"PLAN B"

Recalibrating an Economy in Decline: Building an Economy in Balance

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Executive Summary

With the economy in the worst shape since the Great Depression, there is much hand-wringing over how to save the system from further collapse. Economists from all sides of the political spectrum are weighing in with advice for the Obama administration. Most economists seem to agree that large amounts of government spending for both a bank rescue and stimulus package are required to save the nation from catastrophe. Though many positive elements are included in these packages, some are less sound, and may actually encourage continued decline. Huge sums are being allocated to prop up failing financial institutions and industries and provide further tax cuts, while the fundamental imbalances of our economy are left largely unaddressed. These prescriptions appear based more on economic ideologies on what makes our economy work, rather than a real-world, common sense understanding of how to create an economy in balance and where its real strength lies. A broader perspective may be required to clearly see our way out of the current abyss.

We should begin by viewing the economy as a system of inputs and outputs that require balance in order to thrive. The wealth generated in our economy can either enable or destabilize this balance. Wealth must be allowed to circulate widely in order for broad based prosperity and economic equilibrium to be achieved. However, our current economic system has allowed the wealth of our nation to transfer from the middle and lower classes of our economy, and consolidate at the top with limited circulation. This process drained the functional base of our economy, the vast middle and working classes, whose spending drives 70% of the economic engine of the nation, effectively depriving our economic system of needed input in the form of consumer spending.

Conventional wisdom states that, in order to “fix” the economy, we must first fix the financial sector and get credit flowing again so that people can spend. However, simply encouraging more indebtedness to a population already heavily in debt, is not a long term strategy for economic health. Furthermore, this strategy ignores the systemic problems in our economy that created the imbalances which caused its collapse in the first place, i.e., the transfer of wealth from the functional base of our economy to the very top, where it created our current problems. The areas leading to this imbalance are: The nation’s wage and compensation structures, the tax system, the regulatory system, and the financial sector. These areas must be recalibrated if economic equilibrium is to be achieved.

To begin with, we should focus on shoring up our economic base, the workers of this nation and their families, in order to provide them with the income and security they need to resume spending. Pumping massive amounts of tax payer money into saving the auto industry will not work if consumers still cannot afford to buy cars. And large amounts of tax payer money poured into the banking system will not help if people still cannot afford to keep their homes. We should, instead, focus on stabilizing American workers and their families. Our nation can survive the collapse of some parts of the financial sector. It will not, however, survive a large scale collapse of American households.

In order to avert such a disaster, I have outlined the systemic problems in our economy that led to the current economic crisis, and policy proposals for fixing them. However, these solutions will not be easy. Our leaders may be called upon to choose between helping the wealthy elites that caused our current problems, or helping average American who’s spending can help resolve them, as our democracy hangs in the balance.

Introduction

Systems Theory and the Economy

Our economy should be viewed as an economic system. A “system” is defined as “any organized collection of parts united by prescribed interactions and designed for the accomplishment of specific goals or general purposes” (Boulding, 1956 as cited by Shafritz, 2005). Systems theory explains the behavior of systems as “a complex set of dynamically intertwined and interconnected elements, including its inputs, processes, outputs, and feedback loops, and the environment in which it operates and which it continuously interacts” (Shafritz, 2005. p. 476).

Systems are adaptive and dynamic, constantly changing in relationship to changes in their environment in an effort to seek a state of optimal equilibrium. “A change in any element of the system causes change in other elements” (Shafritz, 2005, p. 476). If there is an imbalance that occurs within a system’s inputs and outputs, a healthy system will change and react to the feedback it receives from its environment in order to maintain system equilibrium. If a system is unsuccessful at adapting to changes in feedback that threaten its survival, the system will eventually lack the inputs needed to maintain itself and will collapse.

Our economic system relies on a system of inputs, outputs, processes, and feedback to maintain equilibrium. Inputs occur in the form of labor, capital, investments, education, spending, training, raw materials, etc…while outputs include such things as wages, products, services, and wealth. Taxes, public policies, and regulations can help maintain balance in our economic system by insuring the proper availability of inputs such as capital, job creation, income, and spending to keep the whole system moving.

The Critical Role of Feedback

Feedback is a critical part of any system as it allows it to adjust to changes in its environment that could compromise the system's health. Our economic system is currently in a state of collapse due, in part, to our failure to react to feedback that indicated its growing imbalance. That feedback came in the form of rising unemployment, lack of living wage jobs, increasing inequality, rising home foreclosures, a growing poverty rate, the growth of economic trade bubbles, and evidence that deregulation and tax cuts that benefited the wealthy, were not creating prosperity for all. This feedback was then inputted into the system in the form of collapsing demand due to reduced consumer purchasing power required to keep the economic engine of the nation running. We are now in a downward spiral of decreasing demand for goods and services, which is fueling job cuts and lay offs creating a further decline in demand.

> Businesses are panicked and fighting for survival and slashing their payrolls," said Mark Zandi, chief economist at Moody's Economy.com "I think we're trapped in a very adverse, self-reinforcing cycle. The downturn is intensifying, and likely to intensify further unless policy makers respond aggressively (Andrews, 2009).

It is not that the feedback required to allow our economic system to adjust was not there, but, rather, we chose not to listen. Instead, we hid the feedback our system generated behind indicators that masked the truth about our condition. We counted the number of jobs our economy created, for example, but ignored whether or not those jobs paid enough to allow a family to survive. We counted unemployment, but failed to include all those looking for work, those who could not find work, those wanting full time work who could only find part time, and those who had given up searching altogether. We measured growing income inequality in our nation, but failed to correct it or to see how this imbalance threatened our entire economic system. We measured growing GDP but failed to consider the consequences of declining wages. We measured poverty using the Federal Poverty Line (FPL), but ignored the fact that it was based on an increasingly irrelevant standard: The amount of money it takes to buy basic food, multiplied by three. We failed to include other critical expenses into this calculation such as housing, healthcare, childcare, transportation and energy costs, rendering the entire calculation irrelevant to the real world, but very handy if one's aim was to hide the actual number of people living in poverty in our nation.

If we learn nothing else in the current economic crisis, it must be this: Hiding the reality we face behind indicators that fail to provide an accurate view of where our nation and people stand, will not save us from a crisis. It will hasten one. In addition, depriving American workers of a reasonable share of our nation's economic prosperity may create temporary wealth for people at the top. However, if left unchecked, this imbalance will eventually lead to a system collapse by denying input in the form of consumer wages that drive demand. Consumer spending is the engine upon which our nation's real economy is built. When consumers earn inadequate wages and cannot spend, corporate profits plummet, businesses fail, jobs are lost, and the economy declines. Depriving American workers of purchasing power in the form of adequate wages in an effort to increase corporate profits is short term gain, but long term disaster.

A Balanced Past

If we look to our nation's recent history, we can see the conditions under which a balanced economy was achieved. We succeeded in creating a state of economic equilibrium in the post WW II years from 1947 to 1973, when prosperity was widely shared. According to economist and author, Dean Baker (2009), this shared prosperity created a balanced and functioning economic system that worked:

> In addition to helping more families, it produced a kind of virtuous circle. Productivity gains were passed on to workers in the form of wage growth. Higher wages led to more consumption, which encouraged companies to invest in new plants and equipment. That investment increased productivity, which provided the basis for further wage growth. In this way, growth fed upon itself (p. 7).

We achieved this through a process of fair laws, a balanced tax code, and good public policies that invested in the general welfare of the nation. Economic Policy Institute's Ross Eisenbrey (2007) explains:

> For the first 30 years after World War II, the United States benefited from a balanced economy that brought about a tremendous increase in national wealth and living standards. We invested in our infrastructure (creating a system of interstate highways), in higher education (the GI Bill more than doubled the number of students at many state universities), in health care (Medicare was enacted in 1966), and in research and development (the Apollo Project ushered in the space age). The result was a doubling of national wealth, the highest wages in the world, tremendous advances in longevity, and huge declines in poverty (para. 1).

