Written by Charles Scaliger on October 9, 2013

# Rough Road to Recovery

It’s autumn of 2013, five years after the economic and financial meltdown in the fall of 2008, and tens of millions of Americans are still out of work. Tens of millions more are underemployed or earning significantly less than they were a decade ago. The housing market, whose epic collapse triggered the recession that followed, is still in the doldrums. Millions of households have had to default on their mortgages. Student loan debt is at an all-time high and climbing, as today’s rising generation, apprehensive at slim job prospects, prolong or diversify their post-secondary education, hoping against hope that their dearly purchased credentials will give them a leg up if the economy ever does truly recover.

And politicians, true to form, are trying to take credit for a recovery that looks a lot worse than most normal recessions. “We’ve cleared away the rubble from the financial crisis and we’ve begun to lay a new foundation for economic growth and prosperity,” President Obama said in mid-September, in defense of a disastrous economic policy that has featured trillions of dollars in bailouts and stimulus, tax hikes, skyrocketing deficits, and an onslaught of new government regulations ostensibly designed to “curb the excesses” of the free market.

**Feeling It in the Pocket**

Since the onset of the Great Recession in 2007, Americans have endured more than five years of unremitting economic and financial turmoil. Recent developments in Syria have temporarily diverted public attention from money matters, but the hard reality, which few in Washington are willing to face, is that the American economy remains in desperate condition, weighed down by trillions of dollars of new debt, smothered by a vast regime of new federal controls, including ObamaCare, and hamstrung by an array of burdensome new taxes that seem calculated to prevent significant new capital formation from ever taking place.

The story of the post-recession United States economy is succinctly told in an August 21 report released by Sentier Research, which examined median household incomes before, during, and after the official end of the so-called Great Recession. Median income, it is worth noting, is a far better indicator of where things stand than average income, because the latter can be skewed — and, in this case, is skewed — by huge profits reaped by the wealthy few who have the connections, asset base, and knowledge to profit from massive market swings. Median income, by contrast, is simply the figure that corresponds to what the largest number of individuals or households are earning, and the figures tell a discomforting tale. According to the folks at Sentier, real (i.e., adjusted for inflation) household income has declined by 4.4 percent since the end of the recession in June 2009. Add to this a roughly 1.8 percent decline in median household income during the recession, and the typical American household is earning more than 6 percent less than it did in December 2007, the official start of the recession. In dollar amounts, median household income during the last quarter of 2007 was $55,480, and today, after more than four years of alleged recovery, it stands at about $52,100. And the picture gets bleaker if we go further back in time. Compared to January 2000, the median household in 2013 earns 7.2 percent less.

Noted Sentier Research's Gordon Green:

> This latest report continues our efforts to help chronicle one important dimension of the economic hardships now being experienced by a large number of American households. Our findings complement data on the unemployment rate, GDP estimates, leading economic indicators, and other economic data series. In many ways, median household income provides a measure of the net effect of economic activity on the middle class and how well they are able to buy food, housing, and other necessities every month, especially now during this unprecedented period of economic stagnation. Based on our data, almost every group is worse off now than it was four years ago, with the exception of households with householders 65 to 74 years old. For some groups of householders — Blacks, men living alone, young and upper-middle age brackets, part-time workers, the unemployed, females with children present, and those with only a high school degree or some college but no degree — the declines have tended to be larger than average.

Statistics for various subgroups are even more sobering. In particular, since 2000, household incomes have declined by 9.1 percent for men living alone, by 9.6 percent for householders under 25 years old, by 10.9 percent for black households, by 9.3 percent for householders with a high-school diploma but no college, and by a whopping 21 percent for households with an unemployed householder.

Overall, since the turn of the millennium, the trend is unmistakable: Earnings have drifted lower and lower, and the American standard of living with it. If the economy continues on this track, by early in the next decade, Americans will have a standard of living conditioned by incomes only about 80 percent what their parents enjoyed — and possibly much less if, as seems distinctly possible, the economy slips back into recession sometime before 2020.

As Green noted, the median household income figures more or less mirror what other economic indicators are telling us, namely, that while the economic free-fall of four years ago has been tempered, there is no sign of anything approaching a robust recovery on the horizon. If the American economy were an ER patient, the defibrillators would have been laid aside — within arm's reach — and the patient would be awake and breathing, but still on life support.

**Taking It on the Chin**

Unemployment, for example, is lower than in the depths of the recession, but still close to eight percent — about double what it was in 2000 — even with the deceptive statistical methods used nowadays by the federal government (a more honest reckoning would put the figure at well above 10 percent). And another figure produced by the Bureau of Labor Statistics, which the happy talkers inside the Beltway and in the news media are careful to avoid — the employment to population ratio — tells a very different, and withal more accurate, tale of the state of the American job market. At the beginning of the millennium, immediately before the comparatively brief and shallow recession during the first Bush term, this ratio — the percentage of working-age Americans with a job — stood just shy of 65. It then declined to a low of about 62 by late 2003 before working its way back up to just under 63 on the eve of the Great Recession. It then plummeted to about 58.5 by the beginning of 2010, and has remained nearly stationary below 59 ever since. Translation: A massive number of jobs were destroyed by the collapse, and haven't been re-created.

