016 and 2.7 percent in 2017. European GDP has failed to breach 1.0% since 2007. This trend is influenced by high employment costs that have accelerated the replacement of jobs with internet-based technology, such as online retailors replacing bookstores.

Many of the countries facing the largest fiscal problems and civil unrest are also those who spend the most on pensions, including Greece, Brazil, and Ukraine. Greek pension expenditures totaled

16% of a dwindling GDP in 2014 after many pensions had already been cut by up to 48%. Ukraine tops the list by spending 17.8% of GDP on pensions largely due to the pay-as-you-go system, low retirement ages, and poor demographics. Brazil currently spends 13% of its GDP. Analysts have cited Brazilian pension as one of the largest drags on the economy. Brazil's newly appointed finance minister is making the pension system sustainable a priority. Despite favorable demographics, generous benefits have stressed the system with the average Brazilian drawing 70% of final pay at the age of 54. The massive slowing of real income in Europe and the OECD is creating serious political problems and are contributing to rising civil unrest.



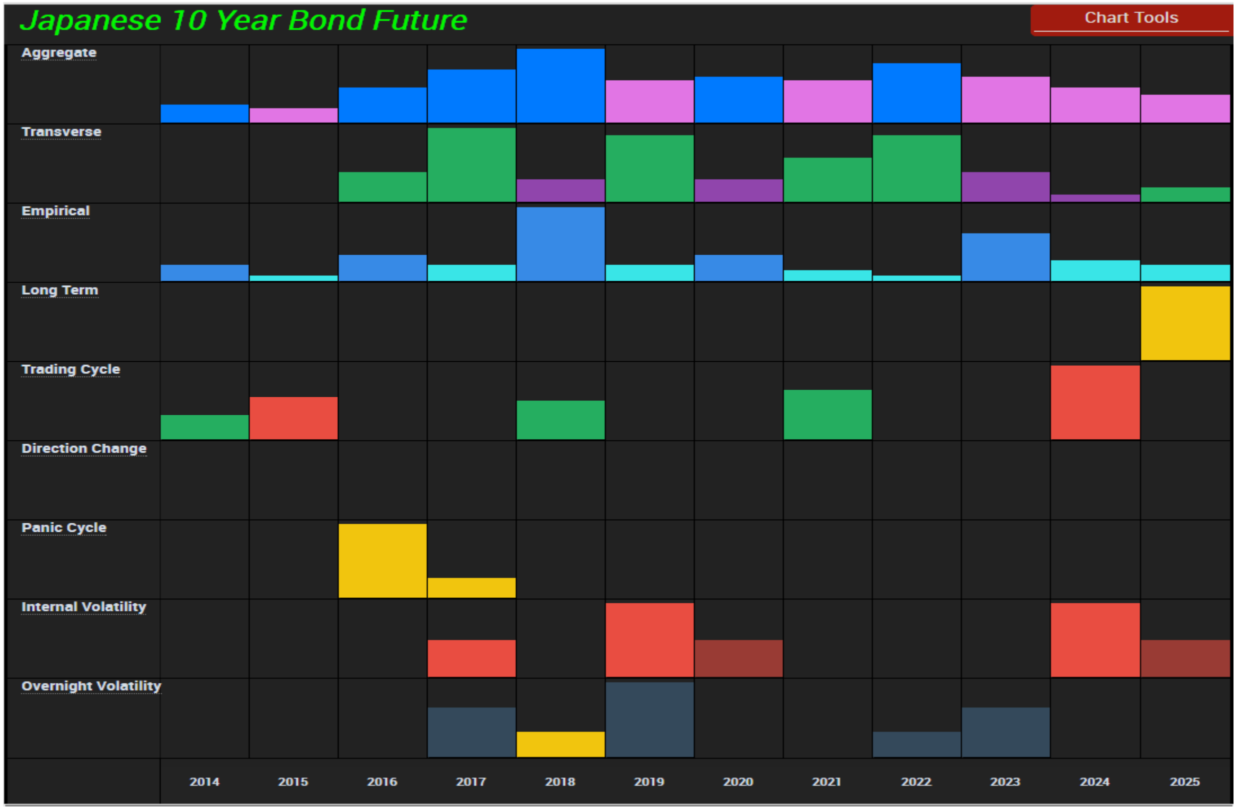
Entitlement spending in the United States has risen from less than 1% of GDP at the turn of the century to 17% with pension spending at 6.8% of GDP and healthcare spending at 7.5% of GDP in 2015. Growth of entitlement programs have matched gross domestic savings since 1965, suppressing economic growth as seen by middle-class wages. Social Security becomes cash flow negative next year in 2017. Analysts estimate that the federal taxes would need to increase by 8.2% of GDP to fully fund Social Security and Medicare. It appears we are facing the collapse of Social Security, which began August 14, 1935 (1935.619), because the politicians made increasing promises without the proper funding. We could see the end of this Social Security program by 2021.772 (October 9, 2021), or about 89 weeks into the next business cycle.



While Social Security and Medicare are large issues, unfunded entitlements of state and local governments are more serious given the inability to print money. Seven states including Virginia and Tennessee have agreed to phase out defined-benefit plans for certain employees. On the flip side, seven states have specific clauses to protect public employee pensions including: Alaska, Arizona, Hawaii, Illinois, Louisiana, Michigan, and New York. New Jersey is now voting on a constitutional amendment to prioritize pension funding on the November 2016 ballot. New Jersey will be sent into an economic crisis as we have seen in Illinois.

While states do not have the ability to file for bankruptcy protection, cities can. Many cities such as Chicago, Houston, New Orleans, San Jose California and Syracuse, NY are seeking to reform its pensions, but state laws often prohibit municipalities from changing benefits. Government workers as a rule always exempt themselves whenever possible from the same checks and balances that private citizens are subjected to.

Pension costs in San Jose totaled 20% of its $1.1 billion budget in 2012. Florida, Illinois, and Oklahoma are considering legislation to allow local governments more leeway to reduce benefits for new employees and even existing employees. Alaska has the highest unfunded liability per capita at $19,394 followed by Illinois at $15,158.



11.2 Asia

Japan's aging population and growth problems are well known. Its dependency ratio is quickly approaching 50%, implying only two workers per retiree. With Social Security comprising a third of the government budget, the government has become a conduit by transferring assets from the youth to the elderly. While cuts to entitlements are desperately needed, strong voting participation of the elderly make it difficult. The list of measures implemented by the Bank of Japan are long in an effort to spur inflation, yet growth and inflation remain sluggish. Japan's government debt is more than two times its GDP, yet politicians are unable to reduce the government deficit that is currently 6% of GDP. Further sales tax increases are continually pushed out into the future as the last sales tax increase from 5% to 8% in April 2014 caused annualized GDP growth to drop 7.9%.

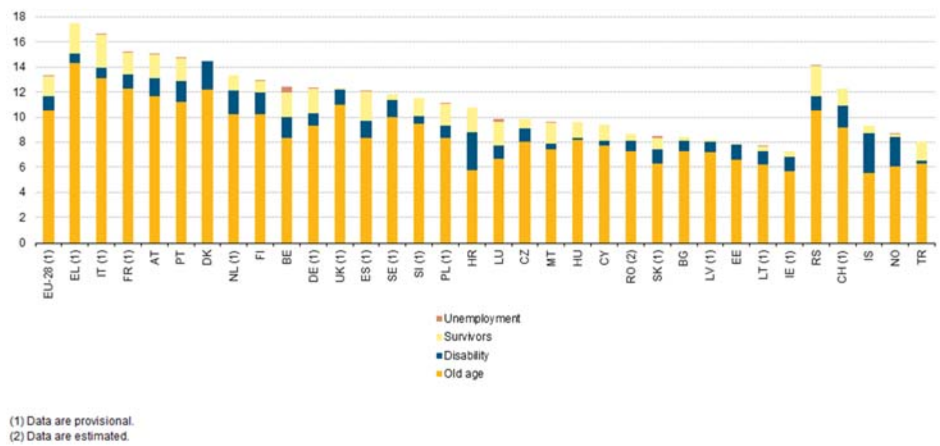
Meanwhile, the demand for JGBs remain strong as the Bank of Japan continues to purchase 80 trillion yen annually and now owns a third of the supply. Developed countries are following the Japanese model, using quantitative easing to try to stimulate growth and inflation. Economists assume interest rates will stay low as Japan's interest rates have remained low for decades. The bond market is much larger than the central banks and the market will prevail.

Chinese pensions are also at the heart of the provincial debt issue. Prior to 1978, China's central planning maintained tight control over the economy by offering secure jobs in state-owned sectors with guaranteed benefits including low-cost housing, healthcare, and pensions. In 1978, pension benefits were expanded to entice older workers to retire, thus providing opportunities for youth. Demographics along with generous benefits have made these pension benefits unsustainable. The working-age population began its decline in 2012. There are currently three workers for every retiree, yet this is set to fall to 1.6 workers per retiree by 2050. China's retirement age was set in the 1950s when life expectancy was still below 45. The current retirement age is 55 for women and 60 for men with typical income replacement of 75% for government workers following 20 years of work. These pensions were funded by the government or state-owned enterprises themselves on a pay-as-you-go (PAYG) basis. As private competition grew, SOEs were no longer able to provide generous benefits and more workers fell outside of the system.

Following protests of unpaid pensions, China passed major pension reforms including a three-tiered system, adding individual accounts to complement the PAYG system and expanding the programs to private employers in 1997. As historically most of the pensions were offered by state-owned enterprises, the provincial and municipal governments ran the pensions resulting in roughly 2,500 separate funds run by local governments. As it became more difficult to pay beneficiaries, the funds borrowed money from pre-funded plans. A report in 2012 put the missing amount at $353 billion. In 2006, a pension scandal in Shanghai alleged that one-third of its pension assets were invested in private real estate and toll road projects leading to the dismissal of Chen Liangyu, the Shanghai Party Chief, and Politburo member from the party.

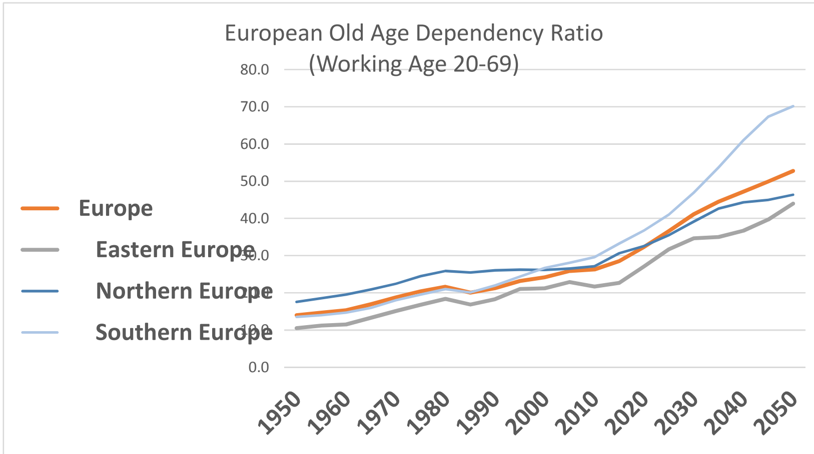
As pension expenses grew, China implemented another major reform in 2015, requiring public workers to contribute 8% of pay to the pension, which matches private sector workers. Private companies have to contribute as much as 20% to urban pension funds. These reforms also attempt to close the gap between benefits for government workers, which are often 80-90% of salary and benefits for private sector employee, which is often below 50%. China's pension problems are at the root of its debt problems with an estimated R$2.6 trillion deficit (USD$353 billion).

11.3 Europe – The Core of the Sovereign Debt Crisis



Europe has some of the most generous entitlements with the lowest retirement ages in the world. While the official retirement age in France is 61, its effective retirement age is only 59.4. These generous benefits lead to some of the highest employment taxes that only inhibit employment needed to pay for current retirees. These generous benefits are a tremendous strain on government budgets. Old age pensions consume over 10% of government budgets in the EU.

Pension contributions by employers make it expensive to hire employees. Italy has the highest pension contribution rate of 45.3% of salary with the employer contributing 36.4%. Official employment taxes paid by employers in France total 50%, which includes a 16.45% complementary pension contribution. Employees contribute an additional 30% of income including an 11% pension contribution. These high contribution taxes are driving up employment costs and contributing to high youth unemployment. Italy has one of the highest youth unemployment rate, which peaked in 2015 at 42%.