However, beginning in the mid 1970's we saw the balance of our economic system begin to tilt away from shared wealth, and became a more extractive economic model that drained some segments of our economy of their wealth in order to create greater wealth for others (Aron-Dine & Shapiro, 2007, Baker, 2009, Johnston, 2003, Shulman, 2005). The growing imbalances these changes created over the past 30 years, eventually led to the current crisis in our economic system, through inadequate wages and a consolidation of wealth that was dangerously leveraged to the point of collapse. And when it did, American consumers, who were highly leveraged themselves, simply lacked the purchasing power to keep the economic engine going.

Tipping the Balance

Several conditions have collided to create the current economic collapse: Skyrocketing CEO pay and bonus structures, declining wages and security for American workers, an imbalanced tax code, deregulation, and an extractive financial sector. These items fed into one another in a negative feedback loop that actually drained our economy from its functional base, and allowed the wealth of our nation to consolidate at the top rather than circulate freely within the entire system. A description of these imbalances follows.

CEO Pay

One of the first signs of a growing imbalance in our economy was the growth of CEO pay relative to average worker pay. Economic Policy Institute's Lawrence Mishel (2006) explains:

> In 1965, U.S. CEOs in major companies earned 24 times more than an average worker; this ratio grew to 35 in 1978 and to 71 in 1989…and hit 300 at the end of the recovery in 2000…and by 2005 the average CEO was paid $10,982,000 a year, or 262 times that of an average worker ($41,861) (para. 2).

While American workers were working harder, increasing their productivity from 1975 – 2007, their wages remained flat, and beginning in 2002, actually began to decline (Mishel, Bernstein & Shierholz, 2008/2009). At the same time CEO pay continued to skyrocket. The top executive in a Fortune 500 company now makes over 400 times the wage of the average worker, earning in one day what it takes an average worker to earn in a year (Eisenbrey, 2007; Mishel, 2002). The Center for Budget and Policy Priorities, using Department of Commerce data, reported "the share of national income going to wages and salaries in 2006 was at its *lowest level on record*, with data going back to 1929" (Aron-Dine & Shapio, 2007, p. 1). This may have been a good development for corporations and CEO's, but it came at the cost of American workers and their families as wealth shifted from wages to executive compensation and corporate profits, slowly draining American workers of their purchasing power.

American Dream versus American Reality

At the same time, the economy began shedding good paying jobs and replacing them with low paying jobs that no longer allowed families to meet basic needs (Shulman, 2005). As women entered the workforce to make up the income difference, Americans began working longer hours to survive; an average 199 hours more per year in 2000 than in 1973 (de Graaf, 2003). Americans now work more hours than any other industrialized nation on earth (International Labour Organization, 1999). Despite this, the American dream that hard work will be rewarded with basic economic security no longer matches the American reality for tens of millions of American families (Chinitz, Fu, & Smith, 2008; Kochan & Shulman, 2007; Shulman, 2005).

The American dream assumes that anyone with a full time job can meet basic needs. The American reality is that one in four working Americans struggle to meet basic needs with low paying jobs that offer no health insurance, retirement benefits or paid time off (Working Poor Families, 2008).

The American dream believes low wage jobs are a temporary stepping stone to better paying employment and that economic mobility will eventually resolve the problems of these workers. The American reality is that most low wage workers never make it into the middle class (Shulman, 2005, p. 7). Even worse, most of their children will share the same fate.

Economic mobility, the corner stone of the American Dream, has come to a near stand-still for many of America's children. According to the Economic Mobility Project funded by the Pew Charitable Trust:

> Contrary to American beliefs about equality of opportunity, a child's economic position is heavily influenced by that of his or her parents...Forty-two percent of children born to parents in the bottom fifth of the income distribution remain in the bottom, while 39 percent born to parents in the top fifth remain at the top…Only 6 percent of children born to parents with family income at the very bottom move to the very top (Isaacs, Sawhill, & Haskins, 2008, p. 7).

The fact is, our current economic system denies adequate pay and opportunity to a growing number of workers in it (Chinitz, Fu, & Smith, 2008; Kochan & Shulman, 2007; Shulman, 2005; Working Poor Families, 2008). Millions of Americans are working full time jobs that pay below the poverty line, while even more work in jobs that do not allow them to make ends meet (workingpoorfamilies.org). The largest growth sector of our economy is now low-paid service sector jobs with few, if any benefits (Shulman, 2005). The startling facts on work in America today are these:

- One in five or 22.2% of all jobs in 2006 paid wages below the poverty threshold for full time work - a total of 29,390,000 jobs (Working Poor Families, 2008, pp. 3-4).
- One in four working families - 42 million adults and children – are working poor and do not earn enough to meet their families' basic needs (Working Poor Families, 2008, p.1).
- The majority of these workers lack basic benefits for themselves and their children including health insurance, retirement plans, paid vacation and sick days or disability pay (Shulman, 2005, p. 7).

- Living wage manufacturing jobs in the U.S. have declined from 44 percent of the workforce in 1983 to 12 percent of the workforce in 2008 (Shulman, 2005, p. 47).
- Low paying service sector jobs now comprise 80 percent, or 134 million non farm jobs in the nation, creating 4.7 million new poverty-wage jobs from 2002 to 2006 (Shulman, 2006, p. 47; Working Poor Families, 2008, p.2).
- Low-paid service sector jobs are expected to increase by twenty-two million by 2010 (Shulman, 2005, p. 49).
- Adults in low-income working families worked an average of 2,552 hours per year, the equivalent of one and a quarter full time jobs – and still can not meet their families’ basic needs (Working Poor Families, 2008, p. 2).
- More than 21 million children live in working poor families struggling to meet basic needs (Working Poor Families, 2008, p.3).
- 34% of job openings in the NW pay less than a living wage for a single adult and 81% pay less than a living wage for a single adult with two children (Chinitz, J., Fu, C. & Smith, G. , 2008, p. 6). This is comparable to findings in other regions.
- Only 40% of these job openings pay enough for two wage earners working full time jobs to provide for the basic needs of two children (Chinitz, J., Fu, C. & Smith, G., 2008, p. 7).

The majority of jobs created in our economy do not allow workers to meet their family’s basic needs, and this problem is expected to get worse in coming years. According to Beth Shulman, author of “The Betrayal of Work” (2005), by 2010:

> Low wage job growth will dwarf high-tech jobs…Employers will hire nearly twice as many food-service workers as software engineers, hire as many cashiers as they do computer-support specialists, and hire more than twice the number of customer-service representatives as they do computer-systems analysts (Shulman, 2005, p. 106).

Improving one's skills can help some workers earn better wages. But, Shulman argues, even if everyone in the nation earned college degrees, the economy would still create primarily low-paying jobs. Improving supply alone does not increase demand.

Compounding the problem for American workers is a growing lack of benefits to support themselves and their families. Only 56% of all jobs offer any health insurance benefits, while even fewer offer retirement pay and time off (Kochan & Shulman, 2007). One in four American jobs offers no benefits at all (Shulman, 2005).

In addition, the work support system in the United States is woefully inadequate to meet the needs of America's families. While programs such as the Earned Income Tax Credit (EITC), food stamps, child care subsidies, Medicaid, and housing assistance can help bridge the gap between low paying jobs and a family's survival needs, they are often means tested with families losing benefits well before their incomes allow them to purchase these services on the open market (Cauthen & Dinan, 2008). Parents who work hard to advance in their jobs and better their families' conditions often end up worse off for their efforts by losing more in benefits than they gain by the raises they receive (Cauthen & Dinan, 2008; Shulman, 2005). In addition work support programs are often hampered by inadequate funding, long waiting lists, and eligibility requirements divorced from the realities of what it actually costs to live and raise children in America today.

