APRIL 2005 BANK NOTES   -- R. Nelson Nash, Editor

Infinite Banking Concepts will be conducting the Ten-Hour Seminar and "Think Tank" session in the Fall of this year. The date will be announced later and will be posted on the website on the SEMINARS button. We are considering the location on the website www.rossbridgeresort.com . This will be contingent on enrolling enough participants who want to combine business with some pleasure. The resort is adjacent to a fabulous golf course, a part of the Robert Trent Jones Golf Trail.

If you are interested in this possibility, please contact us as soon as possible so that adequate plans can be made.

Experience hath shewn, that even under the best forms [of government] those entrusted with power have, in time, and by slow operations, perverted it into tyranny.
-- Thomas Jefferson

Jefferson's observation is still in effect, of course! In view of this fact -- tell me something -- why would anyone ever trust those folks with their financial future (401-K plans, pension plans, IRAs, et al)?

When government causes a problem (onerous taxation) and then turns around and grants you an exception to the problem they created (pension plans, health plans, et al) -- aren't you just a little bit suspicious that you are being manipulated?

If government really wanted to help you out -- why don't they just reduce taxes?   Do you really think they will ever do that?   --   R. Nelson Nash

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To Save the Dollar, Save a Dollar

by Gary North

"A penny saved is a penny earned."~ *Benjamin Franklin*

"A penny saved is 1.39 cents earned if you're in the top U.S. tax bracket." ~ *Gary North*

Most Americans appear to be middle-class people. In the bell-shaped curve of life, this is as it should be. That's what makes the curve bell-shaped.

There was a day when to be middle class meant to be thrifty. This is no longer true.

There are basic habits that pre-baby boomers acquired. They are habits associated with the 1950s: my generation. Some baby boomers acquired them, too, but someone born in 1946 reached age 19 in the era of the counter-culture. For millions of these people, the habits of youth were scraped away, like a frying pan’s grease in a sand storm.

Grandchildren tend to repeat the errors of their grandparents because they rebel against the errors of their parents. The generation born in 1965–70 tends not to wear long hair. Platform shoes are out. Afro haircuts are out. But the children born to the baby boomers are not echoes of my generation. Too much of the frying pan’s Teflon surface got scraped away in the sand storm. Bad habits now stick.

Americans are today in the process of moving from the middle class to the lower class. Here, I use the brilliant insight of Harvard’s political scientist, Edward Banfield. In his 1970 book, *The Unheavenly City*, he argued that class position is tied more to a person’s assessment of the future than to the size of his bank account. A future-oriented person is upper class, he argued. A present-oriented person is lower class.

Nothing better reveals the class position of a person or a society than the commitment to thrift.

THRIFT AND ECONOMIC GROWTH

Thrift is a product of future-orientation. People forego spending today in order to achieve even greater spending tomorrow. It is this attitude that characterizes upper-class culture: "Spend your dividends, never your principal." To a lesser extent, it characterized the middle class of the pre-Beatles era. But for the middle class, the stakes are higher and the required discipline greater. Unlike the rich, who have amassed sufficient capital to be able to avoid entering the job market, the middle class must amass capital out of their wages. They must learn to avoid spending 100% of the fruits of their labor. This takes education and self-discipline. It does not come naturally.

Habits of one generation may not persevere in the next. This is especially true of good habits. Children who were taught to say "Yes, sir," do not seem to have transferred this habit to the baby boomers, who neglected teaching it to their children. My question is this: Is thrift the equivalent of "yes, sir"?

This leads us to the question of deficits: trade, federal, and personal. Let’s consider them in reverse order.

Statistically speaking, personal deficits appear to be the least of our economic worries. The ratio of debt service repayment in relation to disposable personal income has varied little over the years 1980–2003: between 13.4% to 16.2%. It’s in the high 15’s today.

This indicates that individual Americans pay close attention to their ability to repay their debts. They are not wild spendthrifts. But what they also are not these days is wild thrifts. The personal savings rate today is close to 0: about 0.2%.