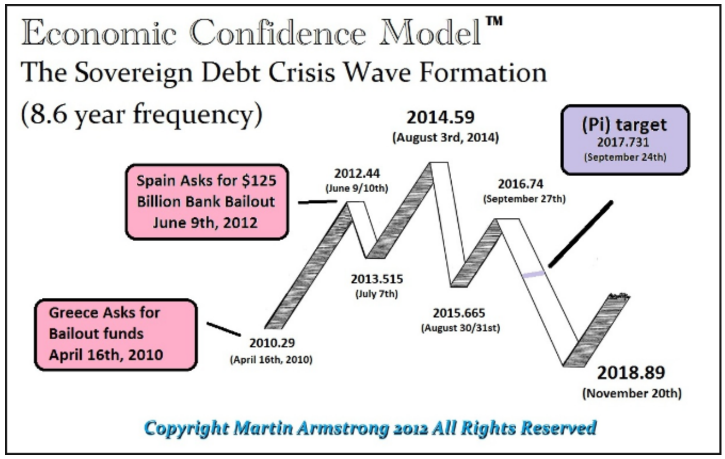
2 Source: EuroStats

Europe's old-age dependency ratio is expected to reach 50% by 2050, yet the situation is more severe in Southern Europe where the old-age dependency ratio is already 30% and is expected to 70% by 2050. The dependency ratio helps explain the languished growth and budgetary issues. Note that many of the countries at the forefront of the Sovereign Debt Crisis, as well as civil unrest, spend upwards of 14% of GDP on pension benefits including Greece, Italy, France, and Portugal. European countries will be required to publish estimates of unfunded pension beginning in 2017.

Meanwhile, low interest rates and even negative interest rates are pressuring returns of pension assets by compounding the issues. While pension managers realize the risk of owning bonds at record price levels, regulations often limits exposure to riskier asset classes. Fifty-one percent of the average European pension was invested in bonds. Norwegian and Portuguese pensions had 60% and 59% of their funds invested in bonds respectively. Large bond exposures will only exasperate the pension issues as rates rise and bond prices fall.

The Sovereign Debt Crisis is unfolding right on schedule beginning in Europe where the dependency ratio is one of the highest, and generous entitlements are curtailing growth. Eurozone peripheral bond yields began rising in 2010, peaked in 2012, only to bottom in 2014. Peripheral yields have recently begun rising again following the Brexit vote as the strength of the European Union is once again called into question. The Brexit vote has sparked the call for similar referendums in several countries and signals the loss of the strongest member. In addition, the terrorist attack in Nice, France, along with continued violence of immigrants has challenged the sustainability of the Schengen Agreement, which allows free travel among EU member countries. The pension crisis, the Sovereign Debt Crisis, and civil unrest are all interrelated.

11.4 Reform



To help offset the fiscal strain, many pension reforms are being discussed but few OECD countries have implemented extensive reforms. Australia has tightened the asset test to qualify for the Old Age Pension while Spain is adjusting the pension benefits to new retirees based upon life expectancy. Several countries have passed legislation for future retirees from up to 67 and 68 years yet these changes are being implemented gradually through 2030. The political will to reform is lacking as long as governments can borrow at these historically low rates.

With low and even negative interest rates, politicians have little incentive to pass unpopular reforms such as raising retirement ages and cutting benefits. The bond market is fooling governments into thinking that they can borrow to perpetuity. When the bond market does correct, government interest costs will implode adding further pressure to government funding. As government funding becomes more scarce, the risk of pension confiscation will increase.

There is precedence. In 2008, Argentina nationalized nearly $30 billion in private pension funds as it sought funds to repay loans. Greek pension plans wrote down roughly 60% of their reserves due to losses on Greek government bonds, which were mandated holdings. More recently, Poland transferred 51.5% of the net assets of privately managed pension funds to the Social Insurance Institution in 2014. The amount transferred equaled the amount invested in public bonds. In the US, Supreme Court ruling Tibble v. Edison has opened the door for the federal government to seize private pensions in an effort to "protect pensioners." It is always when capital is scarce when corruption is exposed. The Pension Crisis is the cornerstone of the Sovereign Debt Crisis. As benefits are cut, citizens will lose confidence in government.

XII. Pensions the Achilles Heel

The greatest threat that we face moving forward is indeed the unfunded pensions of government workers. This was precisely the issue that caused the decline and fall of the Roman Empire. As the state could not fund the pensions, the army turned against its own people by sacking cities to fund themselves using the excuse that they supported someone else for emperor. You might assume that receiving a government pension after working for 20 years is another modern socialistic benefit. Actually, the 20-year term to qualify for a pension was a Roman tradition which was used to entice people to sign up for the military just as today people work for government to eliminate any real risk or responsibility. For whatever reason, that ancient tradition of 20 years of service remained as an expected benefit if you work for government. This 20-year term has been handed down throughout the centuries. It governs the pensions of military and most police today in modern society.

Nonetheless, modern socialists have simply ignored the lessons of the past and adopted the **VERY SAME** pension programs and schemes that truly contributed to the decline and fall of Rome. Economically, pensions destroyed the social fabric of Roman society precisely as they are doing once again in our own society. Today, what has emerged as the government employees versus the people such as in Greece, Detroit, and everywhere, is the same trend which infected Rome.

What we have seen in Greece is merely a test run for what we will soon face in virtually all governments – UNFUNDED ENTITLEMENTS.

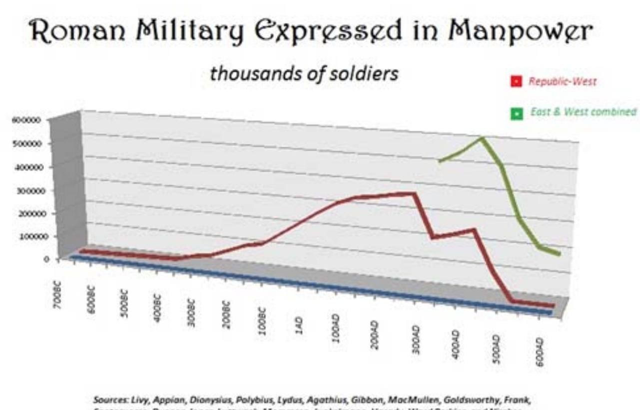
12.1 The Fall of Rome

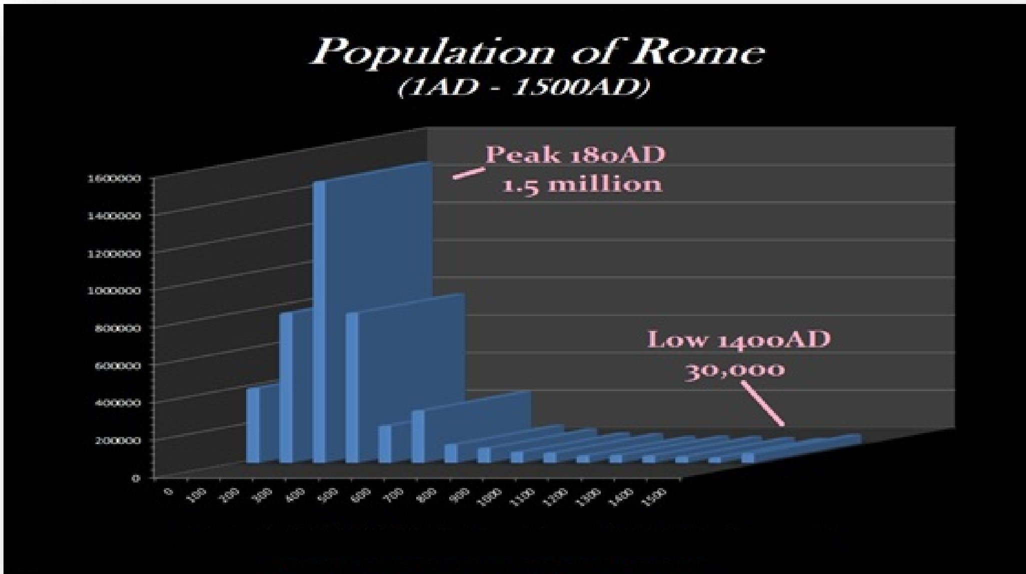
Under Julius Caesar (100-44BC) and Augustus (27BC-14AD), the Roman government established new pay standards whereas donatives (bonuses paid from the spoils of war) to the military were paid in gold ***aurei***. This gradually was transformed into ***expected*** benefits even when there were no spoils from war. When a new emperor came to power, they bought the loyalty of the troops paying a donative upon their accession to the throne.

Augustus
(27BC-14AD)

It was Augustus (27BC-14AD) who first established a personal guard known as the ***Praetorian Guard***, which he paid at twice the wages of the regular army. They were to be in a constant state of readiness to protect his person against any republican zealots ensuring that any rebellion would be crushed. The Romans would not tolerate kings or a police state. Thus, the number of ***Praetorian Guard*** within the city walls was limited to just three cohorts, which during the early Republic was about 480 men, and during the First Century AD had become 800 men.

Marcus Aurelius Antoninus (b 121; 161-180AD) who is regarded as the greatest philosopher emperor marked the pinnacle of the Roman Empire. The peak of the Roman Empire saw the emergence of the understanding of the world and the beginning of international diplomacy between East and West. This was also the peak in the size, scope, and population of the city of Rome – 1.5 million people. The first city to reach that level of population was London during the Victorian Era of the 19th Century.





Following the death of Marcus in 180AD, a vicious downward spiral began to unfold. The greater the threat of political instability, the higher the military pay rose. With the murder of Commodus (180-192AD) ***Praetorian Guard*** who saw themselves as above even the army, auctioned of the office of Emperor. The Decline and Fall of the Roman Empire was in full motion. The Civil War that was unleashed necessitated the victor, Septimius Severus (193-211AD), to increase sharply the pay to the soldiers once again and to relax discipline to secure their favor.


Septimius Severus
(193-211AD)

Severus Alexander (222-235AD) reinstated *Gnaeus Domitius Annius Ulpianus* (c. 170 – 228), who was a fiscal conservative administrator and a chief economic adviser, ***Praefectus Praetorio***. It was *Ulpianus* who implemented the curtailment of the privileges granted to the ***Praetorian Guard***. Ultimately, *Ulpianus* was murdered in the palace when the soldiers rioted over pay.


Severus Alexander
(222-235AD)

Estimated Military Expenditures, 6-235 AD

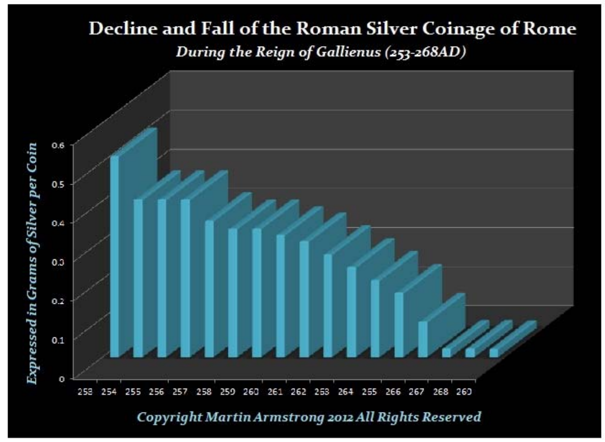
Expressed in millions of Denarii

Table 1.1

Year	Payroll	Retirement Benefits	Equipment and Supplies	Total
6	68	29	27	124
9	60	28	24	112
39-41	66	29	26	121
68-69	69	30	28	127
70	72	31	29	132
83-S6	97	44	39	180
86-92	95	42	38	175
92-100	93	41	41	171
101-32	98	44	39	181
132-61	96	42	3S	176
161-66	100	41	40	181
166-70	104	44	42	190
195	155	70	62	287
215	232	104	93	429
230	236	107	95	438

Source: The calculation of retirement payments (computed at two-thirds of base pay over twenty years) are based on M. Corbier, "Laerarium militare," in Armées e1 *fiscalité*, pp. 220-31.; Kenneth W. Harl "Coinage in the Roman Economy 300BC-700AD (1996).

Historians have recorded the rising wages as well as the **UNFUNDED PENSIONS** that were promised to the military demonstrating their fiscal burden on the Roman Empire. Ultimately, it was the promises of pensions to soldiers in the Roman army that bankrupted the whole Empire. These pensions did not produce income, but rather consumed wealth. This compelled the government to raise taxes and reduce the weight and metal content (debasement) of their currency. However, this debasement would lead a deflationary mode as government then needed to raise taxes causing money to be hoarded. The collapse came swift during the reign of Gallienus (253-268AD) in the course of about just 13 years. The assumption is always that an economy declines gradually like a 747 coming in for a landing. This is just not the case since it is an abrupt collapse in confidence.