A family of three, for example, working full time at the new minimum wage of $7.25 an hour would only earn an annual income of $15,080 – well below the poverty threshold for a family of three, which, for 2009 is $18,310 (HHS, 2009). However, according to the "Basic Needs Budget Calculator" developed by the National Center for Children in Poverty out of Columbia University, a basic family budget for a family of three in Atlanta is $43,363; in Boston it's $55,301; in Chicago it's $43,778; in Boulder it's $48,933; in San Diego it's $50,972; and in Oxford, Alabama it's $32,535 (retrieved from http://www.nccp.org/tools/frs/budget.php). Two parents working full time minimum wage jobs, even at the new level, would not make enough to meet the basic needs of themselves and one child almost anywhere in the nation.

The problem is that our economy does not generate enough living wage jobs to allow families to meet basic needs, and our work support programs do not even remotely bridge the gap between worker earnings and the basic cost of living. The result is that millions of families are unable to meet their children's basic needs, the consequences of which are profound, including: Growing social problems, lower educational outcomes, higher addiction rates, more emergency room visits, poorer health outcomes, higher divorce rates, more child abuse and neglect, entrenched poverty, increasing crime, growing incarceration rates, rising poverty, and limited disposable income leading to low consumer demand (Shulman, 2005). In short, what we see in America today is its vast middle class in decline.

Decline of the Middle Class

From 1970 – 2005, cities all across the country reported declines in their middle class (defined by the Brookings Institute as people earning between 80 and 150 percent of their metro area's median income). During this period, Seattle and San Francisco saw their middle class decline by 13%; Los Angeles and Houston by 14%; St. Paul by 11%'

Chicago by 14%; Miami by 8%, and N.Y. by 12%. (Muro, Rahman & Warren, 2008, as cited in Newsweek, January 26, 2009, p. 63).

Wages for American workers have been flat for 30 years and in decline for several (Bernstein & Mishel, 2003; Shaiken, 2007). Costs for basic needs such as energy, housing, and healthcare have soared while security in the form of living wage jobs, healthcare and retirement benefits are increasingly denied to American workers and their families (Hacker, 2005). The result is that American consumers, who make up 70% of our nation's economy, simply have little to no purchasing power left. "The failure of these jobs to provide adequate wages constricts the purchasing power of these workers and, in turn, decreases the gross domestic product" (Shulman, 2005, p. 94).

Changes in the Tax Code

Subsequent changes in our tax laws have also contributed to the transfer of wealth and the growing imbalance in our economy. In 1981, President Reagan pushed for tax cut laws that overwhelmingly benefited the wealthy (Johnston, 2003). These tax cuts were then greatly expanded by President George W. Bush. The result is now a flip flop in tax policy from the Eisenhower years when top income earners were taxed at a 90% rate, compared with today where our tax system "now levies the poor, the middle class and even the upper middle class to subsidize the rich" (Johnston, 2003, p. 2).

In his book, "Perfectly Legal: The Covert Campaign to Rig Our Tax System to Benefit the Super Rich – And Cheat Everybody Else" Pulitzer Prize winning journalist, David Cay Johnston, (2003), explains:

> The tax system is being used by the rich, through their allies in Congress, to shift risks off of themselves and onto everyone else. And perhaps worst of all, our tax system now forces most Americans to subsidize the lifestyles of the very rich,

> who enjoy the benefits of our democracy without paying their fair share of its price. (p. 19)

The changes in the tax code, Johnston maintains, have created a fundamental shift in the wealth of the nation:

> In 1977, the richest 1 percent of Americans had as much to spend after taxes as the bottom 49 million. Just 22 years later, in 1999, the richest 1 percent – about 2.7 million people – had as much as the bottom 100 million Americans (p. 30).

At the same time, taxes for the middle and lower classes have actually increased to make up the difference. Changes in the tax code during the Clinton Administration allowed the top 400 tax payers to reduce their federal tax burden by 16 percent, while raising the tax burden for everyone else by 18 percent (Johnston, 2003, p. 308).

> Today, the richest Americans have only a 15 percent tax rate on their investment income, while regular families pay 15 percent in payroll taxes in addition to 10 percent, 15 percent or 25 percent in income taxes. As billionaire Warren Buffett noted, the result is that wealthy investors pay lower rates than their secretaries. Making matters worse, George Bush’s tax cuts on wealthy taxpayers’ investments have raised the share of the tax burden borne by middle-class wages. (Edwards, 2008, p.2).

Increasing Social Security deductions for wage earners, while not requiring social security withholding on incomes over $102,000 is only one example of how our tax burden has shifted. The alternative minimum tax first enacted to ensure that wealthy people pay something in taxes, has been repeatedly tweaked over the years to the point where, “By 2010 about 85 % of all taxpayers with two or more children will be forced off the regular income tax and onto the (higher) alternative minimum tax.” (Johnston, 2003, p. 113). Reductions on capital gains to the current 15% have allowed the wealthy to keep more and more of their wealth, while the wage earners of the nation keep less and less.

We now have, in effect, two different tax systems: One for the rich that is “filled with opportunities to hide income, fabricate deductions and reduce taxes” and one for average

American wage earners "in which every dollar of income from a job, a savings account or a stock dividend is reported to the government, and taxes are withheld from each paycheck to make sure wage earners pay in full" (Johnston, 2003, p. 10).

Johnston talks about what the imbalances in our tax code mean to the nation.

> The tax system is becoming a tool to turn the American dream of prosperity and reward for hard work into an impossible goal for tens of millions of Americans and into a nightmare for many others. Our tax system is being used to create a nation with fewer stable jobs and less secure retirement income… (p. 19).

Not only have the wealthy benefited by special provisions inserted into the tax code to benefit them at the cost of the rest of the nation, they have also received most of the benefits from the Bush tax cuts. How these tax cuts have impacted average Americans is revealing. The Center on Budget Policy and Priorities shows distribution of these tax cuts as follows:

> …the top one percent of households (whose incomes average nearly $1.2 million) will receive an average tax cut of approximately $40,990 in 2004…or…more than 40 times the average tax break for those in the middle fifth of the income distribution. (And that in order to offset) the costs of the tax cuts, more than three-quarters of American households ultimately would be made worse off. They will lose more from the financing measures than they would gain from the tax cuts" (Kamin and Shapiro, 2004).

Corporate tax rates have also enjoyed downward momentum. According to Robert McIntyre of Citizens for Tax Justice,

> U.S. corporate tax collections at the federal level alone have fallen from 4.8 percent of the gross domestic product in the 1950s to only 1.6 percent in 2004—a drop of two-thirds. To put that in perspective, if corporations paid the same effective tax rate now that they paid in the fifties, corporate tax payments to the U.S. Treasury would be $380 billion a year higher than they actually are. (McIntyre, 2005, p. 14).

In addition,

> From 2001 to 2003, 82 of the 275 (top) corporations enjoyed at least one year in which they paid nothing at all in federal income tax, despite pretax U.S. profits in those no-tax years totaling $102 billion. (McIntyre, 2005, p. 13).

