



## Saving the U.S. economy with “trickle-up” economics

By Rinaldo S. Brutoco, Founder and President, World Business Academy

**STATUS:** The federal bail out plan (or “rescue plan” as it now is being called) did not solve any underlying fundamental weakness in the economy. All it did was buy us time, band-aid the bleeding if you will, so that we can rapidly address what is really wrong. Wrapping new layers of debt at the Federal level as additional leverage on the existing levels of private and public debt will only cause the economy greater permanent damage if we don’t use the time which has been purchased to change the fundamentals which created the meltdown in the first place.

**The bad news:** The economy as we have known it since World War II is so fundamentally broken that it *cannot be fixed by fine tuning it in its present form* no matter how much intervention the government engages in. **The good news:** Once we develop a dramatically different approach to the economy, what we are calling “trickle up” economics, we will create a level of wealth in the U.S. (and ultimately abroad) that will be at least 100 times greater than the level of economic wealth created since World War II under the old economic system.

**THE FIX:** An economic recovery will require the country to recognize that the financial crisis cannot be solved without changing the underlying culture of debt and replacing “trickle-down” economics with “trickle-up economics.” We need, among other things, to immediately fund infrastructure repair projects on a massive (\$50-100bn/year) annual basis to create good paying

jobs in the respective trades, radically slow down the rate of home foreclosures, freeze the Adjustable Rate Mortgage resets as well as freeze all increases in variable home owner equity lines of credit, and help the average American worker attain affordable comprehensive health care and an affordable college education for their children, as well as a secure retirement through an intact and adequately funded Social Security system.

The following is a punch list of steps necessary for economic recovery.

1. Create the modern day equivalent of the Depression-era Home Owners Loan Corporation (HOLC), which bought up and renegotiated troubled mortgages, and closed shop less than 20 years later after making a bit of profit for taxpayers. When the HOLC is re-authorized, it should have one of its former principal duties, providing free credit counseling to home borrowers. It should also have the power to negotiate on behalf of a mortgage holder who is otherwise unable to represent itself in such negotiations, such as when the mortgage has been chopped up and syndicated into a thousand pieces and no one entity, including the servicing agent, has the authority to speak for the mortgage holder. For a host of reasons, it would be wise to put the great bulk of the \$700bn in funds recently authorized by Congress into this modern day HOLC rather than leave the funds washing around the Treasury Department.

# Common Cents

**2.** For at least a year, freeze interest rates at today's levels on Adjustable Rate Mortgages (ARMs) and home equity lines of credit; prohibit lending institutions from further capital calls under either one based on deteriorating collateral ratios that result from falling home prices; and give the President the authority to continue the freeze and prohibition on a year-by-year basis as necessary, for up to five years, by notifying Congress of his intent to do so and the reasons for his decision. Taken together, these twin reforms would save any homeowners from foreclosure who are capable of making their current mortgage payments as they come due. The prohibition on further capital calls on homeowners based on the falling value of their home would essentially do for homeowners what the FDIC and FASB's new guidance effectively suspending "mark to market" accounting rules does for financial institutions.

**3.** Give bankruptcy courts the authority to modify the mortgage payments on a person's primary home similar to the courts' authority to modify commercial mortgages, and hold Congressional hearings to evaluate last year's amendments to the bankruptcy code that make it more difficult for consumers to use bankruptcy to discharge credit card debt.

**4.** Immediately get control of the unregulated market for Credit Default Swaps (CDSs), and prohibit the issuance of any new swaps at least until a new law or SEC rule defines a CDS as a "security" within the meaning of the 1933 and 1934 Securities Acts if any material portion of the underlying insured obligation relates to a U.S.-based company or asset. Without this reform, it would be destabilizing to bail out the financial industry by buying up assets that cannot be sold on the private market because investors would still use swaps to hedge transactions they deemed to be unacceptably risky. If we do not immediately begin to bring the CDS market under control, trillions of dollars more of swaps will be created even as we try to deal with the damage

caused by the \$63 trillion in swaps already outstanding.

**5.** Increase margin requirements for all stock purchases by 5% per month for each of the next five months so margin requirements are at least 25% higher than now, and impose subsequent monthly increases as necessary to reduce market purchases of equities, bonds and commodities on leveraged speculation. At some point, and Congress should immediately hold hearings on this issue, we will have raised margin requirements high enough to damp down speculation while still providing adequate liquidity for non-speculative, forward purchase-oriented transactions.

**6.** Re-evaluate short selling rules through Congressional hearings to determine whether short selling plays a necessary role in the markets, and if so, how it should be regulated and whether the "uptick" rule repealed 14 months ago should be reinstated. That rule, part of the Securities Exchange Act of 1934, was designed to prevent short sellers from speeding up crisis-induced downward spirals in share prices. The rule prohibited any short sale that was not "higher than the last different price." In other words, a seller could not short a stock unless the share price first ticked upward by a fraction of a point.

**7.** Restore a Glass-Steagall-like wall between commercial banking and investment banking. This is even more critical now that there are no pure investment banking houses of significance left on Wall Street. Goldman and Morgan Stanley have decided to enter retail banking, and the other big investment banks have either been acquired (Bear Stearns by Morgan Chase and Merrill by Bank of America) or liquidated (Lehman Brothers).

**8.** Launch an immediate project, in the \$50-100 billion range annually for the next 5 years, to rebuild and expand American infrastructure, including bridges, roads, hospitals, sewers, public buildings, green transit, alternative energy projects, and broadband capacity.

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**9.** As fast as possible, zero out the \$10 billion/month we spend on the Iraq war. Reduce annual defense spending to \$600bn per, saving \$100bn annually, and spend a third of the savings on each of the following: a crash green fuels program, further infrastructure improvements, and reduction of the national debt.