The crisis in pensions for the state is simple. If there are ten police officers and five retire, the state then needs to replace them yet it must still pay for the five receiving pensions. The cost of government begins to rise exponentially as funding enters a spiral that always concludes in the state committing economic suicide. As the state tries to sustain itself paying the pensions and the current costs of its existence, rising taxes becomes lethal resulting in the state cannibalizing its own economy. The state turns against the "rich" hunting them down to seize assets under the pretense of law. The ***Rule of Law*** collapses and this eventually leads to capital moving into hibernation.

The state typically then rewards citizens for reporting anyone they suspect may be hiding money. They turn neighbor against neighbor, destroying the very core fabric of civilization—one cohesive bond that forms a society. Once the strings that bind society within a functioning entity are cut, less investment follows as capital is then hoarded resulting in rising unemployment that leads to the total destruction of the economy by state cannibalization.

Civilization is the coming together of people and the great diversity creates a sum of individuals that is greater than the parts. When government turns on its own people, they break those bonds of civilization and the entire process reverses. Capital hoards and people becomes less social therein destroying civilization. It is a delicate process of building a civilization. Government becomes drunk with power and makes the assumption that THEY are the nation and the people are just the great unwashed. This is how the rise and fall of empires, nations, and city states unfold.

12.2 Annuities the Downfall of Mainz

City of Mainz 14th Century

Mainz served as a model of political decline in Germany during the 14th century due to excessive government debt. By 1411, 48% of total expenditures and went to annuities it had issued. By 1436–1437, about 75% of total government expenditure was going to the creditors and interest rates continued to rise. The city of Mainz was forced into bankruptcy when there were no longer buyers for its debt.

By 1448, Mainz owed 373,184 gulden and there were no buyers. Around 60% of the debt of Mainz was held by foreign investors, as is the case in the United States today. The city was placed under imperial prohibition and the pope excommunicated the city for usury. As Mainz raised taxes, the rich fled the city, leaving the remaining citizens to repay the debt. Eventually, Mainz was left impoverished, captured and set on fire.

The problem with government debt is that it is owed by society, not an individual. This injects the problem that historically emerges between the debt and the population, the debt per capita rises requiring higher taxes creating a compounding effect. After the death of Marcus Aurelius (161-180AD) in Rome, government became more and more abusive as taxes rose, people began to leave the city of Rome beginning a trend shift from urban living to suburban causing debt per capital to rise. Hence, looking at the population with the debt of Rome reveals its Achilles' heel. This warns that there is a mechanism inherent within society to ensures its cyclical movement over hundreds of years. The more affluent a society becomes, the lower the birth rate and in turn, this burdens future generations to pay the debts of the previous in greater proportion per capita. As the tax rates rise, the economies stagnate and the youth leave to find opportunity elsewhere. We have already seen this in peripheral Europe.

Marcus Aurelius Antoninus
(b 121; 161-180AD)

12.3 Taxes lead to Rebellions

Rising taxes curtail the economy and eventually end in civil unrest. The very birth of Switzerland was sparked by a tax rebellion. The legend of William Tell defied the Austrian authorities who forced him to shoot an apple from his son's head. The *Chronicon Helveticum* (1734-1736) gives the date November 1307 for the incident of Tell, and 1308 for the liberation of Switzerland, which is subject to debate.

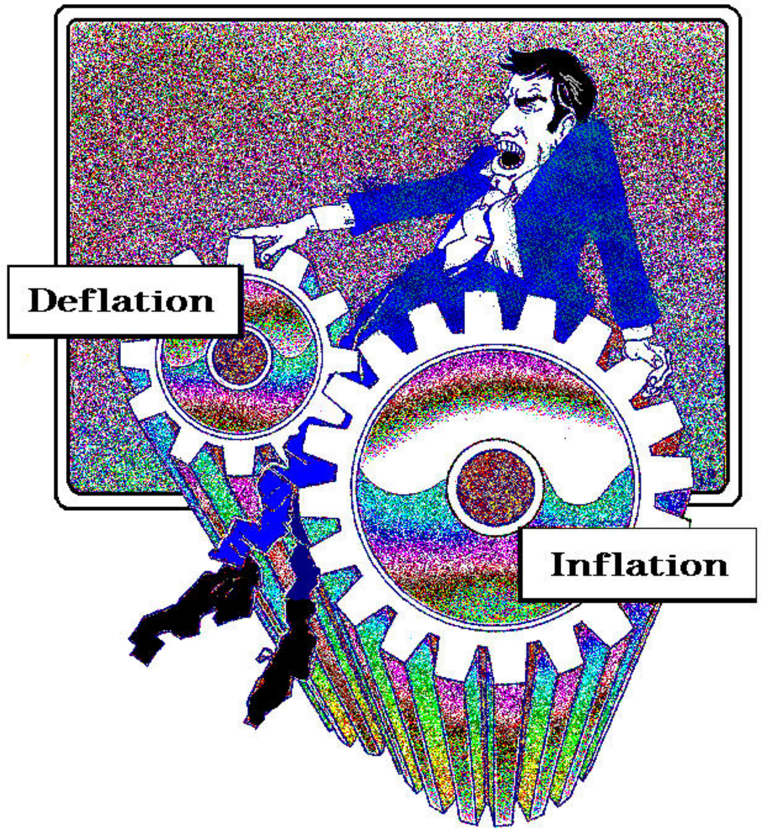
Stamp Act published In the Pennsylvania Journal October 1765

The 17th century saw a series of anti-monarchical rebellions that would no doubt culminate in the American and French Revolutions toward the end of the 18th century. There were tax uprisings throughout Europe which resulted in an independent monarchy for Portugal and limited monarchy in England. Tax rebellions appeared against the King of Spain starting with the Dutch revolt that spread as a **CONTAGION** and appeared in Basque countries, Catalonia, Portugal, Palermo in Sicily and in Naples, Italy. These tax rebellions led to an independent monarchy in Portugal which was finally recognized by Spain in 1688.

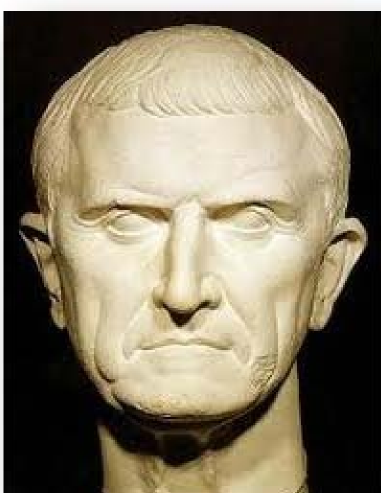
As the number of taxes rose, resistance toward taxation sparked widespread rebellions in America. The stamp tax imposed a direct tax on all colonial commercial and legal papers, newspapers, cards, pamphlets, almanacs, and dice. The "stamped paper" rebellion in Brittany took place in 1675 and of course the Stamp Act of 1765 sparked all sorts of riots in America, stamp burnings, and intimidation of tax collectors. This led to a Stamp Act Congress being called in New York during October 1765, and forced England to repeal that act in 1766. Nevertheless, the stamp act helped create the American Revolution.

Civil unrest is exploding with rising outrage and discontent have caused global protest to triple since 2006. Stagnate economies, rising taxes and austerity measures have spurred the Occupy Wall Street movement while rising food prices has spurred the Arab Spring. This year we are seeing a rise of terrorist attacks as well as protests against police. In addition, a failed military coup in Turkey threatened the democratically elected government. Awareness of government corruption is rising on a global scale. This is all part of the private wave that peaks in 2032.95.

12.4 Deflation and Inflation



The strange mix of **DEFLATION** and **INFLATION** emerge because on the one side there is rising costs of government that shrinks disposable income of the producing class forcing prices higher not because of consumer demand but rising cost of government. This results in simultaneous inflation with lower economic growth producing the combination of the two trends that is **STAGFLATION**. The inflation is reflected in rising prices that in a tangible monetary system unleashes the debasement of the currency that unfolds historically. We can visually see the debasement of the coinage 244AD and 293AD. The typical analysis only looks at the inflation side failing to grasp that this is not caused by a demand boom by consumers, but a rising cost base due to escalating government costs.



Marcus Licinius Crassus (115BC–53BC)

To put this in perspective, at the time of Julius Caesar (100-44BC) when he was rising to power, Caesar was funded by the richest man in Rome at that time, Marcus Licinius Crassus (ca. 115–53BC) in Rome, the general who defeated the slave revolt led by Spartacus. Crassus' wealth was placed at 200 million sestertii at that time, which was a sum equal to 50 million denarii or 2 million gold aurei. By the mid-3rd century, denarii were bronze and were reduced to at best 1/50th of its value.

The debasement in Rome was widespread. Here is a table 1.2 illustrating the debasement of the provincial currency in Egypt. Here we see that the decline from 13.22 to 7.47 grams, but the fineness declined 16.54% of silver to 0.5%. This was all driven by the rising cost of government employees and the unfunded liabilities of retirement at 2/3rds their base pay.

Consequently, history repeats because those in government confuse their power with the ability to dictate to the economy. The cost of government destroyed Rome as the pensions kept rising forcing the confiscation of private property, debasement of the currency, and rising taxation in a desperate attempt to hold on to power and position.

Table 1.2

Debasement of Alexandrian Tetradrachma

		Weight	Silver Content	
Year	Emperor	Grams	Fineness	Gram
58-67	Nero	13.22	16.54	2.19
167-70	Marcus Aurelius	12.68	12.39	1.57
178-82	M. Aurelius &; Commodus	11.90	7.75	0.92
191-92	Commodus	11.90	6.20	0.74
193-211	Septirnius Severus	11.55	1001	1.16
212-17	Caracalla	12.62	7.00	0.88
218-22	Elagabalus	12.28	unknown	
224-27	Severns Alexander	12.75	6.84	0.87
235-38	Maximinus I	12.41	6.00	0.74
238	Gordian I	12.90	7.50	0.96
238-44	Gordian III	12.38	6.00	0.74
244-49	Philip I	12.20	5.00	*0.61*
249-51	Trajan Decius	12.56	7.00	*0.87*
251-53	Trebonianus Gallus	*10.59*	unknown	
253-60	Valerian	10.52	unknown	
260-61	Macrianus &; Quietus	10.49	unknown	
261-68	Gallienus	9.97	4.00	0.40
268-70	Claudius II	9.71	*2.70*	0.26
270-74	Aurelian	9.24	unknown	
274-75	Aurelian	7.99	unknown	
275-76	Tacitus	*8.05*	unknown	
276-82	Probus	7.78	unknown	
282-84	Carus &; Carinus	7.77	unknown	

The same problem of **UNFUNDED LIABILITIES** that destroyed Rome humbling the greatest of the ancient empires is precisely what is undermining our future. Politicians have created a massive Ponzi scheme by making promises without putting the funding in place. Politicians have been spending entitlement taxes to support current spending leaving a large liability to be funded by future generations. Unfunded government pension liabilities have been estimated to total $78 Trillion for 20 OECD countries. The US Social Security Administration estimated the unfunded Social Security liability to be $32.1 trillion, or roughly 65% more than the official debt of $19.4 trillion excluding the almost $48 trillion of estimated Medicare liabilities. The unfunded social security liability raises US debt to GDP from 105% to 285%.

The situation in Europe is equally alarming where many unfunded pension liabilities are estimated at over 2x GDP for more than sixteen countries and exceeds 3x GDP for Germany, France and Italy. Politicians have made the promises and collected the taxes yet have spent the funds on their own projects.

There could be a resolution to our problems, but it will take serious reform and there is just no appetite for that at this time with governments able to borrow money for basically free. Meanwhile, the hunt for taxes is intensifying. The Swiss banking secrecy law dating back to 1934 have been revoked as Switzerland succumbed to the pressures of the EU to share client information. As the government seeks additional revenue corruption rises and the rule of law is no longer enforced properly.