However, the most significant factor that created an imbalance in our tax system is that the wealthy have been allowed to cheat on their taxes with growing impunity and the help of some of the nation's most respected legal, banking, and accounting firms, while Congress turned a blind eye. According to McIntyre,

> …all of the major accounting firms, including Ernst & Young, Deloitte Touche, Pricewaterhouse Coopers and KPMG, have been involved in marketing clearly abusive tax shelters. So have many supposedly-respectable law firms. Numerous large banks and investment firms, such as Citigroup, Bank of America, Wachovia and Merrill Lynch, have also been implicated in tax evasion and/or aggressive sheltering activities. (McIntyre, 2005, p. 2)

Catching wealthy tax cheats has become increasingly difficult, due in part, to severe budget cuts and restrictions on the IRS. From 1988 – 2002, Johnston explains, the IRS budget was cut in half. "IRS had 16,600 auditors, by 2002, down to 11,500, a 30 percent decline while the number of individual income tax returns has doubled" (Johnston, 2003, p. 297). As Congress looks the other way, off shore tax shelters, loop holes and tax evading investment schemes have become common place. Companies who do not actively seek illegal tax shelters are at a competitive disadvantage with those who do. In addition, Congress has required the IRS to focus on the poor while ignoring wealthy tax cheats (Johnston, 2003). The chances of being caught are eight times less for wealthy tax cheats making over $100,000 than they are for poor families using the Earned Income Tax Credit (Johnston, 2003, p. 130). But this has been at significant adverse cost to the nation. Johnston estimates that tax cheats cost the U.S. Treasury $300 billion in lost revenue in 2003 alone (p. 296). This is money our nation will desperately need if we are to work our way out of the current economic crisis.

Rise of the Bubble Economy

Imbalances in the U.S. tax code have helped to create an enormous consolidation of wealth at the very top of our income structure. According to data compiled by Citigroup, the top 1% of U.S. households now has a net worth greater than the bottom 90% combined (Kotkin, J. 2009).

Such a large amount of consolidated wealth has created significant problems for our economy. Wealth consolidation at the very top, for example, is not wealth that is circulating throughout the larger economy in the form of wages and consumption required to keep the economic engine running. It is basically wealth looking for a way to create more investment wealth. It does so by driving up the costs in other areas of our economy through leveraged trading at extreme ratios, causing investment bubbles. And when those bubbles burst, they cause widespread damage to vast areas of our economy and our nation, as I will later explain. At a minimum, this imbalance in the distribution of wealth in our economy is creating a destabilization of our economic and social systems that threaten us all.

> In the short run those at the very top can benefit from our unfair system, reaping quick rewards and paying little in taxes. But in the long run even they will be losers because their undermining of economic growth and social stability will ultimately reduce the value of their investments (Johnston, 2005, p. 307).

Deregulation

As the tax code was being changed to benefit the wealthy and allow a consolidation of wealth at the very top, the basic regulations on businesses that had protected American consumers since the Great Depression were also being gutted. This occurred with the deregulation of financial sector rules originally put in place after the abuses that led to the Great Depression. Savings and Loan Banks were deregulated in the 1980's under the

Reagan Administration, resulting in "the failure of 2,400 U.S. thrift institutions {at the} cost of $560 billion, most of which was ultimately paid for by U.S. taxpayers" (Baker, 2008, p. 11). The Clinton Administration, in 1999, repealed the Glass-Steagall Act, which had mandated the separation of investment and commercial banks (ibid). Glass-Steagall was originally passed by Congress in 1933 in an effort to prevent the fraud and conflicts of interests that had formed between commercial and investment banks that led to the stock market crash and Great Depression. (Baker, 2008; Grumet, 2008). So it should be of no surprise that fraud, abuse, and conflicts of interest in the financial sector once again occurred after these consumer protections were removed.

The argument for deregulation was that the old protections had become increasingly obsolete and were interfering with normal market activities that could generate a new era of prosperity for all. What happened instead was:

> By the late 1990s, in the frenzy of the dot-com bubble, we somehow deluded ourselves into thinking we no longer needed regulatory protection in the financial sector. We allowed the interests of banks, insurance companies, and investors to merge. The resulting concentration of wealth fueled a level of greed that has seemingly overcome good business sense. With no regulatory restraint, financial companies went on a binge until the housing market bubble burst. (Grumet, 2008, para. 6).

Allowing large amounts of consolidated wealth in the hands of a tiny elite, in an environment with few if any rules, was a recipe for disaster. According to former U.S. Treasury Secretary, Henry Paulsen, an excess of deregulation "has now created the worst global financial crisis in a generation, threatening the health of the U.S. economy, the savings of millions of Americans, and the survival of some of the biggest financial institutions in the world" (MarketWatch, March 13, 2008).

Rise in the Financial Sector

The rise of the financial sector, enabled by deregulation and a tax code that allowed an enormous amount of wealth to consolidate at the top, was the final piece of the puzzle causing our current economic collapse. According to Dean Baker, the financial sector played a relatively small role in our economy during the years of economic prosperity and balance between the mid 1940's and the mid 1970's. It accounted for only about 6% of corporate profits in the late 1940's and less than 10% in the 1960's. However, the financial sector, by 2004, accounted for 30% of corporate profits (Baker, 2009, p.8). And with those profits came destabilizing power.

Thomas Jefferson, in a letter to the Secretary of the Treasury, Albert Gallatin, wrote:

> I believe that banking institutions are more dangerous to our liberties than standing armies. If the American people ever allow private banks to control the issue of their currency…the banks and corporations that will grow up around [the banks] will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered. The issuing power should be taken from the banks and restored to the people, to whom it properly belongs.

Today, Jefferson's prophetic words ring true, with banks in greater control over the economy of our nation then ever before, and bank foreclosures expected to reach over eight million families in the next four years (MarketWatch, 2008). According to Simon Johnson, former chief economist at the International Monetary Fund and current professor of global economics and management at MIT's Sloan School of Management, The United States is increasingly under the control of a small group of banking oligarchs that could potentially trump the President, the Congress and the American government by the shear power of their ability to control our nation's economy. "…they are the people who could pull the strings. Who have the influence. Who call the shots" (Johnson, as interviewed by Moyers, 2009). Congresswoman, Marcy Kaptur of Ohio, the longest-serving Democratic congresswoman in U.S. history agrees, "…JPMorgan Chase, Bank of

America, Wachovia, Citigroup and HSBC. They have this country held by the neck." (Kaptur as cited by Goodman, 2009**).**

What highly leveraged trading does is essentially allow financial institutions to issue their own currency with little or no backing. And now the risky investments of poorly run banks are so intertwined are with the financial well-being of average Americans and their homes, retirements, college funds, savings and jobs that the failure of these large institutions could collapse the entire economy on top of the American people who paid for it. Currently we are looking at a bank bailout that could cost American tax payers upwards of $2 trillion. This is in addition to the $8 trillion the U.S. Treasury has committed to backstop the financial sector (Whitten, 2009)

The implied threat of the current crisis is clear: If U.S. tax payers do not bail out banks struggling from their own poor investments these banks will collapse and take the country down with them. Unfortunately, Treasury Secretary Timothy Geithner’s bank rescue plan appears to give the banks what they want. According to Nobel Prize-winning economist, Paul Krugman,

> …the bank rescue plan will contain two main elements: government purchases of some troubled bank assets and guarantees against losses on other assets. The guarantees would represent a big gift to bank stockholders; the purchases might not, if the price was fair — but prices would, The Financial Times reports, probably be based on “valuation models” rather than market prices, suggesting that the government would be making a big gift here, too. And in return for what is likely to be a huge subsidy to stockholders, taxpayers will get, well, nothing. (Krugman, February 1, 2009).

Johnson agrees,

> “...these people think that they've won. They think it's over…They think that we're going to pay out ten or 20 percent of GDP to basically make them whole… This is a decisive moment. Either you break the power or we're stuck for a long time with this arrangement.” (Johnson, as interviewed by Moyers, 2009).

Our nation's financial oligarchs appear highly confident of their control. As millions of families, investors, parents and retirees were watching their stock portfolios and their dreams of retirement or college for their children collapse, losing jobs and deferring dreams, Wall Street was doling out huge bonuses to top executives after accepting tax payer bailout money for their firms.

