American Dream – Restoring Opportunity For All !!

Subjects covered:

Tax policies changes that will help maintain the value of money (debt) during periods of high inflation expectation, create more opportunity, and a sustainable recovery for all.

Full Employment: How We Get There And Stay There Without Excessive Inflation Expectation.

The 2% Appreciation/Inflation Taxation Policy For Economies That Blow Bubbles.

How the income tax can help the Federal Reserve maintain full employment, pricestability, and reduce wide interest rate swings.

Why income tax policies must be in sync with the Federal Reserve's monetary policies.

The rich get richer and the poor get poorer. Are there policies that can be changed to help reduce the wealth inequity in our economy, without increasing taxes?

We need to modernize how we correctly control inflation and inflation psychology to help reduce deep recessions, high appreciation/inflation rates, and improve our trade, and budget deficits.

We need the correct tax policies to get our economy off the economic roller coaster of Gloom, Boom, Doom economics!!

The Federal Government can help maintain the purchasing power of money without costing it a dime.

In America people are finding it harder to get ahead in our economy. Why is this happening in the "Land Of Opportunity."

The video (go to http://www.taxpolicyusa.wordpress.com for video) showed you the economic cycles the economy goes through, through the years. The Gross National Product is represented by the straight line slopping upward. The graph shows the economic cycles as being the same height and depth . But this is not how GNP and economic cycles occur. GNP decreases and increases over the years. The line should show up and downs jags in the line. The economic cycles also will cycle through recessions, low inflation, high inflation, depression and stagflation. The cycles the economy goes through can be referred to economic periods of gloom, boom, and doom, because people's attitude about the economy changes. During the gloom period people don't feel good about the economy, and their future. During the boom people feel very good about the economy, and their finances. During the doom period they feel really bad about the economy. They believe the economy is never going to get better.

At some point in the future inflation pressures will build until inflation is higher than the Federal Reserve's target rate of 2%. In the past monetary policy has been used to raise short term interest

rates. If we can enact the 2% Appreciation/Inflation Taxation Policy before interest rates increase too much, interest rates won't have to rise as much as if we don't enact the 2% Policy. There are many benefits to having the lowest possible interest rates in the current strong dollar, low inflation economic cycle our economy is currently experiencing. (I will explain these points later in the article)

The raising of the Fed Rate raises all interest rates, because short term debt finances long term debt. The effect of higher interest rates causes the economy to slow down by reducing demand from the people located at the bottom, and the middle of the economic ladder. Employment opportunities decrease, and the unemployment rate increases, which causes demand to decrease further. This process continues until a recession is created. After the economy has cooled down sufficiently, and the inflation rate has decreased to the Fed's target rate, or lower, the Fed loosens credit again, and again the economy "recovers". In recent history each time the economy "recovers" we have less jobs, and less jobs that have a "living wage" The middle class has gotten smaller, and the number of people living at the poverty level has increased. There is a flaw in our economic policies. We need to make economic policy changes to rebuild the American economy, and the American Dream..

Our economy, and financial sector has changed considerably over the last 55 years. We no longer have a closed economy. We are the largest economy in a global economy. Our GNP affects other countries economies, and visa versa. Our monetary and fiscal policies affect other countries monetary and fiscal policies, and visa versa. Our currency exchange rate affects our economy, and other economies around the world. We have been using outdated monetary, and fiscal policies for too long. These outdated policies do not work well with a modern global money market system, which can expand liquidity as long as there is a willing buyer, and a willing seller for securities, or it can contract liquidity very fast if there is more sellers of debt than buyers. As economics Professor Perry G .Mehrling of Columbia University states, " **The world's dollar money markets fund the capital lending markets**."

World money markets have the ability to greatly increase the money supply (credit) in an economy. Even when the Fed raises the Fed's funds rate, US dollars continue to flow into our economy from around the world if there is a demand for more credit. It is the world dollar markets that determine the prices (interest rate) of money (debt) in our economy. The Fed has no direct control over the shadow banking system, which includes the world's dollar money market funds. The current out-dated monetary, and fiscal policies we are using helped create the bubble decade of the 2000s, and the rise, and collapse of primary home prices from 2000 to 2008. Thus helping to create the financial crisis of 2008, and the Great Recession. We need new fiscal policies that will help make the Fed's monetary policies more efficient, and effective.