Edward Gibbon in his Decline and Fall of the Roman Empire, wrote of the Emperor Commodus who was the son of Marcus Aurelius where they draw the line for the beginning of the fall starts with this emperor. He simply abandoned the Rule of Law and that starting the decline. Gibbon wrote:

Commodus (180-192AD)
(Pictured as Hercules)

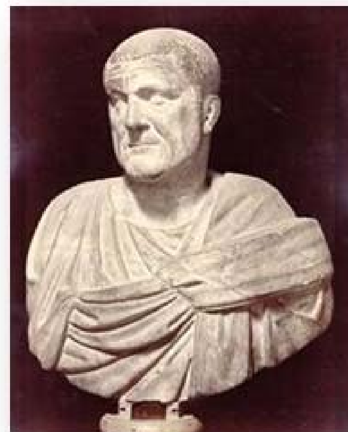
Each "***distinction of every kind soon became criminal. The possession of wealth stimulated the diligence of the informers; rigid virtue implied a tacit censure of the irregularities of Commodus; important services implied a dangerous superiority of merit; and the friendship of the father always insured the aversion of the son. Suspicion was equivalent to proof; trial to condemnation. The execution of a considerable senator was attended with the death of all who might lament or revenge his fate; and when Commodus had once tasted human blood, he became incapable of pity or remorse.***" (Book 1, Chapter 4).

Historically, the ***Rule of Law*** is the lynchpin. Once pulled, everything turns to dust and falls to the ground. Without the ***Rule of Law***, contracts have no meaning and property has no title. The state makes up laws and confiscates whatever it desires always trying to justify itself as being merely judicious. However, the majesty of the law is never safe in the hands of the state that uses it for funding purposes.

The most abusive crime ever invented by government began in Rome for the purpose to seize money. Under the criminal law, a conspiracy remains to this day simply an alleged agreement between two or more persons to commit a crime at some time in the future that does not have to take place. There are three stages of a crime –

(1) The actual criminal act,
(2) An attempt to commit the act, and
(3) An agreement to attempt to commit the act without any attempt.

The Roman Emperor Maximinus I (235-238AD) effectively tore the Roman economy apart at its seams using this theory of conspiracy. He charged a noted Senator by the name of Magnus with conspiracy against the emperor. He immediately found him guilty without a trial, executed him, and then arrested 4,000 others claiming they conspired (agreed) with him to intend to depose the emperor. Maximinus then used the criminal law to claim that 4000 people committed a crime of conspiracy, and that of course justified confiscating all their property.


Maximinus I (235-238AD)

Conspiracy laws were used at the Nuremberg Trials for Nazi leadership who were charged with participating in a ***"conspiracy or common plan"*** to commit international crimes. This was very controversial because conspiracy was not a part of the European civil law tradition. They prosecuted leaders who did not actually commit any act using the theory that they agreed with the acts. The crime of conspiracy continued in international criminal justice, being incorporated into the international criminal laws against genocide.


Sir Walter Raleigh (1554-1618)

One of the most notorious Conspiracy Trails post-Rome was that of Sir Walter Raleigh (1554-1618) who became the classic victim of legal persecution. Queen Elizabeth I died on

March 24th, 1603 and King James I (b 1566; 1603-1625) just didn't much like Raleigh and despised him quite possibly for popularizing tobacco among Englishmen. On one of his voyages, Raleigh saw Indians smoking the leaves of a tobacco plant and he return with this new product. The King accused Raleigh of being involved in a ***conspiracy*** known as the ***Main Plot*** alleged to have been organized by English Catholics to remove the King from the throne. Raleigh was arrested at Exeter Inn in Devon on July 19th, 1603, and imprisoned in the Tower of London. On November 17th, Raleigh was tried for treason. Raleigh conducted his own defense being denied legal counsel, as was the custom. Raleigh showed the conspirator evidence statement was inconsistent and he frequently requested that he be allowed to confront the key witness, Lord Cobham. Raleigh was pointing out that in a civil matter there would be witnesses yet in criminal there are fewer rights in criminal matters than civil. This remains the case to this day.

The right to confront one's accusers is a concept that dates back to Roman times. Nonetheless, England adopted practices to ensure the government always won. Justices of the peace or other officials examined suspects and witnesses before trial and were not shy of torturing them or threatening them with death if they did not say whatever the court demanded.

The Catholic Church established the system of justice known as **Canon Law** that attempted to address the abuses of the legal system. **Canon Law** required two witnesses to any crime and they could not have any interest/benefit whatsoever on the outcome. While the Catholic Church rejected conspiracy that dominated European law outside of England, confessions led to other abuses when there were no witnesses. Now people were being tortured to compel the person to confess when the state had no witnesses.

For centuries in Europe, prosecutors have been extorting confessions and even Shakespeare noted in his play the ***Merchant of Venice*** that when tortured, a man will say anything (**PORTIA:** *"Ay, but I fear you speak upon the rack, where men enforced do speak anything."*). The practice of torture was rejected by the U.S. Constitution. Nevertheless, torture still remains an integral part of modern prosecutions employing threats of extended imprisonment or prosecution of family members that compels the target to confess to anything causing the confession rate to average 98%.


Tomas de Torquemada
(1420-1498)

The European practice of trial by Inquisition became notorious. The Spanish Inquisition under **Tomas de Torquemada (1420-1498)** was used for the confiscation of wealth and personal hatred. **Torquemada** usurped the

Inquisition from the Church being an advisor to the Spanish Crown thereby benefiting the state. **Torquemada** convinced the Spanish Crown that the Moors and the Jews were threats to the state, and once he usurped the Inquisition, he quickly expanded its subject-matter jurisdiction far beyond heresy and apostasy, into witches, sorcery, sodomy, polygamy, blasphemy, usury, and a host of other offenses that he envisioned.

Torquemada authorized the use of torture to extract confessions. He ordered no less than 2000 burnings at the stake. Numerous vile complaints were made about his personal hatred and abuses. The Pope Alexander VI (1492-1503) tried to curb his cruelty, but his powers came from the Spanish Crown. In 1494, the Pope appointed four new inquisitors in June 1494 to restrain **Torquemada's** cruel inhumanity. Today, the U.S. has exceeded **Torquemada's** conviction rate of 93% reaching 99%, as has Japan**.**

The English courts would make up laws for acts already committed in order to punish people and confiscate their property. In 1647, a pamphlet entitled ***The Lawyers Bane*** urged members of Parliament to summarize and publish the corpus of statutory law enacted over the centuries because men should "***understand those laws and ordinances by which their rights, privileges, interests, and estates are secured.***" This tyranny is also prohibited in the US Constitution known as the ***Ex Post Facto Clause*** whereby no one shall be held criminally for a crime enacted retroactively. Of course, pro-government judges have declared that does not apply to property, only one's life and person.

Indeed, the ***Rule of Law*** is absolutely fundamental and essential to maintaining the economy as well as the social structure that underlies civilization itself. Once the strings that bind society within a functioning entity are severed by the greed of the state and corruption, all will be lost. It is political uncertainty that emerges with the collapse in the ***Rule of Law*** becomes self-destructive since that forms the foundation for everything given contracts have no meaning if they are unenforceable. Property loses all value if mere possession becomes title. This collapse in the social structure results in the collapse of banking and in turn the velocity of money resulting in the rise of disinvestment (hoarding), which is why the coinage of Rome has survived as hoards of coins are found especially during periods of political uncertainty that are marked also by and wars. The people simply buried their cash for security.

Capital investment and thus formation begins to decline as capital is driven into hoarding for self-preservation rather than profit. The hoarding of capital results in the decline in the velocity of money causing rising unemployment until the only thing the state accomplishes is the total destruction of the economy. Consequently, the economy crumbles to dust, as the state cannibalization emerges as the dominant trend in a vain effort to retain control and power. All mature economies die by this process of the own hands – economic suicide. The effort to retain control and to survive necessitates the collapse in the ***Rule of Law***, and that is the very purpose of coming together to form a society.

It is the destruction of that synergy known as the ***Invisible Hand*** of Adam Smith (1723–1790), which proves to be so devastating. Each individual in pursuing his own self-interest creates the economy. People try to form businesses or a viable need within society that collectively forms the economy. This is what communism destroyed with centralized planning, which doomed society.

Inflation was the **RESULT**, not the **SOURCE**, of the fiscal mismanagement of Rome. It was the rising pay for the military and the unfunded promises of pensions. As members of the army retired, they were replaced and thus government expenditure rose exponentially. The rise in taxation curbed the growth in the economy causing rising unrest and unemployment. We are witnessing these same identical trends in Europe and the United States as well as Japan and the rest of the so-called democratic governments that are really republics simply masquerading as democracies.

XIII. WHY Your 401K in in Danger

I have warned for some time that government was eyeing up pensions. There is about $19.4 trillion dollars in private pension funds. The U.S. Consumer Financial Protection Bureau (CFPB) has been eying up private pensions as the covert means to bailout public pensions governments, Fed & state, have totally mismanaged. The USCFPB is weighing whether it should take on a role in helping Americans manage the $20 trillion they have put into private retirement savings. Naturally, they are pretending private fund managers present a risk of fraud. But government employees commit crimes all the time and are exempt prosecution. Government's track record even in Social Security, which goes negative in 2017, is by no means a record worthy of qualifying as a fund manager even under SEC rules.

Nonetheless, the CFPB is licking its lips trying to figure a way to seize private pensions to bailout the mismanaged public pernsions. This would be the first move for this agency into consumer investments. The bureau director Richard Cordray has publicly admitted: "That's one of the things we've been exploring and are interested in in terms of whether and what authority we have." He naturally argues that the bureau's primary concern is that many Americans, might fall prey to financial scams. Those in government always pretend to "care" about the people. But the true extent of their caring is simply that they get their hands in your pocket before anyone else.

The retirement savings business in the U.S. has been dominated by a group of companies that handle recordkeeping and management of investments in tax advantaged vehicles such as 401(k) plans and individual retirement accounts. This group includes Fidelity Investments, JPMorgan Chase & Co., Charles Schwab Corp. and T. Rowe Price Group Inc. In total, Americans currently hold about $20 trillion in retirement assets of which about $3.5 trillion of that is in 401(k) plans.

The Securities and Exchange Commission and the Department of Labor are the main regulators of U.S. retirement savings vehicles and funds. However, the consumer bureau is a brand new agency created in 2010 by the Dodd-Frank Act. This new agency is looking for power and it now views itself as the primary mover & shaker for promoting a coherent policy across the government. Of course, they have no such experience to say the least.

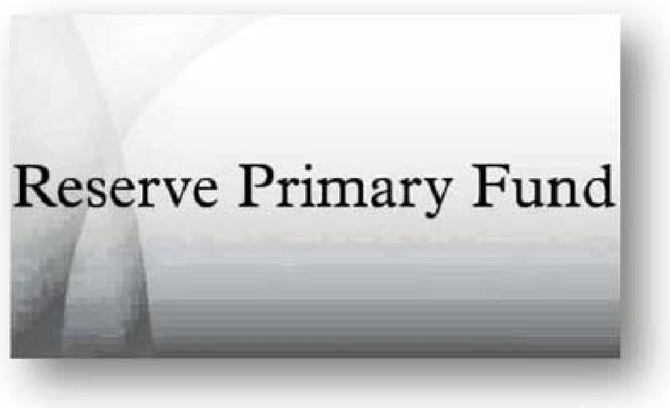
It remains highly questionable whether or not Dodd-Frank specifically gave the CFPB any jurisdiction over such investments. The CFPB is planning its grand role by also eying up mobile payments. They are clearly looking at areas that others already regulate to get their foot in the door. This becomes a turf-war between agencies, for that is how Washington really operates. Nonetheless, the bureau is trying to position itself to claim jurisdiction through its Office for Older Americans, which was established by Dodd-Frank with a mandate to improve financial literacy. The agency officially began work in July 2011 and has focused most of its attention initially on consumer credit products, including credit cards and mortgages. Moving into retirement funds is where the turf-war begins. In reality, the creation of this agency was sloppy to put it mildly. The retirement savings industry is primarily governed by the SEC, which is the main investment regulator.

How will they justify taking over these funds to the people? This is the question debated in secrecy behind the curtain. I have warned that if government seizes pension funds, it will come after 2015.75. The Supreme Court, without any justification constitutionally, just determined how that will be accomplished. The Supreme Court ruled in the unanimous 8-page decision, **Tibble v. Edison International**, 575 U.S. ___ (2015), stating that employers have a duty to protect workers in their 401(k) plans from mutual funds that perform poorly or are too expensive.

This ruling by the Supreme Court introduces a fiduciary responsibility. That is simply astonishing since there is no constitutional requirement for even government to provide social benefits. The Supreme Court held in the 1980 case **Harris v McRae**, 448 U.S. 297 (1980) , that there is no duty imposed upon the state to provide a public program, for that would convert the constitution from a negative restraint upon government to a positive obligation to provide for everyone. By introducing a fiduciary obligation, this clearly given companies the incentive to get out of the pension offering schemes and at the same time prosecuting a small firm for violating this duty will justify the takeover of private pensions because government is here to protect you from yourself as well as all others real or imaginary.