> Despite crippling losses, multibillion-dollar bailouts and the passing of some of the most prominent names in the business, employees at financial companies in New York…collected an estimated $18.4 billion in bonuses for the year. (White, 2009, para 2)

President Obama called the Wall Street bankers "shameful" for awarding themselves nearly $20 billion in bonuses, " as the economy was deteriorating and the government was spending billions to bail out some of the nation's most prominent financial institutions" (Stolbert & Labaton, 2009). Most in the nation agree:

> "It's just not acceptable. You're talking about the same banks that caused the foreclosure crisis, took record bonuses in the past and continue to," said George Goehl, executive director of National Training and Information Center, a nonprofit community reinvestment group in Chicago. (Dash & Story, 2009).

In the ultimate act of impunity, AIG, a recipient of $170 billion in tax payer bailout money, reportedly gave $165 million in bonuses "to executives in the same business unit that brought the company to the brink of collapse last year" (Andrews & Baker, 2009). Anger at this abuse of tax payer funds and the lack of effectiveness of the financial system bailout in general, calls into question the wisdom of the government's plan to place the well-being of the financial sector over the well-being of the general public. We should not throw good money after bad, especially when the general public has growing needs which that same money could help avert.

Impacts of a Bubble Economy

This consolidation of wealth and lack of limitations on the rules that bound it, created a perfect storm of greed. Wealthy individuals with huge amounts of money at their disposal sought more investment opportunities to increase their wealth using newly formed high risk, highly leveraged investment vehicles that our financial sector was only too happy to provide. This fueled a growth in unregulated private equity firms referred to as "hedge funds" that control enormous amounts of wealth in the form of highly leveraged trades that often contain very little real capital – sometimes leveraged as much as 40:1. According to the Suisse Bank, hedge funds account for up to 50 % of all stocks traded on the New York and London stock exchanges (Hedgeweek, 2007). These funds are so large they can destabilize markets as they move around huge sums of money that drive up basic commodities and create dangerous financial bubbles (ibid).

These financial bubbles, while creating tremendous wealth for a few, can create catastrophic problems for everyone else. When the bubble in tech stocks collapsed in 2001, it sent the nation into a recession with a cumulative loss of wealth of "close to $10 trillion, or $33,000 for every person in the country" (Dean, 2009, p. 46). Speculation in the commodities markets spiked the cost of basic foods such as corn, rice and grain, creating enormous hunger that threatened to destabilize nations world wide (Institute for Agriculture and Trade Policy, 2008). The dramatic rise in speculative fuel prices in 2008 helped to launch the current recession and drop in consumer spending as "Economists estimate that every additional penny at the pump takes roughly $1 billion out of overall spending" (Schoen, 2008, p. 2).

Most egregious of all was the rise of the mortgage bubble. According to a report by the Federal Deposit Insurance Corporation (FDIC), 55 metropolitan areas in the U.S. saw housing prices increase by over 30% between 2000 and 2004 (May 2, 2005). This price escalation was fueled by low interest rates that caused a housing bubble in the form of the financial sectors expansion of sub prime loans, which allowed people who really could not afford homes to get into them at very high interest rates for investors. These risky loans were then sold on the open market which further inflated the price of housing beyond its real value. Leveraged trading of these unregulated derivatives skyrocketed, fueling an enormous housing bubble. Wealth in the financial sector was being made hand over fist. However, the whole scheme was predicated on the ability of people who could not afford their homes, actually paying them off. When the low loan rates of these 3 – 5 year adjustable rate mortgages expired, and people's home mortgages shot up dramatically, they, predictably, could not pay the extra interest and began defaulting on their loans in large numbers.

With this, the housing bubble began to collapse. Mortgage loan defaults fueled a huge stock sell-off in late 2008. By January of 2009, nearly 2.4 million homes had gone into foreclosure (Duggan, 2009). These defaults caused a stock market crash in the speculative home mortgage industry that quickly spread to all areas of the market. Home prices fell as a glut of newly foreclosed homes entered the housing market, increasing supply well beyond demand. People stopped spending as they saw their stock portfolios drop, the equity in their homes disappear, and their jobs threatened. Lack of spending caused businesses to lay off workers, further fueling the economic downturn. In addition, flat wages for the last 30 years, accompanied by climbing prices, left people heavily in debt, with no savings and little cushion to shield themselves or their families from economic calamity when it struck. And all this happened with the tacit approval of the U.S. Treasury, Wall Street, and Congress.

According to Dean Baker:

> … the story of these financial bubbles is a tale of major institutional failures. The top corporate actors enriched themselves even as they drove their companies toward bankruptcy. The Federal Reserve Board and other regulatory institutions largely sat on the sidelines. Economists and the media promoted these bubbles, or at least ignored the danger of them popping (Baker, 2009, pp. 4-5).

Anti-Equilibrium and Free Fall

As a result of corporate greed, the consolidation of wealth, a tax system that favored the wealthy over the well-being of the nation, stagnant wages, a declining middle-class, deregulation, and a complete lack of government oversight, our economy is now in freefall.

According to the Bureau of Labor Statistics Household Survey Data, 694,000 more Americans lost their jobs in March alone, bringing the number of unemployed up to 13.2 million (BLS, March 2009). Since the recession began in December 2007, 5.1 million jobs have been lost, with almost two-thirds (3.3 million) of those occurring in the last 5 months (ibid). The official unemployment rate rose from 8.1% in February, 2009 to 8.5% in March – "the highest level in more than a quarter-century" (Goodman & Healy, 2009). However, if we factor in all the part-time employees wanting full time work, and discouraged workers who have just stopped looking, the Department of Labor's comprehensive figure for unemployment went from 14.8% in February to 15.6% in March. According to the *Wall Street Journal*, "That's just about 1 out of 7 Americans who are either unemployed and looking for a job, want a job but stopped looking, or part-timers who want full-time jobs" (Reddy, 2009a). And these figures are expected to get worse. Forecasters predict the official unemployment rate will top 10% by early next year, while the broader unemployment rate is likely to top18%. “For people in this group, comparisons to the Great Depression (when 25% of Americans were out of work) may not look so wild…” (Reedy, 2009b).

To make matters worse, as America continues hemorrhaging jobs at the rate of over 600,000 a month, families are also losing their health insurance. According to the Kaiser Family Foundation, every 1% increase in the unemployment rate means 1.1 million more Americans losing their health insurance coverage (2008). The Congressional Budget Office states that the number of uninsured Americans is expected to rise from 45 million in 2009 to 54 million in 2019. “Driving the increase will be health insurance premiums that rise faster than incomes” (Freaking, 2009, para. 2).

Adding to the problems of job losses is the evaporating wealth from stock portfolios, home prices, college funds, retirement accounts and other forms of investments. And although home foreclosures are currently at the highest rate since the Great Depression, they are expected to get even worse. An expected 8.1 million homes, representing 16% of all home mortgages, are expected to go into foreclosure in the next few years (MarketWatch, 2009). The country is now “trapped in a vortex of plunging consumer demand, rising joblessness and a deepening crisis in the banking system” (Andrews, 2009, Para. 3).

Policy Recommendations

In order to save the nation’s economy, the government must take decisive action to fix systemic problems, shore up the functional base, and create a foundation from which the economy can grow. The purpose of the following policy proposal is:

1. To stop the current free fall in our economic system by providing a basic safety net to create an economic floor upon which the nation’s people and businesses can rebuild.

2. To recalibrate our economic inputs and outputs in a manner that will restore equilibrium and lay the foundation for shared prosperity and long-term well-being.

Stopping the Freefall

The result of the poor choices of our nation’s leaders is that the future of our economy and our very democracy are now called into question (Moyers, 2009). We are currently in a face-off between the interests of the financial sector and the interests of American taxpayers and their children. Who wins will be determined by how the government acts, as the stability of the nation and the health of our democracy hang in the balance. The tax payer money we are pouring into the financial sector is money we need to create economic stability for our citizens. We likely cannot afford to do both and the government may need to choose. Will they wrestle control of the economy away from the financial elites who currently control it, or will they allow these oligarchs to continue draining the economy of its wealth, as we plunge further into the abyss?