Pay close attention to last 5 video lectures in Part 2

https://class.coursera.org/money2-002/lecture Part 1

https://class.coursera.org/money2-002/lecture Part 2

The CPI does not measure the cause of inflation. It tracks price increases of a basket of goods and services. The increase in the prices of assets creates equity, which allows the financial sector, with the fractional banking system, to create the excessive money (debt), that creates inflation.

As asset prices rise it feeds upon itself, creating more, and more debt/money, and higher inflation rates. The way to control this process is not to increase interest rates, but by reducing people's desire to go into financial institutions, and taking out a loan, **during the high appreciation/inflation cycle**.

The middle class is the back bone of our consumption economy. Their disposable income must be maintained to maintain prosperity, and our standard of living. Our military, and economic strength is derived from the taxation of the middle class, and their ability to participate in the economy. The overhang of debt, and underwater debt of the middle class, created by the financial crisis, is depressing the economy. The Fed is re-inflating real estate, and asset prices to create the "wealth effect". This process is not going to be a long term solution to our economy's problems, because the increase in asset prices is investor driven, not consumption derived. The middle class's incomes are not rising to support the single family home, and asset price increases. If wages do not increase, the middle class will have to use credit to maintain their standard of living. If the middle class takes on more debt, if they can obtain it, the increase in debt will work to increase Gross National Product a little, and for a short time, and then demand will fall, because of the debt load.

How do we create a sustainable economic recovery?

Macro economics is not an exact science. We have experienced that fact over the last 100 years ever since the Federal Reserve (Fed) was created, and the Federal government has become proactive about keeping the economy moving. Sometimes the Fed is too early, or too late with their monetary polices. Or they stimulate too much, or too little. They raise interest rates too high, or keep them too low for too long. The Federal government will use too much fiscal policy to stimulate the economy, or not enough stimuli. The government will create tax policy that is ahead of the economy, or behind the economic cycle, or tax policies that should have been eliminated, as the economy changes, from recession to the high appreciation/inflation cycle, are not eliminated, or neutralized.

You can think of the needed policy change, as an "automatic adjustment of tax policy", to help correct domestic financial imbalances before they create financial crisis. The preventing of financial crisis before they occur is something the Fed, or Congress hasn't been able to accomplish. Fed Chairman Ben Bernanke said, "If there is a housing bubble, we will clean up the mess when it pops." Also , the money flowing into the country, to fund the increasing public, and private sector debt, was improving our current account balance. Congress couldn't agree on anything to slow down the primary home market. To them the economy was booming, and that meant more tax revenues to pay for two wars, and other cost.

My thought is that we need an automatic tax policy neutralizer that will help make the Fed's monetary policies more effective. It can be done by changing the tax code automatically as the economy changes from the recession cycle to the high appreciation/inflation cycle. This automatic change in the tax code will help reduce the economic cycles of deep recessions, and high appreciation/inflation rates, and help keep people employed. This automatic income tax policy would help maintain normal consumption, and production. thereby maintaining the standard of living, and the income, and wealth of the middle class, and the working poor. Thus reducing the need for a large government "safety net".

The automatic tax policy neutralizer I had in mind is the "**2% Appreciation/Inflation Taxation Policy.**" I will explain in a little bit how this policy will work. First lets see what it will do. This reform tax policy would automatically change the tax code from encouraging debt creation, and discouraging saving, and money investment, to a tax code that encourages saving, and money investment, **during the high appreciation/inflation cycle**.
The tax code should discourage leveraging credit to make unproductive investments, during the high appreciation/inflation cycle. And then automatically revert back to it's original tax rates when the economy obtains an appreciation/inflation rate of 2%. This change in the tax code would help maintain stable prices, and full employment. Unlike the Fed's changing of monetary policies, which can create higher interest rates, unemployment, foreclosures, bankruptcies, and a recession.

Monetary policies can also increase a nation's trade deficit, if interest rates are increased to fight inflation. It would be much better for our economy if we used the 2% Policy to help control inflation, and inflation psychology. By using the 2% Policy to fight inflation, we would be able to maintain employment, and not increase the value of the dollar with higher interest rates. With a weaker dollar relative to other currencies our exports would increase, employment would increase, and the dollar would appreciate as our balance of trade payments improved.

Why excessively high, or low interest rates, and large government deficits, in a global economy, are very counter productive to global, and domestic economic growth rates is explained here in more detail.

https://class.coursera.org/ucimacroeconomics-005/lecture

Please view all video lectures. Pay close attention to Lectures 10 and 11.

What is money in an modern economy?