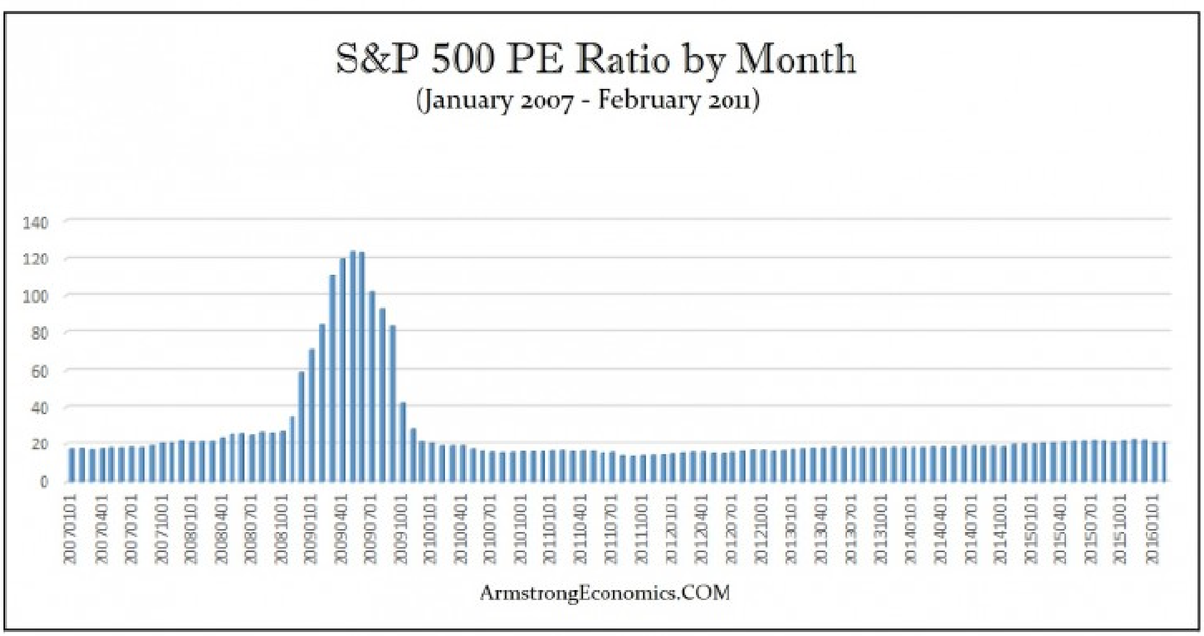
If we take the fact that the constitution is **NEGATIVE**, and was a restraint upon government, then this latest ruling is completely unfounded. Tibble's unanimous ruling sends a warning to employers that they now must improve their plans, as it is currently an obligation to project employees. This comes just in time for the next step is government to seize private funds and prosecute employers who poorly chose a fund manager. This fits perfectly, and is just in time for the Obama Administration's next assault as they prepare a landmark change of its own by issuing rules requiring financial advisers to put the interest of customers ahead of their own. This creates a very grey area wide enough to justify public seizure of pension funds under management.

Part of this strategy to position private retirement funds for a takeover is also lurking behind the new SEC rule on money market funds, which takes effect October 17, 2016. The 2007-2009 crisis did more that wipe out Lehman Brothers and Bear Stearns than anything else. The impact of the crisis led to a panic in money market funds. It was assumed that all money market funds were safe and that you would never get less than what you invested. That proved to be false in the midst of the Lehman failure.



The Reserve Primary Fund, which was the oldest US money market fund, fell during the crisis to 97 cents. You might say it was due to negative interest rates. However, it was perceived as a risk and not safety. True, the fund had some Lehman paper, but that was only a very small portion of the Reserve Fund's assets. The collapse in confidence was the key. People feared banks and bank paper.

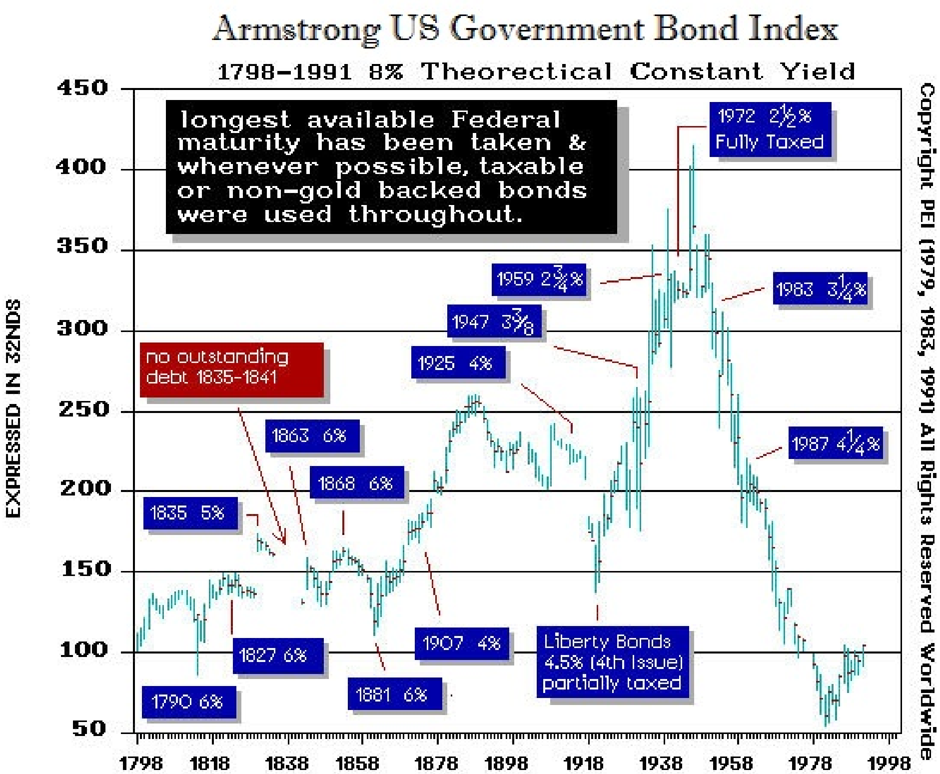
When the market began shorting Goldman Sachs shares, its former CEO came to the rescue and banned the short selling of banks. Investors essentially stampeded out of the Reserve Fund in mass, for if Paulson was banning short selling on Goldman, then a collapse of the banking system was not so far-fetched. This triggered a run on money market funds, and when the oldest went, the contagion spread and threatened the liquidity of the entire financial system.



Big, smart money ran to equities. Many individuals ran into gold. The PE ratio on the S&P exceeded 100; at the peak of the dot.com bubble, it only reached 50:1. Money market funds became vulnerable for they invest short-term debt securities like commercial paper. Indeed, banks and big corporations rely on those funds for liquidity to fund immediate operations.

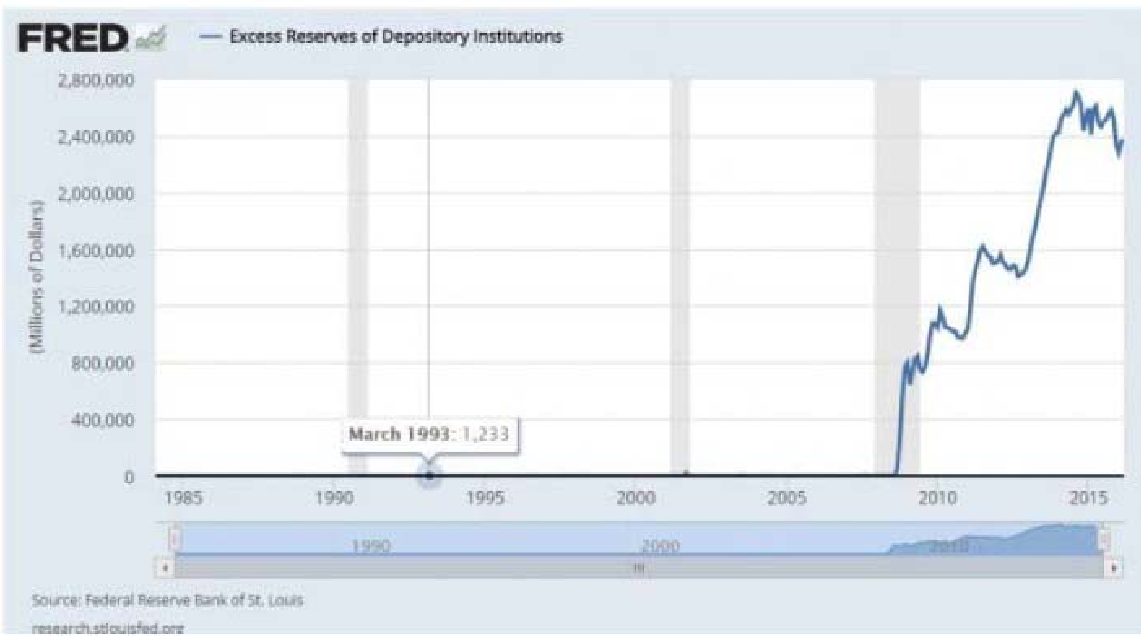
Lehman failed for it could not redeem its overnight paper it borrowed against in the overnight repo market. They had just 24 hours to pay or fail, and they did the latter. This is why the government had to step in with bailouts to make sure the whole system didn't collapse. It was liquidity that evaporated.

The critical factor is always liquidity. Liquidity is the lifeblood of the financial system. When confidence is lost, people hoard money and do not invest or deposit in banks or money market funds. The SEC assumed that the run on money markets was simply because the Reserve Primary Fund fell below par value. They are not looking at the market as a whole.



The October SEC rule will change the valuation of money market funds by eliminating this presumption that what you put in is always there. The funds will be marked-to-market and the SEC thinks this will prevent another run during a crisis. The rule, of course, exempts funds who invest **ONLY** in government paper. So everything else is perceived to be "risky" so it must be marked-to-market for transparency, but if it is a pure government fund, hey, the rules do not apply. Clearly, this is setting the stage to stuff private pensions with government paper because It's "safe" and does not require mark-to-market according to government. That is not supported by our perpetual 30 year bond chart back to inception in 1798.

Already, the weak minded are moving to government-only funds that will just be like the Japanese funds were who hid any losses. The accounting will assume you have lost nothing as long as it is government paper. Investors are being told already that their money market funds restricted to government paper are 100% safe and will always return their money. The floating NAV values for all other funds are risky.



What is happening is very clear, almost $500 billion has moved from money market funds into government funds. Total assets in money market funds have now dropped below $1 trillion for the first time in 17 years. This is very bad for it will enhance the economic decline when banks are already not supporting the economy and hoarding cash deposited at the Fed in its Excess Reserves facility.

Despite the hoopla that sales of US Treasuries are signaling that the end is near, to the contrary, the landscape is changing already and the new rule has not yet gone into effect. As always, you have to pick up the rug to see the real trend. Analyzing just the surface never reveals the truth. You have to pay closer attention.

Combining this SEC rule with the Supreme Court ruling in **Tibble v. Edison International**, will have a dramatic impact upon investment management in the future. What this ruling imposes is a tremendous duty upon the fiduciary who must now backup his decision with proof. This may also have the impact of foreclosing new fund managers from entering the business since they will lack the track record. Of course, this standard will never be applied to government run pensions. As always, they will be exempt from any prosecution. They will be looking for a small fund manager to hang thereby providing the justification to rescue the people.

Yet this decision **<u>Tibble v. Edison International</u>** is even deeper. It sets the stage to **JUSTIFY** government seizure of private pension funds to protect pensioners. When the economy turns down and things get messy, they place measures to eliminate money in its physical dimension by closing all tax loopholes and shutting down the world economy with **FATCA**. As of January 1st, 2017, the G20 snitching program goes into effect. Everyone will be report of other people's citizens; activities in their own country. This is the hunt for taxes globally. In the USA, any foreigner selling US property requires 15% of the proceeds be sent to government just-in-case they owe taxes. The only away around that is for a foreigner to first set up a LLC company in Delaware and purchase any property in that name. The IRS has demanded the sale of property in Miami and New York must be fully disclosed by the title company to see who is behind any LLC.

Governments are dead broke and they are preparing for the final straw of Economic Totalitarianism. In the United States, with the help of the Supreme Court reversing its entire construction of the Constitution laid out in **Harris v McRae** to impose a duty upon employers in a world where interest rates are going negative, the insanity just keeps getting far worse.