If we are to rebuild the American economy we must start by establishing basic economic security for workers and their families in an effort to stop the downward momentum of the current collapse. A population lacking economic security cannot spend if they have no disposable income with which to do so. And we cannot build a strong economy on an economic and social foundation that is crumbling.

We should begin by establishing an economic rescue plan in the form of a national single-payer health care system, a temporary moratorium on home foreclosures, and a significant expansion of the food stamp and unemployment insurance programs. Not only would this immediately pump needed revenue into the economy, but it would allow families the security of meeting basic needs while the nation works out its economic problems. It would put a floor beneath the American people below which they and the economy would not fall, and from which the nation can start to rebuild.

President Obama’s economic stimulus package, home foreclosure, and healthcare plans offer hope that these areas will be addressed. However they must become the focus of the administration’s economic policy, not tangents. The economy will not turn around until average Americans have the economic security and incomes required to resume spending. Achieving this is paramount to success.

People First

Though the reality of putting our nation’s people first seems clear from a common sense point of view, it has somehow been missed by many economists and policy makers who continue to believe that money given to failing industries and financial institutions, and tax cuts for the wealthy are where we should focus our efforts. However, bailing out auto companies will not work if people cannot afford to purchase new cars, and bailing out banks will not work if homeowners continue to default on their loans. The real hole in our economic system is the one American workers and their families are falling through. Our democracy can survive the collapse of some industries, investment banks, and private equity firms. But it will not survive the wholesale collapse of American households. Until average citizens are shored up, nothing built on top of them will stand.

Feasibility

Public support for increasing household economic security is high. The Pew Research Center has been tracking American support for government safety nets since 1987, and found that nearly 70% of all Americans think government should guarantee food and shelter to all Americans (Morin & Neidorf, 2007). Nearly an identical number favor government supported healthcare for all (Roberts, 2007), and 58% believe the wealth and income of the nation should be more evenly distributed (Newport, 2008).

The cost of creating an economic safety net is high, but not insurmountable. According to Physicians for a National Health Program (PNHP), a single-payer health care system would save the nation more than $350 billion per year, "…enough to provide comprehensive coverage to everyone without paying any more than we already do" (PNHP, n.d.). According to Cay Johnston, and other tax experts, beefing up IRS enforcement to catch wealthy tax cheats could add an estimated $300 billion dollars a year to the nation's treasury – a healthy down payment on middle class economic security (Johnston, 2003, McIntyre, 2005). In addition, according to the Brookings Institute, eliminating the Bush tax cuts would provide the US Treasury another $1.8 trillion over a ten year period (Orszag, 2004). This could more than offset investments in national healthcare, while expanding unemployment and food stamp programs. In addition, if we eliminated the cap on Social Security deductions for those who earn over $102,000, and require them to pay the same percentage as everyone else, instead of exempting them as we do now, we could completely eliminate the Social Security deficit and ensure retirement for all working Americans (Bivens, 2005)

With popular support, and the ability to create both fairness and higher revenues in the tax system, the political feasibility of creating a strong economic safety net is sound.

Anger at government bailouts for the wealthy and a tax system skewed to benefit the rich is understandably high. President Obama is currently making the case that now is the time for wealthy Americans to pay their fair share to save the nation. Our government must follow-through to ensure that they do. The social stability and survival of our very democracy could well be at risk. Protests and violent uprisings are already occurring worldwide in response to unemployment and the global recession (Schwartz, 2009). According to the Gallup/Healthways *Monthly U.S. Well-Being Report* for February 2009, an additional 24 million Americans described themselves as struggling to make ends meet over the previous year, a segment that now totals 57.5% of the U.S. population. Researchers expect the number of Americans moving into the "struggling" or "suffering" category of the Well-Being Index to significantly increase over the next year.

In addition, respect Johns Hopkins sociologist, Dr. Harvey Brenner, calculates that,

> for every one percent increase in the unemployment rate (an additional 1.5 million people out of work), we can expect an additional 47,000 deaths, including 26,000 deaths from heart attacks, about 1,200 from suicide, 831 murders, and 635 deaths related to alcohol consumption. If, for example, the unemployment rate jumps from 8.1% to 9.1%, we can expect roughly an extra 1,200 people to commit suicide and another 831 people to commit murder (Dreier, 2009).

Democracy cannot thrive in chaos. It requires stability to survive. Bold action is required to shore up our nation's people, save the economy, protect our democracy, and secure prosperity for all. The President should make American economic security his top priority, and rally the American people to require Congress to act. If not, pressure will continue to mount as states implement their budget cuts, and the ensuing decline in our civil society becomes impossible to ignore.

Creating a Balanced Economy

Once basic security has been established, we can begin the hard work of bringing our economy back into balance in order to achieve long term health. As described above, the areas of our economy leading to the greatest imbalances are our system of work and rewards, the tax system, the regulatory system, and the financial system. Below is a list of policy recommendations to recalibrate each area, and their rationales.

Wages and Work Supports

Bridging the gap between inadequate worker pay and meeting basic needs will require a slow increase in the minimum wage towards the low end of the living wage spectrum nationally. States then can decide if they wish to set a more accurate living wage per their region’s cost of living. Several organizations have electronic programs capable of calculating a living wage by region including the Economic Policy Institute’s “Basic Family Budget Calculator” and the National Center for Children in Poverty’s “Family Resource Simulator.” The President should lead by explaining to the nation (people and businesses) the fact that living wage laws not only improve social conditions, but also significantly boost local economies.

Research at Sonoma State University in Santa Rosa, California has shown that wage increases for low paid workers immediately go back into local economies in the form of increased consumption. (Phillips, 2001). “This new income circulating in the region more than offsets the increased salary costs for most businesses and will provide an overall fiscal boost to the local economy” (Phillips, 2001, p.1). Professor Peter Phillips, one of the study’s lead authors, cites research that shows that the actual cost to businesses in cities with living wage laws are less then 3% of revenue, and that increased sales or nominal price increases easily cover the additional cost of wages (Philips, 2001).

Phillips and his colleagues found, in their study of 5,391 low wage workers in Santa Rosa, was that increasing their incomes to a living wage would circulate an additional $23,818,301 dollars per year in that community (Phillips, 2001). These additional wages would be spent on housing (11.9%), auto purchases (13.6%), auto repairs (6.8%), clothes (9.1%), and food (6.2%), among others. "Santa Rosa auto dealers should know that they would receive over $4,500,000 in new sales and repair orders given the implementation of a living wage in the City" (Phillips, 2001, p. 2). The corollary impact on sales tax revenue would also prove very positive to local and state governments who move towards their own living wage laws.

The federal government should provide a tax incentive to businesses to pay their workers a living wage in order to make doing so more affordable in the short term. In addition, improved work support programs to compliment the safety net described above, would help ensure that low-wage workers who work full time, can meet their families' basic needs as the living wage slowly climbs to a realistic level. The remaining work support programs to be enhanced, beyond the safety net described above, are the Earned Income Tax Credit, federal housing vouchers, and child care subsidies. In developing the policy proposals below, I drew upon the work of several organizations including: The Economic Policy Institute, The National Center for Children in Poverty, and the Agenda for Shared Prosperity. The goals of an upgraded work support program would be to:

- Ensure adequate family resources through a combination of full time work and government work support programs that will enable families to meet basic needs.

- Reward progress in the workforce so that earning more improves a family's financial bottom line instead of punishing it through the elimination of needed supports before self-sufficiency is achieved (Cauthen, 2006, p.4).