Socially speaking, however, personal budgetary deficits really are the heart of our economic worries. But why is this true, if, statistically speaking, personal debt is restrained? Because the difference between personal thrift and personal debt is the defining mark of economic success and economic failure, long-term. The difference individually between a net annual deficit and a net annual surplus – a difference at the margin – marks the United States as an emerging debtor nation.

America is a debtor nation because of the mindset of its common people. This mindset is increasingly present-oriented. It is therefore lower class. The American middle class is steadily becoming lower class, despite its present level of wealth.

There can be debt that is future-oriented. Debt used to buy tools or education is future-oriented, upper-class debt. But debt incurred to purchase depreciating assets is a mark of personal capital consumption: lower class. If, at the margin, the individual's budget is in the red, year after year, then he is consuming his seed corn. Because of budgetary restraints, this consumption may be marginal annually, but it is nonetheless part of a pattern of behavior. This pattern of behavior is present-oriented and anti-economic growth. Multiplied across a nation, it becomes the indicator of future impoverishment.

THRIFT AND GOVERNMENT DEBT

Unlike the individual American, the U.S. government is not under much restraint with respect to its debt. The government is unquestionably a spendthrift. If it were not for the accounting trick of counting Social Security's net revenue as income, rather than as a future liability (debt), the United States government would not have had a single on-budget surplus year in my generation. Nixon's tiny surplus in 1969 was the result of Lyndon Johnson's recommended accounting trick regarding Social Security – taking Social Security off-budget – which went into effect in fiscal year 1969.

The unfunded off-budget liability of Social Security and Medicare combined is now over $45 trillion. (Table 1; scroll down)

The estimated on-budget deficit for fiscal 2005 is in the range of $520 billion. Without Social Security's surplus of income over payments, it would be $675 billion.

We have entered an era of massive Federal deficits. The growth of the Federal deficit is about 5% of gross domestic product. The growth of the economy is under 4%. The deficit is growing faster than the economy. We are in cancer mode.

There are only two ways out of cancer mode: (1) encourage more economic growth by freeing up the economy; (2) cut government spending. Of spending cuts, we see none. As for freeing up the economy, we also see none.

Every year for the last 11 years, *The Wall Street Journal* and the Heritage Foundation have published the Economic Freedom Index. This book-long study ranks 161 nations in terms of economic freedom in 50 different areas: trade policy, fiscal policy, government intervention, monetary policy, etc. In 2004, for the first time, the United States did not make the top ten. It fell to #12. Dr. Ed Fuelner, the president of Heritage, explains why.

> Others are overtaking us. We are treading water.
>
> In recent years, the U.S. has allowed higher government spending and protectionist measures to drag our economy into a trap. We're now choosing to do what is easy and shortsighted, rather than doing the hard work needed to expand economic freedom.
>
> But, as the Index shows year after year, without persistent commitment, economic freedom fades. Luckily, it hasn't come to that here. Yet.
>
> Our economic freedom isn't fading, it's merely holding steady as other nations improve. That's why we've been sliding down the list of economically free countries. This year, Iceland, Australia and Chile all forged past us.
>
> High tax rates – especially high corporate-tax levels – are a major drag on the U.S. economy. Increasing government spending, now at 35.9 percent of GDP, is also a problem.

THRIFT AND THE TRADE DEFICIT

The trade deficit is a combined product: low-cost foreign goods and a willingness of foreigners to invest in the United States. For as long as foreigners are willing and able to provide the money to buy goods offered for sale in their currencies, the trade deficit will continue. Of course, if American consumers said, "Let's save," spending on foreign consumer goods would decline. But it is likely that low-cost imported capital goods would replace them. If foreigners can produce cheap consumer goods to export, it is likely that they can produce low-cost capital goods, too. Americans look for bargains, and this is even more true of capital goods buyers than consumers. Businessmen pay close attention to the bottom line.