Any discussion on how we correctly maintain the value of the US dollar, increase employment, and stabilize our economy must start with the question: What is money in the United States of America? Ninety-seven percent of our money is created by private banks as they make loans. Three percent of our money is represented by paper Federal Reserve Notes, and metal coins.

Because private banks create the majority of our money with debt, we must be primarily concerned with how much money is created by private banks, and when they create the money (debt) in the private sector. We must change what people invest in, and when they make those investments **during the high appreciation/inflation cycle to correctly control inflation psychology.** In real estate it is "location, location, location!! In macro economics it is timing, timing, timing!!!

In September 2008 our nation's economy, and the world's economies experienced the worst financial crisis since the Great Depression of 1929.

The US economy is slowly improving, but it has come about by housing, and asset prices being inflated with very low interest rate money created with the Federal Reserve's (Fed) monetary policy of quantitative easing. The Fed is currently purchasing between 70 to 80 billion dollars of Mortgage Backed Securities, and Federal Government Debt combined, per month (Jan 2014). This monetary policy is known as Quantitative Easing, which has the effect of lowering long

term interest rates.
When the Fed reduces the amount of Government Debt and Mortgage Backed Securities, that they are purchasing, interest rates may rise. If interest rates rise, all the debt (money) that was created with a lower interest rate will decrease in value. It is very possible, if interest rates rise too fast another financial crisis could be created as people sell their (debt) money investments in a panic, to protect their wealth . A financial crisis could also be created if the collateral that is the security for the debt decreases in value!

As explained by Professor Mehrling in these video lectures. Pay close attention to lectures Lec 21-6,7,8,9&10 Part 2

https://class.coursera.org/money2-002/lecture

It is very important that tax policy is changed before the Federal Reserve changes monetary policy to increase, or decrease interest rates, now, and in the future.
For decades the Federal Reserve, and the Federal Government, hasn't used the correct tool to maintain normal economic activity, and to prevent economic bubbles from forming. We should be automatically changing the tax code, on an annual basis, as the economy changes from the recession cycle to the high appreciation/inflation cycle, and then the tax code should automatically revert back to its previous tax rates on interest income, and the deductibility of interest paid, to maintain aggregate demand, and full employment as the economy cools down.

The Great Depression, and the Great Recession were both the result of a financial crisis bought on by the excessive creation of debt (money) in the private sector.
In the last decade, 2000 to 2010, the US economy has had three economic bubbles. The dot com bubble, the commodities bubble, and then the primary home bubble. The primary home bubble is the economic bubble that did so much damage to our economy, and the world's economy when it popped, because it affected household wealth, income, and debt.

When the primary home bubble popped in the US in 2008, we heard the boom that was heard around the world. Millions of people, around the world, lost trillions of dollars in equity in their homes. Those families that were able to keep their homes were left with trillions of dollars of underwater debt when the selling prices of their homes decreased by as much as 60%, depressing our economy's economic activity, and economic activity in many economies around the world.

Million of families lost their homes to foreclosure. Unemployment increased to 25 to 30 percent, or higher in some countries. An enormous amount of misery was created for many people, while other people carted away what little wealth the middle class, and the working poor had accumulated. The lose of wealth by the middle class, and the working poor has occurred each time our economy has went through a boom/bust cycle. The wealth and capital assets of our economy have moved up to the people at the top of the economic ladder.

This chart will shock you!!

http://www.nakedcapitalism.com/2014/09/remarkable-chart-ive-seen-time-rich-gain-ground-every-us-expansion.html

The Great Recession is global, because other countries invested in our excessive debt, and their economies also had excessive amounts of debt. Other developed economies also have some of

the same income tax policies as the United States.

By the Federal Government relying primarily on the Federal Reserve (Fed), a part of the private banking sector, to stimulate the economy with low interest rates, and to control the creation of economic bubbles, and inflation expectations with higher interest rates, the Federal Government has helped create a huge inequality of wealth in our economy. We should be using the income tax to stimulate the economy, and control the creation of economic bubbles before the Fed uses monetary policies to raise, or lower interest rates.
To help prevent bubbles, help reduce income, and wealth inequality, have a more stable economy, create a more productive economy, maintain stable long term interest rates, maintain employment, reduce interest rate decrease and increase risk, and control inflation and inflation psychology, we need to enact the **2% Appreciation/Inflation Taxation Policy.**