According to the National Center for Children in Poverty (NCCP), these goals can be achieved by:

- Basing eligibility requirements for work support programs on an actual living wage calculation rather than the increasingly irrelevant federal poverty level standard.
- Phasing out benefits gradually as a family moves towards self-sufficiency, so that workers are not punished by trying to improve their condition.
- Funding programs to meet actual needs. Most fall well short of reaching all families who are eligible, with waiting lists that are sometimes years long.
- Creating a centralized and simplified application process so that families who need help meeting basic needs can more easily obtain coverage of all available programs in unison (Cauthen, 2006, p.4).

Besides work support programs, the government should continue their plan to invest in educational opportunities, living wage jobs, green technology, and infrastructure projects. They should provide tax incentives for businesses to do the same so that families and businesses can thrive together. Common sense dictates that businesses and families need one another. Businesses need families to spend, and families need businesses to pay them enough to do so. The government should encourage the nation to look and act towards our common interests through incentives that support this behavior in its public policies, tax code, and investments.

Rationale

There is widespread belief in this nation that work should be rewarded, and that no one who works full time should have to live in poverty (Gertner, 2006). Public opinion polls, even at the height of Ronald Reagan's popularity, suggested “powerful latent support for the idea that work should pay and that government had a role in making that happen” (Schwartz & Vogely, 1992). A 2000 poll found that 84% of Americans support the idea that anyone who works full-time should not have to live in poverty. (Center for Policy Alternatives, 1999). And a poll taken in 2003 revealed that 88% of respondents thought lifting wages to middle-class levels would be more effective at improving a local economy than giving tax breaks to businesses (Moore, n.d.).

President Obama should use his position and popularity to rally Americans to demand that their Representatives in Congress pass living wage laws and an expansion of work support programs, so that people working full time can meet they and their family’s basic needs. With the economy in shambles and jobs evaporating by the millions, support systems for working families are more important than ever. The $170 billion that Congress spent bailing out AIG alone (some of which may have gone to executive bonuses) could have provided a national healthcare program at a cost of only $104 billion according to the Commonwealth Fund (Krugman, 2009b). We must get our priorities right and put the needs of our nation’s people first.

An Effective Tax Code

Oliver Wendell Holmes said, “Taxes are what we pay for a civilized society.” If we wish to maintain a civil society, we must require all Americans to pay their fair share of taxes. The imbalance in our tax code that encourages an enormous consolidation of wealth for American's top earners is an important contributing factor in our nation's economic collapse. President Obama has proposed raising taxes and cutting deductions for couples earning more than $250,000 a year beginning in 2011, beefing up the IRS, and allowing President Bush's tax cuts expire. These are all welcomed changes however much more is needed in order to restore balance to our nation's tax code. According to Cay Johnston, the government should:

- Update our antiquated tax system that focuses too much attention on watching wage earners and not enough on the new economy mechanisms for wealth.
- Eliminate deferred income except with limited contributions to 401(k) retirement programs.
- Simplify the tax code and increase progressivity**.**
- Require one set of accounting books for corporations instead of the current two: One for shareholders showing one set of profits – and another for the IRS showing (lower) profits. Whatever a corporation tells its shareholders is its profit should be the figure on which it is taxed.
- Eliminate the Limited Liability Partnership (LLP) form for lawyers and accountants, forcing them to be held accountable. "Attorneys and accountants should be pillars of our system of taxation, not the architects of its circumvention." -- Mark W. Everson, Commissioner of the IRS, 2003 (Cay Johnston, as cited by Collins, 2003)

Other good reforms include:

- Taxing capital gains at the same rate as income, increasing it from 15% to 28%. (Edwards, 2008)

- Maintaining the inheritance tax for estates above 4 million dollars in value (Edwards, 2008)
- Creating tax incentives that allow low and middle class families to save more of their income for retirement, college, and investments.
- Creating tax incentives for living wage jobs, green technology, education, and long term investments in our nation and our people.
- Eliminating off-shore tax havens that reportedly contain $1.5 trillion in U.S. untaxed assets held offshore (Edwards, 2008)
- Closing hedge fund and private equity fund loopholes that do not require them to pay corporate taxes, and allow hedge fund managers to only pay capital gains taxes on what they earn. (Edwards, 2008)
- Eliminating deferred compensation deductions that allow top executives to indefinitely defer their reported earnings to the IRS.
- Appling the alternative minimum tax only to those earning over $1 million and tie the amount to annual inflation.
- Cracking down on financial services groups and law firms that peddle tax shelters to the wealthy.
- Beefing up IRS enforcement to track down wealthy tax cheats by doubling the IRS’s budget and the number of professional auditors.
- Removing the cap on social security withholding in order to create long-term solvency in the nation’s key retirement program.

Support for changing the tax code is high. Public polling information from The Tax Foundation, a nonpartisan research group found:

- Widespread perception that the tax code is so riddled with loopholes that people with smart lawyers and accountants can still avoid paying their fair share of taxes.
- 59% of poll respondents felt they paid a larger share of their income in federal income taxes than the wealthy. (Hodge, 2005)

In addition, the IRS Oversight Boards 2008 Taxpayer Attitude Survey revealed that:

- 89% of Americans think it is unacceptable to cheat on your income taxes.
- 72% think it is everyone’s civic duty to pay their fair share of taxes.
- 67% think that everyone who cheats on their taxes should be held accountable.
- 82% think the IRS should ensure that wealthy tax payers are reporting and paying their taxes honesty.
- 86% think the IRS should ensure that corporations are reporting and paying their taxes correctly. (IRS, 2009).

These numbers reflect a clear mandate for government to increase the IRS’ budget so it can aggressively go after wealthy tax cheats and recoup the nation’s lost tax revenue. “Fortunately, we don’t have to worry about the cost. On the contrary, increasing the IRS budget is one kind of government spending that actually increases revenues” (McIntyre, 2005, p, 17). As our economic woes continue, need for additional revenue to invest in the nation, the economy, and our people will become abundantly clear. The looming possibility of social unrest may give Congress the backbone it needs to oppose the lobbying that will likely occur to prevent such changes from taking place.

The Regulatory System

In order to fix the regulatory system, we must institute new laws that take into consideration the complexity of today's financial institutions. Former head of the Federal Reserve, Paul Volker, and the international "Group of Thirty" (G30) did just this with the publication of "Financial Reform: A Framework for Financial Stability," which is gaining widespread support in the United States and abroad. (Economist.com, 2009).

The G30 framework addresses:

> a. The policy issues related to redefining the scope and boundaries of prudential regulation;
> b. Reforming the structure of prudential regulation, including the role of central banks, the implications for the workings of "lender-of-last-resort" facilities and other elements of the official "safety net," and the need for greater international coordination;
> c. Improving governance, risk management, regulatory policies, and accounting practices and standards; and
> d. Improvements in transparency and financial infrastructure arrangements. (Volker & Frenkel, 2009).

Suggestions include increased capitalization requirements for banks and strict regulations on hedge funds and large money market funds in an effort to force transparency and protect investors. The G30 also calls for regulations on the types of financial products that can be packaged and sold in the form of derivatives. In addition, their recommendations "would force banks to retain a significant portion of credit risk when they package loans into securities and resell them on, in order to curb reckless underwriting of mortgages and other debt" (Economist.com, 2009)

The Report is sound, but may not go far enough. For example, it does not call for the strict separation of commercial and investment banking that ended with the repeal of the Glass-Steagall act in 1999. Instead, it soft pedals a bit, and strongly encourages "the investment-banking arms of universal banks to focus on client businesses, such as merger advice, rather than trading" (Economist.com, 2009). One wonders, with the take-over of greed that so engulfed the financial sector, whether a mere “suggestion” of separation of interests will be enough to fix the system. On the other hand the G30 report has widespread support, and Paul Volker, as an economic advisor to President Obama, has the President’s ear. Congressional passage of the provisions in the report, in addition to other much needed legislation currently being sought by members in Congress, would force needed reform of the financial system.