Now, if Americans started saving at rates comparable to foreigners who invest in dollar-denominated assets, foreigners would buy fewer assets. This would have an effect on the distribution of future payments, Americans vs. foreigners. Americans would earn higher incomes than if they had refused to save. Output here would rise: more capital. American industry would grow more competitive. We could compete better with Asian manufacturers. But it would take an enormous increase in thrift by Americans to outbid foreigners for ownership of capital used in domestic firms.

Basically, the trade deficit is a product of Americans who are looking for bargains and foreigners who are looking to buy assets owned by Americans: bargains. Americans buy consumer goods. Foreigners buy producer goods and debt instruments. For this arrangement to change, it would take a transformation of thinking on both sides: by foreigners, who would decide to invest less money here, and Americans, who would decide to invest abroad or in the U.S., thereby raising the price of American capital assets. Americans would outbid foreign investors.

The likelihood of this changing dramatically on both sides is minimal. There are basic habits of mind already firmly ingrained. Americans don't like to save. Foreigners do. So, any major reduction of the trade deficit must come from capital's supply side, i.e., foreign investors. They keep buying dollars, which raises the price of the dollar, which enables Americans to buy imports less expensively.

In other words, the fate of the dollar is now in the hands of foreigners: private investors and central bankers. The initiative comes from foreigners, who invest here. They make foreign currencies available at today's low but climbing prices. Americans are in full consumption mode. They are taking to heart the demand-side economics of John Maynard Keynes: "Spend ourselves rich."

FEAR AND GREED

We know now that in the U.S. capital markets, Americans have decided to forego greed – future income – for present enjoyment. The lure of greed is now minimal in the thinking of most Americans. They are content not to get rich.

Then what of fear? John Mauldin, in his January 7 letter, predicts that fear will be the great motivator.

> A falling dollar will not be enough to cure the trade deficit. It will also take a rising savings rate from the consumer. What will bring that about? When the next recession comes in 2006 or 2007, the stock market will drop. Average drops during a recession are 43%. The Baby Boomer generation will realize that the stock market is not going to bail out their retirement hopes. They will stop spending and start saving with a vengeance.

That's John: ever the optimist. He is always ready to draw to an inside straight.

I think the habit of thrift is so far removed from the thinking of baby boomers that it's not worth considering as a macroeconomic factor. Why not? Because the boomers have so little time to prepare for their looming retirement. The slogan, "It's never to late to begin," is true. But the unstated assumption – "You can still live comfortably in retirement if you start saving now" – is poppycock. Thirty years gone by cannot be recovered in a decade of thrift. There is no way for high rates of thrift to make up for three decades of "Me Decade" investing by the generation that reached adulthood in the 1970s. They did not change in the 1980s.

Those of us who reached adulthood before the Beatles arrived in 1964 vaguely recognized that thrift is vital. But, after February, 1964, the counter-culture captured the minds of America's youth. The counter-culture as an in-your-face phenomenon lasted only from 1964 to the recession of 1970, but that was sufficient. The Me Decade began in 1970, and the 70s generation did not have thrift in its agenda.

Now those Me Decade people are reaching the end of their careers. Why will they change their spending habits at this late date? We have already gone through a recession: 2001. Consumers didn't miss a beat. The housing market boomed. The Federal Reserve System pumped in money to keep the consumer boom from faltering. This reconfirmed the worldview of the Me Decade's cohorts: "There are no significant negative sanctions for big spenders." The FED forced down interest rates, which allowed households to increase their spending without hitting the debt-repayment ceiling. They borrowed more because money was cheaper. The FED offered the bait; the consumers bit.

The Me Decade's cohorts have always believed that, with respect to their retirement years, something will turn up, that the government will provide the good life, that deficits don't matter. They are willing to cut spending when they fear that they can't make their monthly payments, but this is not the same as saying that they are willing to cut spending sufficiently to pay off their debts and not take on new ones. On the contrary, the idea of paying off debts and becoming net savers is so far outside the box for the Me Decade brigade that it is not worth considering as a way to save the dollar from a continuing fall.