The message here is not that all 401(k) plans are bad or too expensive. In fact, costs have fallen 30% over the past decade as more plan sponsors turn to low-cost passive investing options. However, this can be highly dangerous, for to lower costs they turn to government debt where there is no need for fund management decisions. Yes, when I did hedge fund management, the cost was 5% annually plus 20% performance. That cost went to staff around the world that had to monitor positions of the world economy on a 24 hours basis. You also paid **NOT** to trade, for most losses took place when traders were bored and tried to make money when there was nothing to be done. Our track record was the very best in the industry with the lowest drawn down, perhaps in fund management. But that risk reduction cost money.

Today, costs vary widely. Plans with more than $100 million in assets usually have total annual costs below 1% whereas the biggest plans usually are below 0.50%. In small plans, the costs can be as high as 2% today. The focus is now on cost – not performance. Of course, government could never manage such funds with such a low cost even if they kept their fingers out of the cookie-jar.

Financial service companies can charge a range of management, administrative, marketing, distribution and record-keeping fees for 401(k) plans. Plan sponsors can assume the costs, but employees are paying at least 85% of all fees typically. It is true that most workers do not know they pay the bulk of the share of costs. A 2011 AARP survey found that 71% of retirement savers do not think they pay any investment fees at all. It is true that the fees make a huge difference in returns over time. However, this drive to lower costs has also lowered the quality of funds management.

The U.S. Department of Labor estimates that a 1% point difference on a current account balance of $25,000 will reduce total accumulations by 28% over 35 years, assuming average returns of 7% and no further contributions. The focus is all on these management fees without any consideration of the problem. Trying to manage money varies according to the size of the fund. Often the more you gather, the lower the performance, because the markets are not unlimited. You can pick up the phone and say, "Sell at the market!" when you have a $100 million fund, but you cannot do that with a $100 billion fund. So the management fee was also a means to reduce the number of clients; it was never a question of unlimited capacity to trade. The numbers on performance would decline with greater amounts of money under management for the manager lost flexibility.

The Supreme Court case clearly shows a lack of understanding of the industry, yet the battle centered on the 401(k) plans use of retail-class mutual funds when less-expensive institutional shares are available. The difference between those classes typically is 25 basis points. This will now put pressure on large plans to cut costs further, but it will not have much impact on smaller plans. This is because the big plans have the buying power to negotiate better deals, but at the same time they are an easy target for lawyers, making them much more attractive targets for litigation.

Cutting management fees to the bone may in fact set the stage for massive losses, for many of the older better traders are now just resigning. The quality of fund management is more likely than not going to decline noticeably.

Between the Supreme Court ruling and the Obama Administration's push for stronger fiduciary rules sends a strong message that government can easily seize the pension fund management industry, of course to "protect the consumer." But Obama has been getting push-back on taking over private pensions. Therefore, he turned to the Department of Labor to at least open the door for states to seize private pensions. This is what the Department of Labor just issued:

> ***"DEPARTMENT OF LABOR Employee Benefits Security Administration***
> ***29 CFR Part 2510 RIN 1210-AB71***
> ***Savings Arrangements Established by States for Non-Governmental Employees***
> ***AGENCY: Employee Benefits Security Administration, Department of Labor.***
> ***ACTION: Final rule.***
> ***SUMMARY: This document describes circumstances in which state payroll deduction savings programs with automatic enrollment would not give rise to the establishment of employee pension benefit plans under the Employee Retirement Income Security Act***

of 1974, as amended (ERISA). This document provides guidance for states in designing such programs so as to reduce the risk of ERISA preemption of the relevant state laws. This document also provides guidance to private-sector employers that may be covered by such state laws. This rule affects individuals and employers subject to such state laws."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Merge Social Security and Public Sector Pensions

June 23, 2013 / by Ed Ring

When solutions to the challenge to provide retirement security to American citizens in the 21st century are considered, they typically address either social security or public sector pensions, but rarely focus on both of these systems together. But when considered together, as systems that each have unique strengths and weaknesses that might be combined in a single program available to all Americans, options present themselves that might otherwise be ignored.

With both social security and public sector pensions, the challenge of maintaining financial sustainability is dramatically affected by the demographic reality of an aging population. As

The Department of Labor has actually issued a rule ***29 CFR Part 2510 RIN 1210-AB71*** to assist states in getting around federal law to enable them to seize private pensions under the pretense of protecting them. There have been proposals to even merge Social Security with State Pensions to also bailout such funds and reduce payments.

So on this subject, it is a **VERY SERIOUS ISSUE**. There has been "lobbying" efforts by state pensions that have been taking place behind the curtain from my direct sources. There are states looking for Congress to create some sort of mandatory contribution that would take from people's private savings to bail out state workers. Nothing has been decided as of yet. However, I would expect this to become more forceful next year when Social Security goes negative in 2017 and the elections have passed.

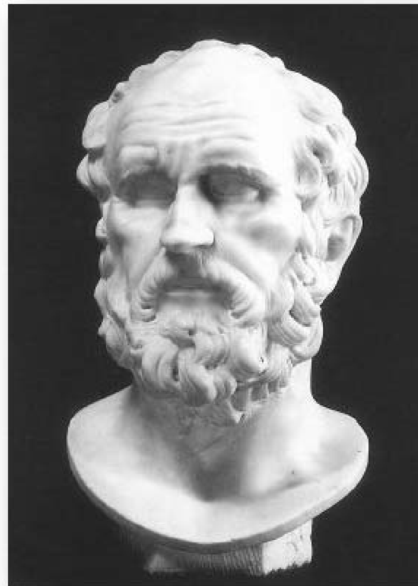
XIV. The Conclusion

The pension crisis is at the brink of total disaster. The idea that the state will provide for its people was perhaps a noble idea when first proposed. But politicians will always be politicians. They cannot stop saying whatever needs to be promised to keep their job. This is the fundamental flaw and why politicians can NEVER be allowed to never leave. They cross that threshold and become a bureaucrat, which is indistinguishable from any monarch pursuing their own self-interest against the people.

The pension crisis is in the middle of an explosion as global demographics place an enormous strain on government budgets at a time when debt levels are at historically high levels. With negative interest rates, governments have expanded their debts and the normal compounding of the debt has been reduced masking the debt crisis, which in itself will start to be exposed in 2017. The US social security system shifts to negative cash flows in 2017 while the Chinese workforce is beginning to decline this year in 2016. In Europe, the pension crisis also reaches critical mass beginning in 2017 and in Japan they are asking workers to keep working longer for they lack member of the young generation as the birth rate collapsed.

Many pensions are already cash flow negative and compounding their funding shortfall has been the entire negative interest rates policy that has utterly failed. These demographic trends are putting enormous pressure on government budgets. Politicians are hunting additional tax revenues and are now becoming ruthless. Local police are ticketing people for anything and everything to raise money for local municipalities. The hunt for money is spreading to all levels of government. The is resulting in the complete collapse of the rule of law and former crimes intended for drug dealers, such as money laundering, are now reinterpreted to cover hiding money from government.

> *"[T]he different forms of government make law democratical, aristocratical, tyrannical, with a view to their several interests; and these laws, which are made by them for their own interests, are the justice which they deliver to subjects, and him who transgresses them they punish as a breaker of the law, and unjust. And that is what I mean when I say that in all states there is the same principle of justice, which is the interest of the government; and as the government must be supposed to have power, the only reasonable conclusion as, that everywhere there is one principle of justice, which is the interest of the stronger."*



Thrasymachus (Θρασύμαχος)
(ca. 459-400 BC)

There is a complete lack of the rule of law on a global scale and this is greatly contributing to the age of deflation as capital is simply being hoarded. History repeats because those in power will always become desperate to retain power. Thrasymachus in his famous debate with Socrates recorded by Plato, hits the nail on the head. The rule of law is simply the self-interest of those in power. Therefore, it does not matter what type of government you live, the end result is always the same – the rule of law "is the interest of the stronger" (government). Unfortunately, this is the harsh reality of history, which is the **ONLY** guide we have to the future. For one consistent factor throughout the centuries of record time remain human nature. People try to ignore history claiming this time it is different or we have advanced somehow. But because we send emails instead of mailing a letter, or scribbling it on a piece of paper and attaching it to a pigeon, may be advancing technology, but is does not change the fact that the same motivations influence human nature today as they did in ancient time.

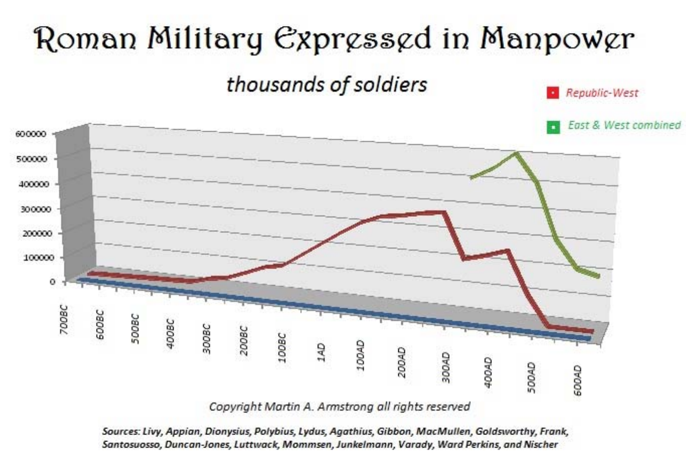
As taxes rise, the economy stagnates further creating a viscous deflationary cycle. Taxes cannot be raised sufficiently to provide promised entitlements. This is becoming more evident as the population ages. When government employees cannot be paid, taxes rise and the rule of law collapses. This is the stage we are now entering. The state of Illinois is collapsing before our eyes. The state employee pensions must be paid even if the fund loses money. It is a constitutional clause which the courts have interpreted cannot be retroactively altered. This is the very same mechanism which destroyed Rome. It was the pensions owed to the army.

It was the inability to pay the troops that led to revolts and various sectors of the army hailed their leader as emperor to just get paid. There were 26 emperors declared by the army between 235 and 268AD or a 33-year period. Various segments of the army fought each other for the right to sack Roman cities. This would be like the police in New York not being paid so they go invade Chicago and steal everything they can. This becomes the criminalization of government.

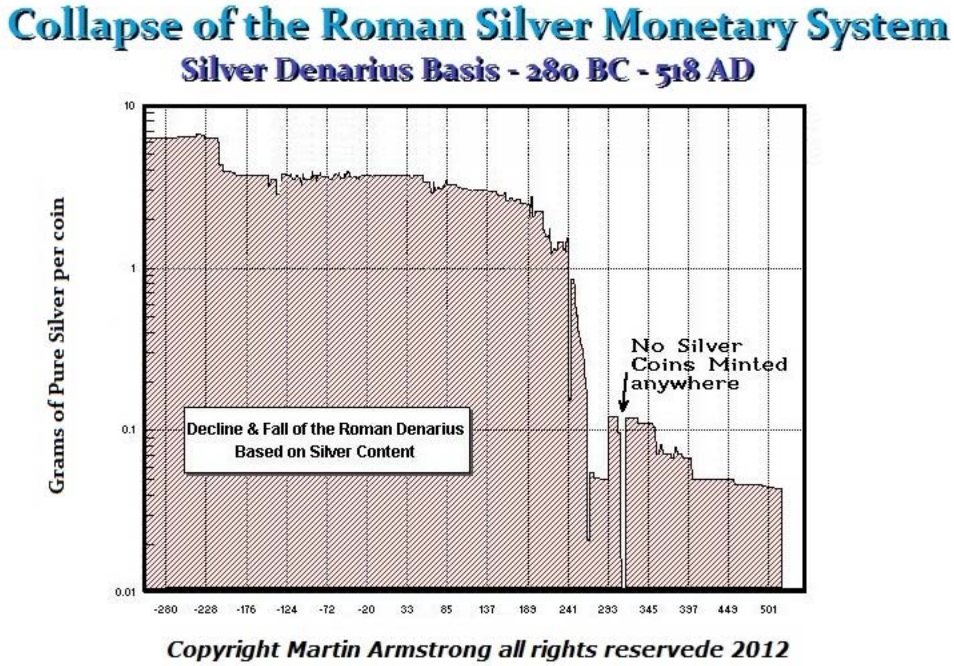
1) Maximinus I –235-238AD
2) Gordian I – 238AD
3) Gordian II – 238AD
4) Balbinus – 238AD
5) Pupienus – 238AD
6) Gordian III – 238-244AD
7) Philip I – 244-249AD
8) Pacatian – 248AD
9) Jotapian – 248AD
10) Silbannacus – 249AD
11) Trajan Decius – 249-251AD
12) Trebonianus Gallus – 251-253AD
13) Volusian – 251-253AD
14) Aemilian – 252-253AD
15) Uranius Antoninus – 252-254AD
16) Valerian I – 253-260AD
17) Gallienus 253-268AD
18) Macrianus – 260-261AD
19) Quietus – 260-261AD
20) Regalianus – 260-261AD
21) Postumus – 259-268AD
22) Laelianus – 268AD
23) Marius – 268AD
24) Victorinus – 268AD
25) Tetricus I – 270-273AD
26) Claudius II Gothicus – 268-270AD

We are at that stage now. Government employees in Chicago are demanding the government tax people who just trade on the exchange. Union in New York also have proposed taxes trades on the New York exchanges. Government employee care nothing about the consequences for the nation, it is just about them.