Gasoline prices were around $1.60 per gallon 10 years ago. After ballooning up to about four dollars a gallon in late 2008, they dropped back down to about $1.60 per gallon by early 2009 — when President Obama was inaugurated — and have been climbing steadily ever since, back to about $3.60 a gallon at the time of this writing.

The stock markets have essentially flatlined since the bursting of the dotcom bubble in 2000; there have been ups and downs, including, of course, the spectacular plunge associated with the financial panic in the fall of 2008, but in the long term, the Dow has yet to surpass — in adjusted terms — the highs of the late 1990s, while the Nasdaq remains far short of its all-time highs achieved during that same giddy period. We are, in other words, in a secular bear market (a long-term trend where there are short bull markets and extended bear markets), regardless of the quarter-by-quarter pronouncements of short-term investment shysters. And recent market gains are modest, percentage-wise, compared to the sort of thing America became accustomed to during the secular bull market of the '80s and '90s; most market "growth" over the last five years is nothing more than a response to Federal Reserve money creation, and will evaporate the moment the Fed begins raising interest rates.

Culturally, Americans have never been particularly debt-averse, but during the late bull market run, people borrowed money to buy houses (and second houses, and third houses), in the expectation that seemingly never-ending economic growth would enlarge their asset bases and incomes, making debt service easy. And, until the contraction began in earnest, they were generally right.

But now, five years into the new economy, long-term student and credit card debts languish unpaid, as interest and charges pile up and creditors scramble to track down and put the squeeze on millions of delinquent debtors. The realization is slowly dawning that a huge percentage of America's $1 trillion-plus-and-growing student debt is never going to be repaid, and efforts are under way to legalize — for the first time in a generation — the discharge of student debt in bankruptcy. Average Americans — young, middle-aged, and old alike — are up to their eyeballs in debt, with no prospect for relief anywhere on the horizon. In the meantime, homeowners (a misnomer if there ever was one!) are defaulting by the tens of thousands on mortgages that, not long ago, were just another monthly payment for dual-salary, six-figure household incomes.

And the picture is even worse for the public sector. Simply put, after taking on trillions in new debt, ostensibly to stimulate the economy and to save corporations deemed too big to fail, the federal government has next to nothing to show for it. To be sure, the show of bravado by the Obama administration and Bernanke's Fed helped to allay fears and mend frayed emotions, but in the long run, even the finest rhetoric has to cede to reality.

And the reality is that America has run out of money. There's a reason that debt-ceiling fights have become an annual game of brinksmanship in Washington, D.C.: Even the politicians have figured out how desperate are the straits into which the ship of state has been guided, and none of them want to be at the helm when it finally runs aground.

**A Once-vibrant Middle Class**

Taken together, these factors add up to the death of the once-vibrant American middle class, the end of the so-called American dream as it has been understood since the beginning of the modern age. As Michael Lombardi of Business2 Community put it, in “An Obituary for the American Middle Class”:

> The middle class helped the U.S. economy (following World War II and up until the credit crisis of 2008) by buying goods and services they needed or wanted. They bought cars, TV sets, furniture, appliances, clothing, computers, and flashy gadgets. In simple terms: they spent money.

The spending by the middle class resulted in American companies selling more, making more, and hiring more people to meet consumer demand. Businesses then took their profits and invested in new projects and built more factories. This is how cities like Detroit flourished....

Today, the middle class is not buying or spending like it once did — and this is not by choice.

The collapse of the housing market in the U.S. economy has taken a devastating toll on the middle class in this country.

While the media and politicians keep telling us the housing market has turned the corner and is healthy again, the delinquency rate on single-family residential mortgages at all commercial banks in the second quarter of this year stood at 9.41% — that’s 558% higher than the delinquency rate in the first quarter of 2005.... The middle class is moving from mid-tier retail stores like Macy’s, Inc. … to low-end retailers like the Dollar General Corporation....

When presenting his company’s second-quarter earnings, the chairman and CEO of Dollar General, Richard Dreiling, said, “Dollar General delivered another solid quarter. Our same-store sales growth for the second quarter of 2013 accelerated to 5.1%. We are very pleased with the increase in customer traffic in our stores. We continue to grow our market share and believe that our second quarter results position us well to deliver our financial outlook for the year.” … Unlike Dollar General, the executives from Macy’s complained about slower sales in the U.S. economy. (Mind you, Macy’s isn’t the only middle-of-the-road retailer complaining about customer demand.)