**10.** Enact a universal health care system that provides affordable care to every American and relieves employers of the inordinate burden of providing such coverage. Employer healthcare costs make U.S. industry less competitive than other western industrialized countries where employers do not have to absorb such costs. This one reform would make U.S. industry immediately more competitive on world markets. Require pharmaceutical companies that sell drug products in the U.S. to sell the product to government health programs and private outlets at the lowest price they sell the same product anywhere else in the world. This would leave drug companies with more than adequate profits while drastically reducing the nation's healthcare bill. (No pharmaceutical company refuses to sell drugs in Europe where prices are up to 40% lower than in the U.S. for the very same brand drug.) These healthcare proposals are vital in order to help keep homeowners from going bankrupt due to their inability to pay for the skyrocketing medical premiums and/or the cost of medicine and drugs in the absence of full insurance. These proposals will be particularly welcomed by senior citizens who are faced with a disproportionate burden of paying for our broken healthcare system even as their incomes are declining in retirement.

**11.** Immediately remove the double taxation of dividends, allowing companies to take the same tax deduction for dividend payments as they take for interest payments, thereby: (a) decreasing the incentives for companies to assume more debt than is absolutely neces-

sary, (b) increasing the incentives for companies to pay dividends; (c) increasing federal tax revenue as a result of the higher tax rates on shareholders' dividends than on corporate profits, and (d) transforming the U.S. economy from a culture of debt to a culture of savings and equity. This reform would begin to reverse the quarter-to-quarter mentality of business. Companies would no longer be judged by a PE (Price Earnings) ratio that can be manipulated, but by a DE (Dividend Earnings) ratio that cannot; no accounting sleight of hand can hide how much a company pays out in dividends. This reform would allow the individual investor, 401k plan holder, IRA holder, and the like to make investment decisions based on companies' actual dividends rather than on some number that is subject to manipulation.

**12.** To discourage speculative trading, and raise federal revenues, reinstitute the federal .25% securities transfer tax like the one in effect in the U.S. 1914-1966, and still in effect in the UK and other countries. A group of Democrats included such a provision in the "No Bailouts Act" introduced after the House voted down the first bailout plan last week. They estimate that it would raise \$150 billion a year.

**13.** Ensure the effectiveness of the oversight panel created as part of the bailout plan to rescue financial institutions by buying up their soured assets. A strong oversight panel will be necessary to ensure the fairness to taxpayers of the cost-basis contracts that the Treasury Department will need to enter into with financial experts to manage those assets. What must happen next is for the Treasury to write the rules it will play by, have Congress review those rules to ensure they provide for adequate oversight, and then have the rules take the full force of law.

**14.** Immediately create a bridge-financing fund for state, county, and city government entities to provide temporary relief from

shortfalls caused by falling tax revenues as a result of the economic downturn. The entities should be required to guarantee repayment with a priority lien against future tax receipts on some equitable basis. The fund is not intended to encourage governments' deficit spending but to provide liquidity at a time when banks are unwilling to provide bridge financing. In addition, provide a governmental financing authority for state, county, and city entities until the market for revenue-backed municipal bonds and state financing of revenue-backed infrastructure projects normalizes

In making the suggestions above, and the many more that are sure to follow as we continue to analyze the current financial crisis, the question that we will most frequently be asked is: "With all the costs of the bailout, won't it mean the next President will have to reduce domestic spending to pay for everything?"

First, this question assumes that military spending could not be reduced to pay for the entire package and still leave the U.S. military with an extraordinary high level of funding by historical standards. The American people must realize that even after the minor 10% cut recommended above, military spending would be dramatically higher than when George Bush took office, and that we are so broke we can no longer afford to spend more on military matters than the rest of the world combined. We have been on a permanent wartime funding in this country since World War II and such funding, more than any other single item, has led to the brink of financial ruin. Like every other empire that has preceded us, we must understand that the cost of maintaining a global military presence exceeds its value to us and is not making us safer. The time has come for us to take our responsible role as one very powerful nation amongst a family of nations rather than continue time has come for us to take our responsible role as one very powerful nation

amongst a family of nations rather than continue to attempt to run the world at the expense of the American taxpayer. We can no longer afford to have hundreds of military bases around the world nor continue to procure weapons at the staggering rate we have for over 60 years. President Eisenhower warned us precisely of this danger in his Farewell Address at the completion of this second term. It is time we took his admonitions to heart.

The second reason why we need not concern ourselves with reducing our domestic spending is because it is precisely that domestic spending that will re-ignite our economy to levels as yet undreamed of. That is why President Roosevelt in similar circumstances created the Works Progress Administration, the Civil Conservation Corporation and Social Security itself to name but a few. The only way we can ever pay off the massive federal deficit we have created is by re-creating our economy so that we generate far higher levels of wealth. This can be done by implementing each of the 14 points above. Due to the famous "multiplier effect," doing so will actually create an economy that is dramatically larger and more efficient than anything most people can even envision.

The current economic crisis is actually a blessing. No amount of tinkering with the existing "trickle-down" approach to the economy could ever create the wealth necessary to re-build U.S. society. Because the culture of speculation has made us near-bankrupt, we have no other choice but to embrace a more sane culture of equity, savings, and liquidity based on the creation of real goods and services. There really is no other choice left to us.

We must remember Winston Churchill's war-time observation, "The Americans can always be counted upon to do the right thing – after they have exhausted all other alternatives." The current crisis makes it abundantly clear that we have exhausted all other alternatives. It is now time to embrace some old-fashioned Common Cents.