Our entire pension scheme for police and the army tends to be 20 years of service. This has been a tradition that existed in Roman times. The typical soldier had to serve for 20 years and then he would retire and be given land and a pension. Those who think history is worthless do not know where we have been so they are clueless about where we are headed.



It is always government pensions that have destroyed civilization. Once the government demands to be taken care of for life, it is time to turn out the lights. The Roman soldiers pillaged their own people just to be paid. We are going in the same direction.



In Europe, people are buying safes and withdrawing large bills from banks to avoid negative interest rates and to hedge against the banks, which are in a wholesale trend toward insolvency. As money hoards, the velocity of money declines and this is the hallmark of how economies decline and governments collapse. The gold promoters always talk about hyperinflation, yet they fail completely to comprehend how it is even caused and what results. It is never that government hyperinflates first. They hyperinflate as a result of the collapse in the velocity of money as people hoard money and do not spend or invest. You actually suffer a slingshot type of move that FIRST is marked by a steep and protracted deflation marked by hoarding and the collapse in the velocity of money.

We can see how the silver content of the Roman coinage collapsed during this period of about 31.4 years from the time Maximinus I began declaring that all wealth belonged to the state. That set in motion the survival instinct and people began to hoard money causing the velocity to decline. The steep decline in a Phase Transition mode lasted but just 8.6 years and was initiated by the capture of Valerian I by the Persians in 260AD. The coins still had some visible silver contend.

It was not the hyperinflation in Rome that made people hoard. That came as the result of people hoarding. There was not enough metals to pay the troops and government expenses so the debasement came as a result of the shortage of cash. The same deflationary process took place during the Great Depression. There was such a shortage of money, more than 200 cities issued their own currency called "scrip" to facilitate commerce. This is what was taking place in Roman during this period. It was not hyperinflation, but deflation marked by the shortage of money.

The second phase is when the confidence in the sustainability of government hits the public. Then you end up with the slingshot move. First down with the deflation-sparking hoarding, then the inflation when confidence in government collapses. It was after the assassination of Gallienus in 268AD that the next 16 years was just more chaos with another 18 emperors.

1) Claudius II Gothicus – 268-270AD
2) Domitianus – 268AD
3) Quintillus – 270AD
4) Aurelian – 270-275AD
5) Zenobla – Mother Vabalathus
6) Tacitus – 275-276AD
7) Florianus – 276AD
8) Probus – 276-282AD
9) Bonosus – 280AD
10) Saturninus – 280AD
11) Carus – 282-283AD
12) Numerian – 283-284AD
13) Carinus – 283-285AD
14) Julian Of Pannonia – 284-285AD
15) Amandus – 285-286 AD
16) Carausius – 287-293 AD
17) Allectus – 293-296 AD
18) Domitius Domitianus – 296-297 AD

It was not until we have the rise of Diocletian in 284AD and the birth of the Tetrachy two years later in 286AD when we see attempts to reform the monetary system. It was Diocletian (284-305AD) who introduces passports that people cannot travel within the Roman Empire without proving they paid their taxes. Today, if you owe the US government more than $50,000, the IRS revokes your passport. History always repeats for the human mind comes up with the same conclusion every time.

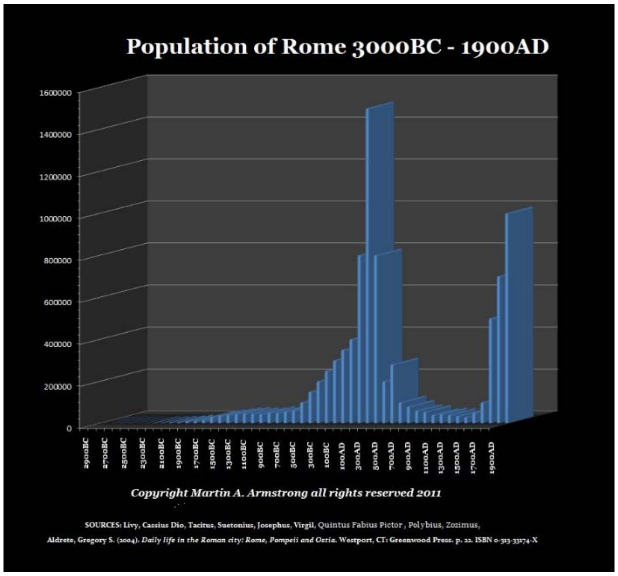
Diocletian is also famous for his edit, which was the first attempt at wage and price controls. We have Hammurabi's code setting price limits illustrating that was a debt crisis back then as well, for he also prescribes legal interest rates and contracts become enforceable only when in writing. Commodities are expressed in value based upon silver and grain.

The Tetrachy established in 286 was a major political reform. Diocletian brought in Maximianus as co-emperor and each then established a vice president (Caesar) who would be their successor. The selection was cross-controlled so that Diocletian selected the successor for Maximianus and he in turn selected the successor for Diocletian. Both Diocletian and Maximianus retired becoming the first to do so, in 305AD.

Therefore, Rome went through the stages of deflation, then hyperinflation, and then political reform and a complete new structure of government. They reintroduced silver coinage known as the argentius and from the peak in the Roman Empire during the reign of Marcus Aurelius (168-180AD), to the reforms of the Tetrachy was a total of 112 years, or half of the Political Cycle of 224 years in total.

This is our guide to the future. We see the same collapse in confidence in Japan. Each new emperor demonetized all the coinage in circulation to one-tenth his new issue. This led to people refusing to even accept the currency for if the emperor died, it would demonetized. The Japanese emperors lost all confidence and were unable to issue any coinage whatsoever from the mid-900s for the next 600 years. As in the German hyperinflation and Zimbabwe, the people conducted business in foreign currency. In the case of Japan, Chinese coins were used, not Japanese.

Understanding that the pension crisis goes beyond just the pension crisis within the private sector. This is turning government workers against the private sector. On the ballot in November 2016 in New Jersey, is a constitutional provision mandating that state pensions come before everything else. This will be a constitutional amendment meaning that taxes will rise and property values will fall. In Rome, as taxes rose, people eventually just walked away from their homes unable to afford the taxes. This set in motion the great migration away from cities and back to outlying regions they called suburbia.



This is why Roman was abandoned. At 180-AD, the city of Rome was the first to ever reach a population of 1 million. As the debt crisis loomed and taxes increased, people began to sell property and leave. The collapse came swift and was directly linked to the rise in taxation. The last to leave found no buyers and just walked away unable to pay the taxes.

By the time we see Rome in the middle ages, all that was left were the remains of huge relics of what used to be. **Edward Gibbon's** (1737-1794) ***Decline and Fall of the Roman Empire*** (1776), he wrote in the final chapter telling us about two attendants to Pope Eugenius IV (1431-1447) who are sitting on top of the Capitoline Hill in Rome overlooking the Roman Forum. Poggius then comments upon the vicissitudes of fortune, which spares nothing and nobody while it buries empires, nations, and city-states in a common grave.

> *"Her primeval state, such as she -might--appear in a remote age, when Evander entertained the stranger of Troy, has been delineated by the fancy of Virgil. This Tarpeian rock was then a savage and solitary thicket; in the time of the poet, it was crowned with the golden roofs of a temple, the temple is overthrown, the gold has been pillaged, the wheel of Fortune has accomplished her revolution, and the sacred ground is again disfigured with thorns and brambles. The hill of the Capitol, on which we sit, was formerly the head of the Roman Empire, the citadel of the earth, the terror of kings; illustrated by the footsteps of so many triumphs, enriched with the spoils and tributes of so many nations. This spectacle of the world, how is it fallen! how changed! how defaced! The path of victory is obliterated by vines, and the benches of the senators are concealed by a dunghill. Cast your eyes on the Palatine hill, and seek among the shapeless and enormous fragments the marble theatre, the obelisks, the colossal statues, the porticos of Nero's palace: survey the other hills of the city, the vacant space is interrupted only by ruins and gardens. The forum of the Roman people where they assembled to enact their laws and elect their magistrates, is now enclosed for the cultivation of pot-herbs, or thrown open for the reception of swine and buffaloes. The public and private edifices that were founded for eternity lie prostrate, naked, and broken, like the limbs of a mighty giant, and the ruin is the more visible from the stupendous relics that have survived the injuries of time and fortune."*


Painting of Rome Middle Ages - by Jan Both

The Pension Crisis is the key to understanding how we too will fall. Meanwhile, the German Finance Minister Schäuble is touted to replace Merkel, is justifying the refugee crisis by dancing around the Pension Crisis. Despite the fact that 2/3 of Germans are fed up with Merkel over the immigration issue, Schäuble is calling for more immigration into Europe. Otherwise, Europe will "degenerate into [an] inbred" continent. Is it really inbreeding, or the fact that the birth rate has declined and the aging population presents a massive Pension Crisis? He supports more refugees because of this crisis that socialism is in a state of collapse. It is not that he wants German girls to date Syrians, he want youth to come in and work to pay taxes to keep the failed system afloat.

Therefore, there is also a hidden agenda here behind the curtain. Many politicians are trying to use the "Syrian" refugees in hopes of offsetting its aging population. But these are people who are not accustomed to Western culture and will not be the next generation of economic slaves to keep the elite in power. This is why politicians have not cared about where these refugees came from. Nor have they been concerned that the fact that the majority are young men in their twenties pretending to be under 18.

The weak economy, tax increases, falling benefits and increased violence is creating civil unrest in Europe. Meanwhile, politicians lack the incentive to pass unpopular entitlement reforms with cost of capital so low around the world.

Janet Yellen, Fed Chair, keeps saying rates must be "normalized" and the pundits are blind to what is transpiring behind the curtain. Yellen has inherited a complete nightmare. There is a lot of speculation about why the Fed seems so reluctant to "normalize monetary policy". There are, of course, the typical domestic issues of low inflation and weak wage gains in the face of strong job growth. A hike will increase the Federal deficit. Then there is the argument that corporations now have $12.5 trillion in debt. All that is nice, but with corporate debt, our clients are locking in long-term at these levels, not funding anything short-term. Those clients who have listened are preparing for what is to come, unlike government, who has been forced to shorten the average duration of their debts blindly to what happens when rates rise, which will be set in motion by the markets — not Yellen.

The Fed is trapped between a rock and a very hard place. Yes, they have the IMF and the world pleading with them not to raise rates for it will hurt other debtors who borrowed excessively using dollars to save money such as the emerging markets. The Fed is also caught between domestic and international policy objectives. Domestic policy dictates that the Fed **MUST** raise rates or they will bankrupt countless pension funds; yet doing so will also raise the fiscal deficit, as government also must pay more to borrow. Internationally policy objectives argue for caution because emerging markets will go into wholesale default unable to meet their obligations since commodities have collapsed. Additionally, raising rates in the States draws the contrast with Europe and Japan unable to reverse their policy without admitting total failure. Moreover, the debt of emerging markets has exploded rising to about 50% of the entire U.S. national debt, which obviously makes this too a serious issue.

The $64 trillion question remains; has the United States lost control of its domestic economy because the dollar is the only real reserve currency of any stature? There are those who are starting to realize that a monetary reform is necessary to replace the dollar as the reserve currency for the world just to regain control of domestic policy objectives. The Federal Reserve has been forced, by default, into the new role of central bank for the world. It cannot carry the weight of the world around so easily.