There has been much talk about making our tax code simpler. That would be nice, but economies are not simple. Economies are continually moving between the recession cycle, and the inflation cycle. Sometimes economies stagnate into an economic cycle of a deep recession. The United States economy has gone through many such boom/bust cycles. To name a few; The Great Recession that started in 2007, and which we are still experiencing the effects of, 8 years later. The 1930 to 1942 Great Depression. The high appreciation/inflation cycle of 1970 to 1979 is known as the high inflation, and stagflation decade. The 1980 to 1984 Deep Recession was created by the Fed with very high interest rates. We are now in a cycle of very low interest rates created by the Fed. The Primary Home Bubble of 2000 to 2008 was created by government housing policy, tax policy changes, the deregulation of the our economy's financial sector, a change in global money flows, fraud and greed. The Stock Market Bubble of 1922 to 1930 has many similarities to the primary home bubble of the 2000 to 2007. (I will explain later). These are just a few of the economic boom/bust cycles that have occurred in the US economy in the last 100 years.

We must change tax policies to create a more stable economy, to help reduce the boom/bust cycles, if we want to have a better future for ourselves, and our children.

Currently people with money must use the tax code to protect their money from inflation and excessive taxation all the time. It would be better for our economy during the high appreciation cycle, if they would be guided to invest their money in money investments. The 2% Policy automatic change in our tax code would create longer periods of prosperity. I am not faulting the people at the top of the economy ladder for what they have to do with their money under the current tax policies. The income tax code is misguiding them on where to invest their money during the high appreciation/inflation cycle, therefore more inflation, and higher collateral prices are created. This allows the financial sector to create more debt/money during the wrong economic cycle, which creates higher inflation rates, and higher collateral prices.

Under certain economic conditions the tax code super charges people to make purchases, and invest with credit. Investing in hard capital assets, land, housing, commodities, and other assets becomes very profitable. As the economy heats up people's attitude about money (debt) changes. If asset prices are increasing more than 2%, people will reduce their money investments. and move into the hard capital assets, land, housing commodities, and other asset markets to obtain long term capital gains, which are taxed at a lower tax rate than interest income, or purchase products, or assets before prices increase further. But as more buyers enter the market the

pressure on prices to increase, increases.

As prices rise more poverty is created, if wages do not increase. To slow down the excessive credit use (money creation) the Fed uses monetary policies to increase interest rates, which can create a recession, unemployment, foreclosures, bankruptcies, and more poverty.

A more efficient solution to controlling inflation expectations.

The tax code can guide people to invest, and spend money to speed up economic recovery. But, tax policies that are enacted to stimulate the economy, during the recession cycle, can become **destructive during the high appreciation/inflation cycle** by over stimulating the economy, with the use of excessive debt (money) creation in the private sector, if left enforce for too long.

It is important for the tax code to counter-act what economic cycle the economy is moving through. The tax code should change before the economy creates economic bubbles, and before the Fed must raise, or lower interest rates excessively. The tax code should change automatically as the economy changes between economic cycles.

Our economy is dynamic. Our tax system is static. The economy cannot wait for Congress, a 535 politically divided committee, to change the tax code, which can take years. The 2% Policy is an automatic income tax reform policy that will stabilizes long-term interest rates, thus decreasing interest rate increase and decrease risk, and help reduce the excessive use of credit during the high appreciation/inflation cycle.

The tax code should also encourage money (debt) investment, and savings to help increase production; to help increase supply and reduce demand during the high appreciation/inflation cycle. During the recession cycle the income tax should encourage people to spend money, make all kinds investments, and to use credit to expand the money supply.

The 2% Policy will help slow down the economy in the correct way, without adding cost, when the economy is expanding too rapidly. This change in the tax code will also decrease the wealth gap between the impoverished, the middle income people, the working poor, and the people at the top of the economic ladder, without unnecessary tax increases. As explained later.

Raising and lowering of interest rates excessively is very damaging to a capitalist economy, the middle class, working poor, and small businesses.

When the Fed is trying to slow down the economy with monetary policy, it has to cause interest rates to rise higher than it would if the tax on interest earned, and high appreciation/inflation derived profits where taxed at the same rate. The Fed has to raise interest rates high enough to make the money (debt) investment worth as much as the inflation profit investment. If there is a 50% difference between the two tax rates, then the interest rate must rise 50% more than what would be necessary without the differential tax rate between long term capital gains, and interest income. This difference in tax rates is why mortgage interest rates, in 1980, had to increased to 18%, to purchase a home, to decrease inflation psychology in our economy. The inflation rate was 12%, in 1979, so interest rates had to go 50% higher, to a minimum interest rate of 18%, to make the money (debt) investment as valuable as the high appreciation/ inflation profit investment. Even after interest rates were raised to 18% to purchase real estate, it took the elimination of the deferential of the lower tax rate on long term capital gains, in 1986, to

eliminate inflation expectations in our economy, which allowed interest rates to decrease for some years.