Then what will reverse the fall? This: the individual decisions of foreign investors to cease financing Americans' buying spree. How do they finance this? By their purchase of dollar-denominated assets, thereby increasing demand for dollars. The dollar will fall when they quit investing here.

You should invest in terms of this understanding. Thrift by Americans will not reappear as if by magic during the next recession. The dollar will fall. Americans will then of necessity buy fewer foreign-made goods. The trade deficit will shrink. This state of affairs will be imposed on American consumers. It will not be initiated by them.

OTHER SCENARIOS

There could be a change in attitude if the benefits were high enough. If the United States government ceased to tax profits and dividends until the money is taken as personal income, that would increase the domestic savings rate. But it would also increase the savings rate of foreign buyers of dollar-denominated assets. This would increase the value of the dollar internationally, making imported goods cheaper. The trade deficit would continue until such time as improved American productivity began to make itself felt in the world's markets or until foreign investment markets and legal systems became competitive with America's. This would not be an overnight phenomenon. I think it would take well over a decade. We cannot make up for lost investing in one decade, either personally or nationally.

The possibility of a major overhaul of the tax code today is minimal. To get rid of the corporate tax and the taxation of retained earnings would take an ideological revolution. It's not going to happen soon.

Stable money would stop the fall of the dollar, but that would not necessarily end the trade deficit. Stable money would give foreigners another reason to invest here. The dollar would then rise. It would buy more foreign goods. The trade deficit would increase.

Mauldin writes: "A falling dollar will not be enough to cure the trade deficit." I think to myself, "enough, plus what?" With the trade deficit for the month of November at $60 billion, what kind of motivation would be able to reverse the trend? I can think of none that will come from America's side of the equation.

I can think of only one American-initiated factor that might conceivably cure the trade deficit over the next decade: the return of the commitment to thrift by Americans – a level of commitment on a scale not seen in my generation. Nevertheless, this commitment must not lure American manufacturers to buy imported capital equipment. The trouble is, it would. Americans want a bargain. America's capital goods industries are not sufficiently competitive.

What America's economy needs most is increased productivity. We need to be able to compete in world markets. We need more investment, especially in education, but not the education provided by tax-funded bureaucrats, i.e., classroom teachers. We need education in entrepreneurship. We need education by market-tested masters.

We need a return to apprenticeship. This is not going to happen. This country spends over $270 billion a year on education, and most of this money goes for classroom instruction in tax-funded, tenure-governed institutions. These institutions are well-organized politically. They are not going to turn loose of the money tree.

Would you rather spend a year as an apprentice to Donald Trump or as an apprentice to a tenured professor of marketing who has never worked in private industry? Give me The Donald! Americans instinctively know this. Nobody would watch The Apprentice if the mentor were Professor Anyone. Nobody would tune in to hear Professor Anyone say, "You flunked!"

The state touts education as a cure-all. But it touts only state-funded education. It seeks to feather its own bureaucratic nest. The result: a soiled nest. There are too many degree-holders and not enough entrepreneurs. There are too many lawyers and not enough engineers.

Two things can reverse the trade deficit: (1) vastly increased thrift by Americans (unlikely), who will invest in companies that insist on buying American-made capital goods; (2) a refusal of foreigners to buy American investment assets. The first isn't going to happen until the dollar falls so low that American capitalists can't afford to buy foreign-made capital goods. I don't know when the second will happen. I know only that it will.

DEBT AS A TOOL OF DOMINION

Some debts make sense for the debtor. I just bought a 4-bedroom, 2-bath home for $90,000. (Note: not in California.) I paid 5% down and got a 30-year loan at 5.375%. My total mortgage payment is under $540 a month. The home is located in the middle of a boom area with growing in-migration.