This is all happening because the middle class in the U.S. economy is actually earning less, which is something the politicians are not talking about.

Of course, the decline of the middle class did not begin with the Great Recession. It has been under way for decades, unremarked by many because — until recently — Americans have been able to simply make adjustments in their lifestyles to counter the effects of inflation, deteriorating wages, higher taxes, and ever-more-comprehensive regimes of regulatory control of commerce by federal, state, and local governments. For example, sometime in the 1970s and 1980s, the one-income household became obsolete, as American couples discovered that a single income was no longer enough to pay for the proverbial house in the suburbs with the white picket fence, the family car, and the children’s college educations. Difficult to imagine as it is today, this writer’s parents were able to afford to purchase, in 1966, a farm with about 40 acres of field and woodland in Maine, as well as a family car (a VW bus), while supporting two (and later, three) children and paying off a 10-year student loan that had paid for a BA at an elite private university — all on my father’s salary working as a librarian at a small liberal arts college. Five years later, with the student loan nearly paid off, my parents moved to Pennsylvania, where they purchased another farm, which included two houses and more than a hundred acres of forest and field — still on a single librarian's salary.

Nowadays, of course, such a lifestyle would be impossible for any but the wealthy; for nearly all middle-class families, second incomes are necessary for owning just about any kind of home that isn't mobile, let alone a place in the country with acreage beyond a yard. And, increasingly, even the two-income arrangement is no longer sufficient, as millions of Americans find their pay and hours reduced even as the cost of living continues to rise.

**Manufacturing Malaise**

Is continued decline inevitable? To answer the question, we need to understand clearly what is happening, and why. First of all, what isn't happening: The economic collapse and continued stagnation are not the consequence of failures of the markets, or of capitalism, or of laissez-faire, or whatever we may choose to call the processes associated with free-market economic behavior upon which our economy was formerly based. They are not the result of too little government regulation of the markets, nor of the allegedly irresponsible trend toward deregulation embarked upon in the years leading up to the crash.

The root cause of the so-called business cycle, the seemingly unavoidable alternation of boom and bust, bull and bear, bubble and recession, is government interference in the economy. There are three activities that government engages in that distort the workings of the free market: taxation, regulation of market activities, and manipulation of the money supply. Of these, taxation in some form is unavoidable, taxes being the price we pay for government. Originally, though, America was virtually a tax-free society, and the federal government, confined to its proper constitutional functions, was financed in peacetime via tariffs and excises on imports. Even that practice was soon politicized in the early American Republic, such that tariffs, instead of being uniform, were used to target certain imports and protect certain domestic industries at the expense of others. But the damage done by such preferential tariffs, though significant, paled beside what the government was able to achieve with modern "progressive" taxes like the graduated income tax and the FICA tax levied to sustain Social Security and Medicare. Modern-day federal taxes, in combination with heavy state and local taxes, devour around 50 percent of what used to be disposable (and savable) income, diminishing for most of us the rewards of working hard, and making saving significant amounts of money all but impossible for tens of millions of Americans — especially those who choose to have large families.

But taxation is not the most important contributor to the recent economic collapse, although President Obama's recent tax hikes on the wealthy and return to higher FICA exactions on the rest of us have certainly had a damping effect. Far more deleterious is the ever-growing web of federal controls on virtually every aspect of commercial activity. Post-2008, entirely new federal regulatory regimes have been contrived to allow the federal government to micromanage the entire financial sector, including the insurance industry. And as everyone knows, the federal government has now effectively taken over the vast healthcare sector, in what will yet be seen as a fateful turn into full-blown socialized medicine, American-style. Millions of Americans will see their health insurance premiums double or triple in coming months, and millions more will be compelled to purchase health insurance — or find themselves on the receiving end of the Internal Revenue Service's inquisitors. It is no exaggeration to say that America no longer has anything resembling a free-market economy, with the entire financial and healthcare sectors — which together account for more than 26 percent of the American GDP, with the financial sector accounting for more than 30 percent of all corporate profits — micromanaged by thousands of federal regulators.

This state of affairs alone makes it extremely unlikely that the American economy as a whole can rebound, with vast swaths of the economy kept shackled by armies of bureaucrats. However, the core cause of the 2008 bust and the stubborn stagnation that has followed in its wake is currency manipulation, undertaken by the Federal Reserve in cahoots with the Department of the Treasury, foreign central banks, certain privileged securities dealers, and the commercial banking system as a whole. As more and more Americans are coming to understand, what the Fed does, in essence, is print money, although in recent years, its money-manufacturing activities have come to be known by the deliberately obscurantist term "quantitative easing." Of course, the Fed does not literally print bales of new money and throw it from helicopters; instead, it uses a variety of subtle techniques to "pump" new money into circulation. We need not examine all of them; the most important, "open market operations," is typical of how the entire system works and suffices to show how inflationism not only debases the value of the dollar, but does so in such a manner that certain groups benefit at the expense of others.