In the early 1990s when the long term capital gains tax rate was again made lower than the tax rate on interest income, the Fed had to cause interest rates to rise when the economy showed signs of creating high inflation, because of excessive debt (money) creation in the private sector. When interest rates increased, the higher interest rates created a recession.

Higher than necessary interest rates create unemployment, foreclosures, bankruptcies, closure of small businesses (which reduces competition), depresses world trade. Higher than necessary interest rates damage other countries' economies by not only creating a recession in the United States, but by also creating a recession in their economies.
Higher, or lower than necessary interest rates create problems with capital flows between nations. Too much money flows toward the nation that has the strongest currency with the highest interest rates based on inflation rates. Then the other nations of the world must lower, or raise their interest rates to maintain their domestic economy, and their exports to obtain the needed gross national product to help maintain prosperity.

http://www.nakedcapitalism.com/2014/09/ilargi-fed-kills-emerging-markets-profit.html

When the Fed tries to stimulate the economy with very low interest rates it is also very damaging to a capitalist economy.

Zero bound interest rates deprive retirees of needed income, reducing their ability to consume, which reduces demand, and consumption during the recession cycle. Very low interest rates increases senior poverty rates. With less income from interest income, seniors spend their savings. After their savings are depleted seniors must turn to government programs to maintain themselves. As the baby boom generation retires at 10,000 people, or more a month, this situation will become worse.

The depletion of the savings of seniors increases government expenditures and deficits, unless taxes are raised. We should not raise taxes during a recession, because raising taxes reduces demand.

Very low interest rates discourage the young, and the working poor to save the money needed to get a leg up on the economic ladder. When interest rates are very low people wanting/needing higher returns on their capital will make riskier, and undesirable investments, which can destabilize the economy, with the possibility of creating another financial crisis in the future.

People at the top of the economic ladder have money to invest, or make debt (money) investments, unlike the people at the bottom of the economic ladder. Implementing the 2% Appreciation/Inflation Taxation Policy would reduce excess demand from the top of the economic ladder **during the high appreciation/inflation cycle rather than from the bottom of the economic ladder, as high interest rate policies do.** With the 2% Policy enacted, people with money investments would remain in money investments, or productive investments, which increases supply, and reduces demand, without raising the cost of production and consumption.

When the Fed has to raise interest rates excessively, to over come the effects of the long term capital gains tax rate, the cost of interest on the national debt rises more than necessary, which

reduces the ability of Congress to fund other necessary programs. State government debt is affected in the same manner. The 2% Policy would rectify this operational flaw in our economic system.

When the Fed is making interest rates increase or decrease, the Fed is making an educated guess on how the economy will be performing up to six months in the future. The Fed tries to be correct on it's predictions, but most of the time their monetary policies are lagging, or premature to the economic cycle.

The 2% Policy is a better way of stimulating the economy, and controlling inflation and inflation psychology.

The 2% Appreciation/Inflation Taxation Policy would be based on how the economy was performing each year. The income tax code concerning interest income and the deduction of interest paid would remain as it is now, during the recession cycle, and while the economy is in near balance to maintain production, productive investment, and increase consumption in the economy. The tax rates on interest income, and long term capital gains would remain the same as they currently are until the economy started to become over heated, and assets and real estate prices began to increase more than 2% a year, the income tax would automatically change annually based on the asset appreciation/inflation rate before the Federal Reserve raised short term interest rates, and tightened credit to the banks, to increase interest rates.

How would the 2% Appreciation/Inflation Tax Policy operate?

If asset and real estate prices were increasing more than 2% , the tax on savings and money investments (bonds and other debt investments) would automatically decrease based on the asset appreciation/inflation rate, and at the same time the interest deduction would automatically decrease based on the appreciation/inflation rate. This automatic change in our tax code would slow the economy down without raising cost of production, and consumption. This change would maintain employment, and also allow production the time it needs to balance supply with normal demand.

Employment would be maintained, as the economy balances itself, therefore normal consumption would continue with the 2% Policy enacted.