> (Hooray for the Web, with its published mortgage rate sites. I will save total payments of $17,200 over the rate quoted to me locally. It took less than 20 minutes of toll-free phone time to get the loan.)

Was I foolish to borrow? Not when I can rent the home for more than I pay to the lender. Why can I do this? Because I have an almost flawless credit rating. Also, because lenders trust the dollar's future.

I evaluate a housing bubble thusly: Can I rent the home for more than I must pay to repay the mortgage? If I can, it's not a bubble. It's merely a boom. I like booms.

For me, thrift is a way of life. It always has been. So, I can now borrow cheap money. The person who spends what he earns and runs up debts doesn't have the credit rating to enable him to buy. He must rent.

Some poor schnook is going to spend my monthly mortgage payment to buy a few groceries before it's paid off. I'll probably be in one of those stately ethereal mansions, but my wife will have minimal monthly payments to make in terms of purchasing power. She will have a roof over her head.

I invest in hard assets, such as a piece of commercial real estate that will produce 20% per annum, probably appreciate, and let me earn a $50,000 salary while I'm at it. (http://www.demischools.org)

This is why we should teach our children to save. Saving requires budgeting. I probably did not do a great job teaching my children most of what I know, but this lesson they learned. They are frugal. This won't make them rich, but it will keep them from being poor. They may rent today, but, at some point, they will have the ability to secure a mortgage because of their good credit.

I may have overdone it. They should borrow short-term money to buy tools or get meaningful educations/licenses, and then pay off the debt, fast. This way, they will build a credit history. That's the wisest strategy. But if there is a temptation to go into consumer debt, then it's best not to borrow at all. Like other addictions, the first snort should be avoided.

Borrowing is not an evil. It depends of what you are borrowing for. If your debt supplies tools, education, or a comfortable but modest place to live, then it's a tool of dominion. But if debt is used to buy depreciating assets, it is a curse. Most assets depreciate. Buy them used for cash from someone who is strapped for cash.

CONCLUSION

Patterns of thought and behavior take years to acquire. They can be lost in one generation. This is what happened to the ideal of thrift in the United States. Joe Lunchbucket is dead or retired. His children are in hock. His grandchildren want to be like their parents. Debt is easier than thrift. As the saying goes, "Things are easier to get into than out of."

The habit of thrift for the wealthy upper 20% is still with us, although declining, but this habit is compromised by the twin assumptions of a stable dollar and trust in government promises. Thus, the creditors who buy government debt think they will be repaid. It will take a universal default to disabuse them of this confidence. That default is coming, in one form or another.

Fact: there are more debtors who vote than creditors who vote. And the biggest debtor on earth is the U.S. government. It won't take anything new to persuade Congress to run a deficit. The voters are on their side.

There will be tens of millions of victims of government promises. There are two varieties of victims: (1) government-trusting debtors who never save, and (2) government-trusting creditors who do. Don't be in either camp.

Greenspan's Whopper

by Bill Bonner

"You are wasting your life and your talents writing about Alan Greenspan every day," said an old friend.

For years, we have been working on Greenspan's obituary. As far as we know, the man is still in excellent health. But we do not want to be caught off guard. Maybe we could even rush out a quickie biography, explaining to the masses the meaning of Mr. Greenspan's life and work.

Perhaps our friend is right. But then again, we weren't doing anything special before we started keeping up with the Fed chairman. Besides, we see something in Alan Greenspan's career…his comportment…his betrayal of his old ideas…his pact with the

Devil in Washington…and his attempt to hold off nature's revenge at least until he leaves the Fed…that is both entertaining and educational. It smacks of Greek tragedy without the boring monologues or bloody intrigues. Even the language of it is Greek to most people. Though the Fed chairman speaks English, of course, his words often need translation and historical annotation. Rarely does the maestro make a statement that is comprehensible to the ordinary mortal. So much the better, we guess. If the average fellow really knew what he was talking about, he would be alarmed. And we have no illusions. Whoever attempts to explain it to him will get no thanks; he might as well tell his teenage daughter what is in her hotdog.