The Financial System

According to Simon Johnson and members of the IMF, the government must break the power of the banking elites if we are to restore functional balance to our economy and our democracy (Johnson as cited in Moyers, 2009). To accomplish this Johnson suggests applying the stress test Treasury Secretary Timothy Geithner outlined to determine the solvency of our largest banks (ibid). If they are solvent, they can continue to operate. If they are not, they should be given the opportunity to raise the necessary capital to restore solvency from willing shareholders. If they cannot raise the needed funds, the government should temporarily nationalize these banks, fire the CEO’s and top executives, and restore the banks to solvency. (Johnson as cited in Moyers, 2009)

Many top economists agree that failed banks must be nationalized, including Nobel Prize-winning economist, Paul Krugman,

> ‘If taxpayers are footing the bill for rescuing the banks, why shouldn’t they get ownership, at least until private buyers can be found?’ His remarks echo those of Nassim Nicholas Taleb and Nouriel Roubini, who said last week that nationalizations will be necessary to bring the U.S. banking system out of insolvency” (Swint, 2009, para, 2).

Joseph Stiglitz, another Nobel-winning economist agrees:

> American citizens have become majority owners in a very large number of the major banks. But they have no control. Any system where there is a separation of ownership and control is a recipe for disaster. (Knigge, 2009).

In addition, a rising tide of conservative voices are calling for temporary nationalization of failing banks including Senator Lindsey Graham (R-SC), former, former Federal Reserve Chairman, Alan Greenspan, and former Secretary of the Treasury and Secretary of Defense, James Baker,

> Evidence – a mountain of toxic assets, housing market declines, a sharp economic recession, rising unemployment and increasing taxpayer exposure through guarantees, loans, and infusion of capital – strongly suggests that some American banks face a solvency problem and not merely a liquidity one…. I abhor the idea of government ownership – either partial or full – even if only temporary. Unfortunately, we may have no choice. (Baker, J., 2009).

The Obama administration's plan for bailing out the financial sector is costing hundreds of billions of tax payer dollars, while turning the notion of fundamental fairness on its head. We should not be rewarding those who created our economic problems while hard working Americans are left to suffer. Krugman refers to Treasury Secretary, Timothy Geithner's bank bailout proposal as "lemon socialism" where taxpayers bear the cost if things go wrong, but stockholders and executives get the benefits if things go right" (Krugman, 2009a).

My policy proposal for the banking sector might appear extreme in more normal times, but these are not normal times. In a sinking ship, choices sometimes must be made on whom to save. As such, the government should nationalize insolvent banks, allow the market to correct its own excesses, and focus, instead, on providing economic security to average Americans. Temporary bank nationalization would enable the government to reignite the primary functions of the "real" economy by loaning money and protecting deposits upon which most Americans depend. This would also allow the market system to work out the excesses it created in highly leveraged trading, at costs borne primarily by those who engaged in them, i.e., the shareholders and executives - not taxpayers and their children.

Spillover would occur through market corrections in the form of losses to pension accounts, college funds and other's who invested in risky commodities. These would be tragic losses, however, the Comptroller of the Currency Administrator of National Banks, for the third quarter of 2008, reported that the notional value of derivatives held in U.S. commercial banks were $175.8 trillion (Schweber, 2009). By contrast, the total GDP of the world in 2008 was only $70.5 trillion. The sad reality is that the investments of the American people in risky institutions may already be lost, as the outstanding debts of these banks can not possibly be repaid. The nation, on the other hand, could very well go bankrupt if we continue trying. We must make wise choices on where to invest our nation's limited funds.

By providing the strong safety net described above in areas of housing, healthcare, retirement and nutrition, the government could help cushion most Americans from insolvency and catastrophic loss should parts of the financial sector collapse due to its own excesses. This, in turn, would provide a foundation from which the rest of the nation and the "real" economy could rebuild. In addition, such a rebuilding would be greatly facilitated if the government split these larger banks into smaller community banks charged with investing in local economies (Korten, 2009).

Financial Analyst, Amy Dominici, explains the investment in local economies that occurred during The Great Depression under FDR:

> When the great reforms of 1933 and 1934 came along, they {the government} had assistance for local and cooperative opportunities. We're not seeing those kinds

> of things {in the current stimulus package}. Credit Unions assistance was also put into place and non profit banking facilities were put into place during that time. There is tremendous opportunity {to expand this effort} with this interest in local foods, local business, shop at home. (Domini as interviewed by Brancaccio, 2009).

Local community banks could become the central hubs of new local economies nationwide by making sound loans to local homeowners and businesses, holding on to those loans and investing in local communities. This, in turn, could pave the way for the transition our nation must make in light of diminishing oil supplies and global warming issues. As imports becoming prohibitively expensive due to declining oil supplies, the ability to manufacture what our people need locally, regionally and nationally, will become increasingly important. Community Banks can help support local businesses and manufacturing efforts that, in turn, will create jobs that improve local economies, while reducing our consumption of fossil fuels and our nation’s carbon emissions.

Temporarily nationalizing failed banks, splitting them into smaller community banks, freeing up credit, and freezing home foreclosures until functional terms can be worked out, while providing a basic safety net so American’s can meet basic needs, would restore order to primary parts of our economic system, and provide the nation a foundation from which a healthy, balanced economy could grow.

Conclusion

In this paper, I have described the imbalances in our economic system that led to the current system collapse. These were: Executive compensation and corporate profits at the cost of worker pay; changes in the U.S. tax code that greatly facilitated a transfer of wealth from the middle and bottom classes to the top; deregulation that enabled corporate profits to grow at the cost of consumer protection, prices and investments; the enormous consolidation of wealth that was fed into the financial sector, creating highly profitable, but risky investment opportunities to leverage itself and grow into destabilizing trade bubbles. These trade bubbles created inflated prices for, first, technology stocks, and then energy, basic commodities, and, finally, home mortgages in the form of mortgage backed securities. However, the housing bubble, in particular, was predicated on the ability of financially strapped middle and lower class families actually being able to pay the highly inflated interest rates on their home loans. When tapped out homeowners, predictably, could not make their higher mortgage payments, the housing bubble collapsed, and eventually took the entire economy down with it. Like a pyramid turned upside down, the wealth of the nation had gravitated to the top, leaving little at the base to support it.

I have also described a series of short and long term solutions that would stop our economic freefall, recalibrate our economic inputs and out puts, and provide a firm foundation from which a more balanced economy could grow.

These solutions will not be welcomed by those who benefited from the old ways our economy was run. However, those ways led us to the economic crisis we are in today. These solutions, instead, involve common sense changes that can restore our economic system to balance so it works well for the entire nation - not just for a few - over the long term. They include:

- Temporarily nationalizing failed banks; restoring them to solvency and splitting them into small, local community banks.
- Using these banks as vehicles to provide credit to the nation's homeowners and businesses while protecting deposits and maintaining control of tax payer funds;

- Putting a moratorium on home foreclosures until better terms can be arranged;
- Allowing the market to determine the fate of the financial sector, private equity firms, and those who made risky investments;
- Creating a progressive tax code, closing tax loopholes and beefing up IRS capacity to catch wealthy tax cheats in order to re-coop the estimated $300 billion in yearly treasury loses;
- Ending Bush tax cuts that will add an addition $1.8 trillion to the treasury over 10 years;
- Using these funds to create a safety net for average Americans in the form of national healthcare, expanded unemployment, food stamps, and work support programs in order to stabilize our economic base;
- Investing in green technology, education, and infrastructure to create both opportunity and jobs;
- Moving towards living wage laws that allow families to meet basic needs through full-time work, and an improved work support system to help bridge the gaps.

The ultimate purpose of this proposal is not to recreate the wealth of the past for the limited few, nor is it to create a socialist society where everyone has the same wealth. The purpose is to create basic economic security for all Americans and, in doing so, secure our democracy and expand economic opportunity and national well-being now and into the future. In short, it is a way out of the abyss.

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