The 2% Policy will increase money (debt) investment, and the savings rate **during the high appreciation/inflation cycle.** This change in our tax code will make available the monetary capital, at the lowest possible interest rate, to increase supply.
Speculation with credit would decreased during the high appreciation/inflation cycle, with the 2% Policy enacted, less people would not feel as if they needed to spend their money, or invest their money to protect it against high inflation, which increases demand unnecessarily, which increases the appreciation/inflation rate excessively.

The long term capital gains tax rate would be neutralized, **during the high appreciation/inflation cycle**, because the return on investment would be the same as on high appreciation/inflation derived profits, when interest income is being taxed at the same tax rate as long term capital gains.

The almost 50% differential between the tax on long term capital gains tax, and savings and

money (debt) investment would be automatically eliminated until the high appreciation/inflation rate was reduced to 1 to 2 percent. Also during the high appreciation/inflation cycle the interest paid on loans would not be 100% tax deductible, which will reduce the stimuli in the tax code for people to increase their debt for unproductive investments, and speculation reasons. To increase aggregate demand during a recession, and a very low inflation cycle, the interest deduction for interest paid on credit used for personal consumption should be made available. In this way the tax code would encourage more purchases of automobiles, trucks, and the consumption of other products and services would take place.

If interest rates are not raised excessively to control inflation and inflation psychology, people living on interest income will not have an income increase, therefore they will not increase demand in the economy when less demand is needed to balance the economy. The cost of government programs that are index to inflation will not increase as much when inflation and inflation psychology are correctly controlled with the 2% Policy.

The lower long term capital gains tax rate would still be available, and meaningful to those people who want to make, or sell productive investments.

We have had a couple of periods in our history where the long term capital gains tax rate was the same as the tax rate on interest income, and other forms of income. From 1913 to 1921 and 1988 to 1990 the tax rates for both forms of income were the same. When we lowered the long term capital gains tax rate lower than other forms of income, economic activity increased, reducing the length and depth of the recession, but if it was left at the lower rate for too long it contributed to excessive debt (money) creation, speculation, and high appreciation/inflation rates in the private sector. Long term capital gains taxes were lowered in the recession of 1921 which helped end the recession. The lower long term capital gains tax rate was lowered to 12.5 % in 1922 from 73% in 1921. The tax on interest and earned income remained at 73%. The lower tax rate for long term capital gains was left enforce for too long, from 1922 to 1931. Also the top income tax rates on earned income, and other types of income was lowered each year until 1931 to 25%, which left more money in the hands of speculators, increasing speculation, ending with the creation of the the financial crisis of 1929, and the Great Depression.

The surge in primary home prices from 2000 to 2007 has a distinct correlation with the stock market price surge from 1922 to 1928, and the rapid price decline in 1929.

Some of similarities between tax policies before the financial crisis of 1929 and the financial crisis of 2008 are:

The financial sector was regulated very little by the government in the 1920s. In 1999 Congress and President Clinton eliminated some of the regulations the federal government had enacted in the 1930s, during the Great Depression. In 1920 our economy was in recession. To stimulate the economy, Congress lowered the long term capital gains tax rate (LTCGTR) from 73% to 12.5%. Interest income was taxed at 58%. By 1929 the tax rate on interest income was lowered to 24%. In 1999 Congress, to stimulate the primary home market, eliminated long term capital gains taxes on up to $500,000.00 on the sale of a primary home. In 2000 the LTCGTR was reduced from 29% to 21%. interest income was taxed at 43%. In 2003 the tax on interest income was lowered to 35%, and the LTCGTR was lowered to 15%. The economy was in recession in 2000. The Fed lowered interest rates. The 0% tax rate for home owners, and the 15% tax rate for LTCG

made the selling, and buying of primary homes more profitable than holding debt as an investment. Leaving the differential in the tax rates for so long, with a deregulated financial sector, is what triggered the creation of the primary home price bubble from 2000 to 2007. In 2008 when nobody was willing to hold the over leveraged mortgage debt as an investment, in other words, the debt was not able to be refinanced or roiled over, it caused the rapid decrease in the prices of primary homes. The same process occurred with the over leveraged margin debt of the stock market of the 1920s.

The financial sector is involved in the creation of economic bubbles by doing what it was created to do, make loans. The problem is it doesn't know when to slow down making loans. It feels it is providing a service, that allows the economy to grow. If the collateral prices are increasing it can make larger and larger loans, on existing assets, which increases it profits. The financial sector feels the loan is secure, because primary home prices, in the past, had increased nationally over a long period of time.