We persevere anyway, more in mischief than in earnest.

The background: The U.S. economy faced a major recession in 2001 and had a minor one. The necessary slump he held off by a dramatic resort to central planning. The "invisible hand" is fine for lumber and poultry prices. But at the short end of the market in debt, Alan Greenspan's paw presses down, like a butcher's thumb on the meat scale. The Fed quickly cut rates to head off the recession. Indeed, never before had rates been cut so much, so fast. George W. Bush, meanwhile, boosted spending. The resultant shock of renewed, ersatz demand not only postponed the recession; it misled consumers, investors and businessmen to make even more egregious errors. Investors bought stock with low earnings yields. Consumers went further into debt. Government liabilities rose. The trade deficit grew larger. Even on the other side of the globe, foreign businessmen geared up to meet the phony new demand; China enjoyed a capital spending boom as excessive as any the world has ever seen.

What the Greenspan Fed had accomplished was to put off a natural, cyclical correction and transmogrify an entire economy into a monstrous ECONOMIC bubble. A bubble in stock prices may do little real economic damage. Eventually, the bubble pops and the phony money people thought they had disappears like a puff of marijuana smoke. There are winners and losers. But in the end, the economy is about where it began – unharmed and unhelped. The households are still there…and still spending money as they did before…and the companies still in business. Only those that leveraged themselves too highly in the bubble years are in any trouble – and they probably deserve to go out of business.

Even a property bubble may come and go with little effect on the overall economy. House prices have been running up in France, for example, at nearly the same rates as in America. But in France there is very little mortgage refinancing…or "taking out" of equity. The European Central Bank was repeatedly urged to lower rates in line with those in America. It refused to budge. Without falling rates, there was no "refi boom." Nor were European banks offering "home equity lines of credit." Property could run up…and run down…and the only people who cared would be the actual buyers or sellers, who either cursed themselves or felt like geniuses, depending on their luck.

But in Greenspan's bubble economy something remarkably awful happened. Householders were lured to "take out" the equity in their homes. They believed that the bubble in real estate priced created "wealth" that they could spend. Many did not hesitate. Mortgage debt ballooned in the early years of the 21st century – from about $6 trillion in 1999 to nearly $9 trillion at the end of 2004. Three trillion dollars may not seem like much to you, dear reader. But it increased the average household's debt by $30,000. Americans still lived in more or less the same houses. But they owed far more on them.

We had given up all hope of ever getting an honest word out of the Fed chairman on this subject when, in early February, in the year of our Lord 2005, the maestro slipped up. His speech was entitled "Current Account." Jet lagged, his defenses down, the poor man seems to have committed truth.

"The growth of home mortgage debt has been the major contributor to the decline in the personal saving rate in the United States from almost 6 percent in 1993 to its current level of 1 percent," he admitted. Thus, he did bring up the subject. Then, he began a confession: The rapid growth in home mortgage debt over the past five years has been "driven largely by equity extraction," said the man most responsible for it. By this time, listeners were beginning to put Mr. Greenspan at the scene of the crime. And pretty soon, even the dullest economist in the room was adding 2 and 2. Mr. Greenspan lowered lending rates far below where a free market in credit would have put them. With little to be gained by putting money in savings accounts…and a lot to be gained by borrowing…households did what you would expect; they ceased saving and began borrowing. What did they borrow against? The rising value of their homes – "extracting equity," to use Mr. Greenspan's own jargon. The Fed chairman had misled them into believing that house prices increases were the same as new, disposable wealth.

But the world's most famous and most revered economist didn't stop there. He must have had the audience on the edge of its chairs. He confessed not only to having done the thing…but also to having his wits about him when he did it. This was no accident. No negligence. This was intentional.

"Approximately half of equity extraction shows up in additional household expenditures, reducing savings commensurately and thereby presumably contributing to the current account deficit…. The fall in U.S. interest rates since the early 1980s has supported home price increases," continues America's answer to Adam Smith.