Clearly, by avoiding the normalization of interest rates (hikes), the Fed has encouraged government to spend far more than they realize because money is cheap. Obamacare alone will bankrupt everything if interest rates were 8% instead of near zero and its failure to induce the youth who really have little use for healthcare insurance to sign up preferring to pay the fine. Costs have exploded and insurance companies are bailing out bringing Obamacare to the edge of collapse in 2017. There has been no fiscal restraint or management whatsoever besides politicians being delusional. Politicians now look exclusively for the Fed to manage the economy while they promise the moon and are incapable of a managing a simple bubblegum machine.

The crisis on the horizon stems from interest rates. With interest rates at negative to virtually zero around the world, pension funds are being driven into insolvency unable to meet future obligations. Public pension funds are the real crisis for they merely turn to taxpayers to fund the difference. As the economy dwindles, taxes rise at the State/Province and municipal level of governments furthering deflation by reducing spendable income.

Furthermore, interest expenditures will crowd out all other spending at the federal level. The attempt to stimulate the economy by central banks buying in government debt, merely rubberstamped the total lack of fiscal policy by politicians. They remain blind to the pending crisis that the central banks will be unable to resell the bonds they purchased and the private sector will turn its back on unrestrained borrowing by governments. Thus, the only buyer could be central banks and there lies the problem. If central banks merely purchase government debt, they in reality are simply expanding money supply under the pretense of borrowing.

Clinton's interest gimmick to make debt much worse

By MARTIN A. ARMSTRONG
Guest Columnist

WHEN BILL CLINTON announced that he would cut the deficit by a projected $500 billion over five years, there was no screaming or cries of pain. Lobbyists were not weeping in the streets and nobody in the media claimed that children would starve. This miracle of miracles was accomplished in part by raising taxes $250 billion, but also via a parlor trick — shifting the funding of the national debt toward short-term maturities to save on interest expenditures.

In 1990, 68 percent of the national debt was funded at five years or less. In 1994, 74 percent of the debt was funded at that term, with nearly 33 percent funded at one year or less. This manipulation created nearly $50 billion in savings on interest payments, since, at the end of 1993, 30-year bond rates stood at about twice that of one-year rates.

Multiply that by five years and you come up with a projected budget savings of $250 billion (assuming no change in interest rates). Add the tax hike and you get a projected deficit reduction of $500 billion over five years. This sleight of hand allowed Mr. Clinton to look like he was reducing government while in fact doing nothing of the sort.

The problem we now face is quite simple. Until the Clinton years, every administration since World War II tried to extend the national debt for as long as possible. This protected the budget from wild swings in interest rates while tending to reduce volatility as a whole. When the Fed sought to fight inflation, it had a two-to-four-year window before any interest-rate hike would cause a surge in the nation's deficit from interest expenditures. The Clinton debt manipulation has now endangered our economy, and the dramatic decline in bond prices last year is just the first warning sign.

WITH ABOUT 33 percent of the national debt now funded one year or less, and with short-term rates double those of a year ago, the deficit will rise far faster than anyone in Washington is prepared to forecast. The rise in interest expenditures could easily outpace the government's ability to reduce spending. For every one-percentage-point rise in short-term rates, another $200 billion or more could be added to the debt by 1998. The immediate crisis in the dollar began when the balanced-budget amendment failed. The real international crisis is not currency, but debt. The widening deficit will once again become an issue for the capital markets.

The immediate crisis in the dollar began when the balanced-budget amendment failed. The real international crisis is not currency, but debt.

To see the debt crisis in action, we need only look north to Canada, one of countless nations that have so squandered their national wealth that dramatic political change is forced upon them by the capital markets. Last year, 40 percent of every dollar the Canadian government spent went to interest. With virtually 40 percent of the entire national debt coming due by 1996 and short-term rates double those of a year ago, Canada's interest expenditures will soar to 50 percent of total spending or higher, joining the ranks of Italy, Sweden and Mexico.

The concern over government debt is building world-wide as all industrialized nations continue to run bigger deficits. The old maxim that a national debt is merely a borrowing from ourselves died when holders of the debt ceased exclusively to be a nation's own citizens. Interest expenditures of this magnitude are nothing more than a wholesale license to export the national wealth of a nation where government spending no longer stimulates the domestic economy.

DEBT BY ITSELF is not necessarily bad, and it certainly does not cause a financial disaster alone. What is most important is how the debt is being used. The governments that are falling first are those where the greatest amount of spending has gone to social programs. If government spending fails to create good-paying jobs, the net effect is not a stimulus but a drain on the economy. Welfare recipients do not receive enough in transfer payments to buy a new home, automobile or other higher-end durable goods that create jobs. Combine this with the vast expansion of government itself (to 33 percent of the civilian work force), and you have the real reason for political unrest in America.

How can we get out of this mess? The U.S. must:

- Make a concerted effort to shift the national debt back toward a long-term focus.
- Place an immediate freeze on government employment at all levels and start taking an honest approach to reducing the government work force.
- Implement a tax amnesty, with the proceeds used to retire the national debt.

And, finally, the long-term goal should be to abolish the income tax and replace it with a national sales tax — not a VAT — that is capable of extracting revenues from the underground economy, including illegal aliens. Under such a system, the upper class will naturally pay more, and exemptions for food and housing will protect the poor. This must be done with a simultaneous repeal of the 16th Amendment, which authorized the income tax.

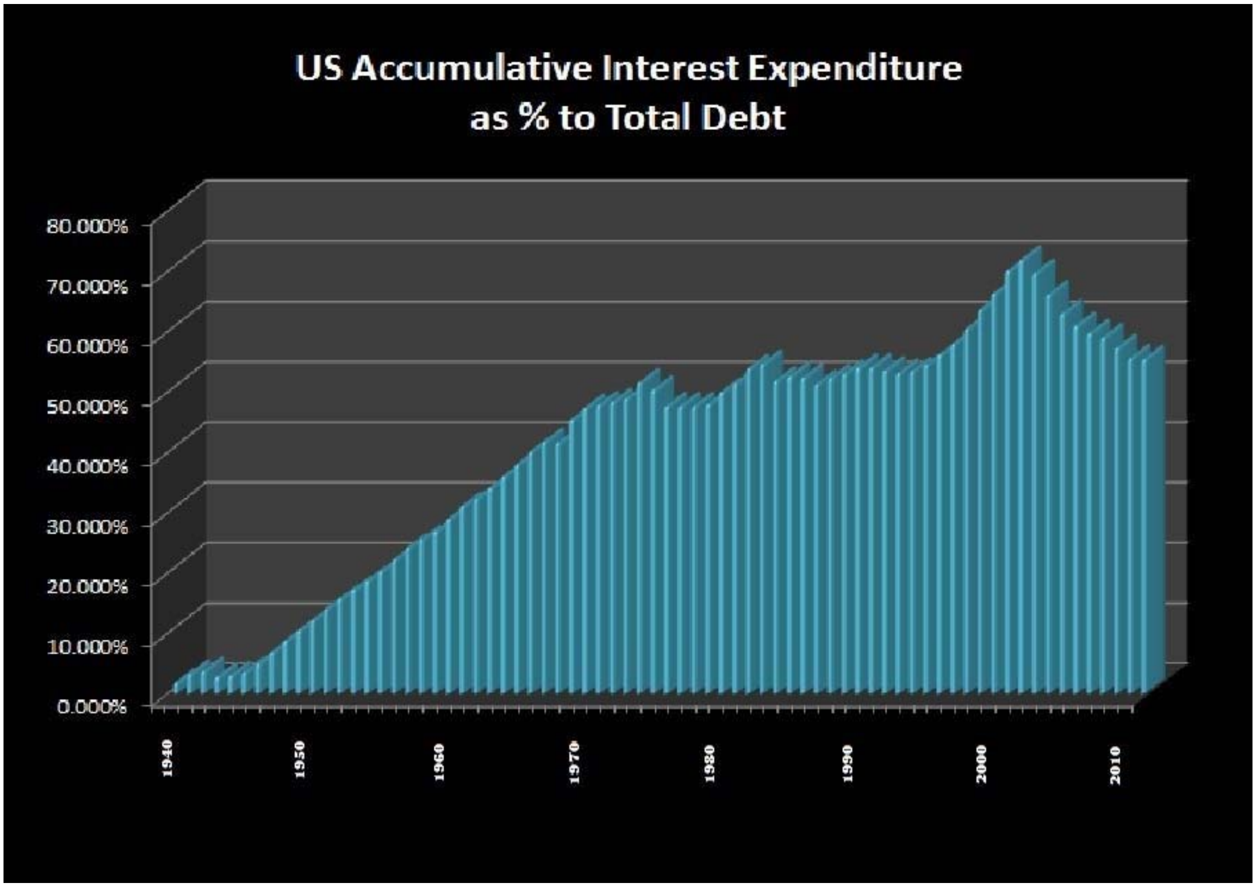
SINCE THE MARKETPLACE will not allow the U.S. to shift its debt back toward long-term bonds without paying sharply higher interest rates, we must use another approach. Government bonds were always tax-free prior to World War II, save for partial taxation during World War I. To reverse the damage done by the Clinton administration, the Treasury should issue 10-to-30-year tax-free bonds in denominations as low as $1,000. Foreign holders of debt pay next to nothing in taxes on the interest derived in the U.S. It is about time the American people had the same privilege.

These should be nonmarketable zero coupon issues. This would not only extend the national debt but also help to bring the debt home and slash the deficit in the current fiscal year. A portion of the savings in interest expenditures should then be used to retire short-term debt. This program would have the same net effect as a company buying back its own stock. The price of bonds would rise and interest rates would fall. A separate gold backed bond could be offered at half the normal yield. Those who remain gold bugs would find this a reasonable way to own gold and earn interest, too.

The Clinton debt crisis is real. This year, alone, interest expenditures may rise more than $60 billion — far outpacing any spending reductions the Republicans have in mind. Government taxation on all levels has been growing faster than the economy itself. If we do not start managing our debt in a professional manner, the capital markets will do the job for us — and the entire public-debt sector of the world will be thrown into chaos as we go into the end of this century.

Martin A. Armstrong is chairman of Princeton Economic Institute

Former President Bill Clinton claims he balanced the budget when in office. That miracle is never explained how someone who turned the White House into a brothel had the spare time to actually balance the budget? I explained the miracle on April 19th, 1995 for the Wall Street Journal. All Bill did was shorten the maturity of the national debt to reduce interest expenditures. There was nothing he managed economically on the fiscal spending side to balance a budget. Since long-term rates are significantly higher than short-term at virtual zero, the illusion that the fiscal side is in control has been a great illusion.



The complete nonsense of "New Economics" whereby government pretends to be capable of managing the economy. The primary tool has been to raise or lower interest rates to influence demand. The very theory is rather absurd and appears to be more of a sales pitch by a conman selling used cars. The proposition would make some sense if government were the impartial observer. However, when government is the biggest borrower within the economy, it is impossible for the central bank to manage the economy, as a whole using interest rates for the very action has not impact upon altering the behavior of government.

The accumulated interest expenditures have risen at times up to 70% of the national debt. Borrowing has crowded out spending on even social programs. Interest expenditures amounts to taxation without representation. The next generation must pay taxes simply to cover interest to roll the past debt for which they receive no benefit and have not right to approve by vote.

Consequently, lowering interest rates has encouraged more government spending through increased borrowing. Therefore, raising interest rates to "normalize" for the benefit of the private sector being pensions and the elderly will cause the budget deficits to explode. The central banks have lost control of the domestic economy entirely.

This will eventually light the fire under the economy, helping to fuel the Sovereign Debt Crisis. There appears to be no hope for the Fed since they will be forced to raise rates only when they see asset inflation in equities. Then they will have no choice. This is the worst possible mess and the longer they wait to normalize interest rates, the worse the total crisis will become for they will have zero control over the economy. Once that is seen, holy hell will break loose. The bond markets will implode as investors realize they will not be repaid. The situation is working to create tension between rich and poor as well as intergenerational conflict. Ultimately, families will reemerge as the provider of stability within society.

There is a way out. It requires understanding the evil inside government. Everything simply becomes a tool of manipulation to sustain their power and lifestyle. The way out is to reform the very political system in which we live. We simply must eliminate career politicians for all Republican forms of government have turned into oppressive oligarchies. We must take that step into the light of a new form of government neither monarchy nor republic. The way forward for our posterity and ourselves is only a democracy that provides one-year terms to supervise, temper, and control the bureaucracy.

As far as pensions are concerned, the greatest risk is the seizure of private pensions to merge with state pensions to bailout a failed system. The idea that pensions are secure must be let go. Your greatest security will be yourself and your family. Look well to that and do not expect much from government. In Eastern Europe, people learned they could not count of government. In the West, it is our time to learn the same lesson.