There have been times in our history, that there have been major price drops, and price increases in home prices in individual States, and geographical areas. What was different between 2000 and 2007 was that Congress had enacted tax policy that affected the taxation of the profit from the sale of primary homes nationally. Because of global money markets, banks, Fannie Mae and Freddie Mac, and Wall St. were selling the Mortgage Backed Securities (MBS), and our other debts all over the world. The low reported inflation rates, 2000 to 2007, that was being reported by the government, even though primary home prices were rising 30% annually in some markets, gave the Fed no reason to limit private sector debt. The AAA rating on the MBSs satisfied bank regulators for reserve requirements. With willing borrowers, and willing MBS investors primary home prices began to rise dramatically.

The Fed, and the Federal Government managed to prevent another Great Depression with fiscal, and monetary policies. These policies have worked some what, but asset, primary home prices, and the debt bubble are being inflated again.

When appreciation rates are higher than 1 or 2 percent the "Animal Spirits," John Maynard Keynes, the British economist referred to in his writings, are released, and the herd begins to gather, until an investor stampede is created to cash in on the easy paper profits to be had with the lower tax on long term capital gains. The herd bids up the prices of assets, and real estate until prices are unsustainable, and then the bubble goes boom, and prices collapse.

A fraudster will tell you, the easiest, and fastest way to motivate people to act, or to defraud them is to offer something for free, or include them in the idea they will reap a reward without working for it. With the tax changes that were made to the tax code concerning the sale of a person's primary home, people were persuaded to take on more debt than they could afford, with the promise of tax free money when the home was sold. The person, or persons that benefit the most are the fraudsters. They are in control of the whole scram. In regards to the primary housing bubble Wall St. and the Bank directors are the people that walked away with billions of dollars of bonuses, and stock options at the expense of the shareholders, and tax payers. It was the financial sector that lobbied Congress, and President Clinton to deregulate the financial sector.

http://www.salon.com/2014/09/07/finally_wall_street_gets_put_on_trial_we_can_still_hold_the_0_1_percent_responsible_for_tanking_the_economy/

The tax code changes of the 1990s, and the early 2000s not only brought more investors into the single family home market, families also realized they could earn a large amount of tax free money by selling their highly appreciated home. When the financial sector created the debt (money) for the buyer to purchase the home, the financial sector flooded the economy with new money by monetizing the equity in the homes. The home buyers also realized that in a couple of years, because of the high price appreciation rates of single family homes during 2000 to 2007, it was possible that they also could receive a large amount of tax free money. Because of this realization they were not too concerned about what price they were paying for the home. Considering interest, and property taxes were 100% tax deductible, and they would be using the "investment in the property "to live in the home" made the "investment" even better.

With higher collateral prices, the financial sector can create larger loans, creating more money (debt). As the high appreciation/inflation cycle progresses the middle class, and the working poor's, "Animal Spirits" are excited, and they then put it "all on the line" by increasing their debt beyond what they can afford. You guessed it! The banks, Wall St. the entire financial sector, and the real estate sector profits go up, while the working poor, and the middle class can't earn enough money, fast enough, to maintain their debt load, and their standard of living without both parents working, or using more credit. Many of the middle class will go further into debt if they can obtain a larger loan on their homes, as the selling price of their home increases. If the mortgage has a balloon payment, or an Adjustable Interest Rate Mortgage, the homeowner may not be able to make the balloon payment, or the higher mortgage payments, if interest rates rise, they could lose their home to foreclosure. The result is that the economy, and society are increasingly becoming more unstable.

The 2% Policy would help reduce wealth inequality

The 2% Policy tax change would help create more real wealth, and less paper profits. When the middle class and the working poor are able to stay employed during economic cycles, the middle class, and the working poor would be able to accumulate, and maintain their wealth. It would help close the wealth gap between the people at the top of the economic ladder, and everyone else in the economy, because the economy would maintain a closer balance. The middle class and the working poor would stay employed as the economy balanced supply and demand. The money that the middle class, and the working poor earned would maintain its value over a longer period of time after the 2% Policy was enacted. If there was a recession, caused by over supply, the excesses would be used up quicker if more people remained employed earning a higher income than if they were drawing unemployment insurance . Only certain sectors of the economy would be affected by the over supply. Economies are local therefore tax policies should be applied locally. The entire national economy would not be affected as when interest rates are raised to slow down an over heated economy. State governments should adopt the 2% Policy to maintain demand, employment, productive investment, and production..