People take money out of their homes. With this source of spending power available to them, they see no reason to save. Instead, they spend – often on foreign-made goods. With no savings available domestically, America must look overseas for credit.

"The obvious and most important point is that rapid growth of U.S. mortgage debt did not come out of thin air," comments Stephen Roach. "It was, of course, a direct outgrowth of the Fed's hyper-accommodation of the post-bubble era – namely, short-term interest rates that have been negative in real terms for longer than at any point since the 1970s.".

The crime of which Mr. Greenspan is guilty is fraud. Putting interest rates at an artificially low level, the Fed chairman intentionally misled Americans. Were it not for the Fed's low rates and easy lending policies, Americans wouldn't have thought themselves so rich. Their houses wouldn't have gone up so much; they wouldn't have taken out so much equity, because they wouldn't have had any equity to take out. They would have had to spend less, which would have reduced the U.S. current account deficit and diminished household indebtedness.

"Lacking in job creation and real wage growth," explains Roach, "private sector real wage and salary disbursements have increased a mere 4% over the first 37 months of this recovery – fully ten percentage points short of the average gains of more than 14% that occurred over the five preceding cyclical upturns. Yet consumers didn't flinch in the face of what in the past would have been a major impediment to spending. Spurred on by home equity extraction and Bush Administration tax cuts, income-short households pushed the consumption share of US GDP up to a record 71.1% in early 2003 (and still 70.7% in 4Q04) – an unprecedented breakout from the 67% norm that had prevailed over the 1975 to 2000 period…. At long last, Chairman Greenspan owns up to the central role he and his colleagues at the Federal Reserve have played in fostering these developments."

Our own Fed chairman, guardian of the nation's money…custodian of its economy…night watchman of its wealth…

How could he do such a thing? And yet he has done it. He turned a financial bubble into an economic bubble. Not only were the prices of financial assets ballooned to excess…so were the prices of houses…and so were the debts of the average household.

Where does it lead? The force of a correction is equal to the deception that preceded it. Mr. Greenspan's whopper must be followed by a whopper of a slump.

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Mortgaging the Farm

by Bill Bonner

"What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom," wrote Adam Smith. We wonder about the contrary...what is folly in private conduct, if it is not folly for the great kingdom?

Volatility is at a 12-year low. People do not expect much movement in the stock market. They are not getting much. Investors are calm, bullish, and delusional. Nothing happens. And nothing is just fine.

Because while they are making nothing from their stocks – the market is no higher today than it was 6 years ago – they are getting rich in real estate. Seventy percent of Americans own their own houses. In round numbers, the average house is worth $200,000. And the average house goes up 10% per year. This gives the average household $20,000 more "wealth" each year. What's not to like?

In some areas, houses are going up five, six, even 10 times faster than consumer price inflation.

Wait, how could house prices be rising so fast and consumer price inflation so slowly? Isn't housing the biggest single item in private expense accounts? Well, the statisticians who compile the figures take care to put into the CPI only items that people don't like to see go up. More than two out of three houses are owned by their occupants, but who among them complains when house prices rise? The complainers are renters. So it is the rental figures that go into the CPI.

For the homeowner, the rise in house prices comes like free booze on an empty stomach. He puts the cup to his lip; in hardly any time, he's a little giddy. The average homeowner thinks he has $20,000 more to spend. How is he supposed to know that the "wealth" is a figment of Alan Greenspan's financial fiddle, and not the real thing?

Who can blame him for wanting to take advantage of a free drink?

Multiplied over millions of households, the alcohol eats away at the nation's balance sheet as if it were liver. Every day, as Warren Buffett puts it, the nation spends 5% more than it earns. We are like a very wealthy family, he says, with a very big farm. We don't earn the money we used to, so we keep mortgaging more and more of it to pay current expenses. In the end, we will still be a family, but we will not be wealthy.