Open-market operations were first devised by Benjamin Strong, the head of the Federal Reserve Bank of New York, who was, in the first decade and a half of the Fed's existence, its de facto leader. He realized that, with the Fed empowered with virtually limitless authority to expand the money supply, it would have to do so in such a manner that its operations could not be easily understood by outsiders, and that it could also contract the money supply if it needed to do so.

The best mechanism by which new money can be injected into the money supply has always been via debt; in other words, central banks have always sought to create *debt* out of thin air, and then issue money to back it. Open-market operations, which take place weekly, are public auctions in which the Fed buys or sells government debt (treasury bonds of various terms and denominations) from authorized dealers, and pays for them by computer entry. Buying debt pumps more money into the overall supply, while selling it has the reverse effect. Of course, the Fed is always under political pressure to open wider the money spigots rather than close them, because the money issued in exchange for its purchases goes directly into the coffers of a handful of huge financial firms — "primary dealers" — who enjoy the special privilege of buying and selling directly from the Fed.

There are usually between 18 and 22 primary dealers authorized to participate in the Fed's open-market operations. They include the likes of Goldman Sachs, Merrill Lynch, J. P. Morgan, Cantor Fitzgerald, and Citigroup. Revealingly, a number of huge foreign banking concerns, such as Credit Suisse, Deutsche Bank, and Nomura Securities, are also on the list. These multinational investment banks are the first beneficiaries of new money issued by the Fed; with every new injection of new money, they purchase stocks, bonds, commodities, and the like. This is the reason that the stock markets love quantitative easing, because investors know that most of the new money will be pumped into stocks and other assets owned mainly by the super-wealthy. The easy money drives up stock and other asset prices, and the rich are richer than ever before.

Meanwhile, for the vast majority of America's middle and lower classes, expansion of the money supply merely degrades the value of earnings; their paychecks buy less and less gas, food, clothing, car repairs, and so forth, and their standard of life diminishes.

### Picking on the Poor and Middle Class

The wealthy all understand precisely how the system is rigged to work in their favor. In a remarkably candid conversation on CNBC's *Squawk Box*, billionaire hedge fund manager Stanley Druckenmiller, founder of Duquesne Capital, admitted that he and his ultra-rich colleagues are the only ones benefiting from five years of "quantitative easing":

> This [i.e., the Fed's easy money policy] is fantastic for every rich person. This is the biggest redistribution of wealth from the middle class and the poor to the rich ever. Who owns assets? The rich, the billionaires. You think Warren Buffett hates this stuff? You think I hate this stuff? I had a very good day yesterday.

He and fellow financier Jimmy Dunne went on to acknowledge that, while the Fed's policies were great for people like them, they weren't so great for their caddies, their children, and their grandchildren.

This fact — that central banks and governments must use mechanisms like open-market operations, which of necessity enlist the aid of the privileged few, to pump money into the economy — is responsible for the accelerating gap between the very wealthy and the rest of us. Indeed, in the past few years, it's been a very good time to be rich. In America, only a few thousand people control the lion's share of all the assets, and the gap between them and the rest of us is growing wider and wider.

What the Great Recession, and the monetary policies that have followed, has created is not one economy but two. For the top one percent or less, the times are good and getting better, with the Fed showing no inclination to ease up on the money spigots any time soon. In mid-September, it was rumored that the Fed might actually raise interest rates (another mechanism for controlling — in this case, contracting — the money supply) for the first time in years, and the stock markets swooned. In the end, though, the money spigots remained wide open, and stocks responded with yet another exuberant uptick.

For the rest of us, times are tough and getting tougher. Besides watching our savings dwindle, our home equity collapse, and our salaries decline or disappear, we are now facing the consequences of massive hikes in healthcare and insurance costs, courtesy of ObamaCare.

What is happening is the extinction of the middle class and a return to the order that has characterized most of human history: a small governing elite band of wealthy, well-connected aristocrats and a vast populace of serfs, whose function it is to serve the elites. There is but one remedy: The power of the government over the economy must be rolled back to a level consistent with the free markets Americans once enjoyed. Many of us have been conditioned to distrust free markets, because the elites have been telling us that free markets cannot be trusted and are responsible for the mess we're in. But in reality, the elites are more united against the common weal than ever before, fiercely protective of the political privileges that have multiplied their wealth and consolidated their influence. They are especially protective of the Federal Reserve System, because it is so beneficial to the Stanley Druckenmillers of the world.

The only safeguard against such abuses is greater market freedom, which would necessarily include the abolition of the Federal Reserve System as well as the dismantling of the oppressive regulatory regimes controlling most commercial activity. Until these things happen, do not expect America's economy to reverse course on the newly accelerated road to serfdom.

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