The 2% Policy would help reduce the economic cycles that reduce the income and wealth of the middle class and the working poor, and help reduce the economic cycles that increase the wealth of the upper income people, as we are currently witnessing with the foreclosure crisis, and the massive investment by investors in single family homes. In some single family home markets we have seen the middle income people, and the working poor being out-bid by investors, and Wall St. hedge funds with all cash offers as they buy 40%, or more of the single family homes for sale.

We need to empower qualified families, and the working poor, with new mortgage terms, to purchase the single family homes, as I have written about in the article "Resolving Underwater Mortgages Without Inflating Asset And Primary Home Prices".
The single family home market should be made up of those people that want the home to live in. Single family home prices should reflect their purchasing power. Investors have many other multi-unit housing investments available to them. The single family home market should not include investors, and hedge funds. Encouraging investors to get into the single family home market during a recession, with tax incentives and other financial incentives, to inflate single family home prices, is short sighted, and will lead to another sell off, and a possible financial crisis. This could happen when investors decide to sell, and families can't qualify for a mortgage to purchase the single family homes at their current inflated prices.

The tax deduction that investors currently have, that allows investors to deduct the cost of repairing a house should be given to homeowners. so neighborhoods do not deteriorate. Homeowners will hire contractors to do the work, thereby reducing unemployment and neighborhood blight. All tax incentives for investors, or Wall St. firms to invest in a single family home should be eliminated from the tax code. This tax code policy change would not affect investors that own existing single family homes. Only new purchases of a single family home by an investor would be affected by the tax policy change. If an investor does buy a single family home, they will quickly build multi-unit housing on the property, if zoning codes allow it, thereby increasing the supply of housing.

I would like to point out this fact. If families could not maintain the payments on the inflated home prices before the financial crisis of 2008 occurred, they won't be able to afford to purchase, and make the mortgage payments on homes with the same inflated prices. If interest rates rise it will make primary home less affordable. In the last 20 years personal income for millions of people have decreased, yet home prices have increased due to investor demand.

Think about it. If we can create an economy where people can stay employed, housed, and productive, they will be able to provide for themselves and their families. More taxes do not need to be collected, or tax rates do not have to be increased to support a larger government "safety net."
Our country is the "Land of Opportunity". We must take this opportunity to change policies that have reduced opportunities for people to provide for themselves, and their families. The crowding out of families in the single family home market by investors must be corrected. Monetary policies and tax policies that help create high housing cost, unemployment, bankruptcies, foreclosures, and the closing of small businesses must be changed to increase opportunity in the economy of our great nation. I would suggest that we say it out loud more often, and to set a goal for our nation, to add two words to the Pledge of Allegiance. The Pledge should reflect what America is committed to. The words that many of our Presidents, Governors, and Representatives repeatedly speak of. The words Responsibility and Opportunity should be included in the last sentence of the Pledge. The last sentence of the the Pledge should include, " **WITH LIBERTY, JUSTICE, RESPONSIBILITY, and OPPORTUNITY FOR ALL.**"

With the 2% Policy in place, the people at the top of the economic ladder would have to make money the "old fashioned way", they would have to "earn it". More long term investments would be made to create products and services, which would create good paying jobs and "real wealth" rather than "paper profits" and higher prices.

The 2% Policy is a better way to guide people's financial decisions, than the Fed's policy of changing interest rates. Instead of interest rates changing by excessive amounts, the 2% Policy would help maintain interest rates in a much narrower range. This would allow businesses, and consumers to make long term financial decisions.
Tax policy would automatically change, when needed, rather than interest rates changing after the damage has already been done. After the 2008 financial crisis occurred is when we found out that consumers, investor, businesses, banks, Wall St., and the entire financial sector had created too much private sector debt(money). That is too late, and is very damaging to people lives, and our economy.

While I am on the subject of improving opportunities for people.

Euro Zone countries should use the 2% Appreciation/Inflation Taxation Policy to stimulate & cool down different countries at different times instead of excessive interest rate changes. One interest rate for all countries in Europe will not work, because the different countries are not experiencing the same economic cycle at the same time. Tax policy can change the value of the euro the same as having different interest rates in each country. The 2% Policy can change people's consumption, investment and financial decisions the same as interest rate changes can. People will move their money, and asset investments to the country with the best tax policy. As the tax policies automatically change, as economic cycles change in each country, money will move efficiently where it will be used to increase the standard of living without excessively raising the cost of living with excessive speculation, or unproductive investment.

The USA can use one interest rate, because the Federal government collects money from all states and sends it back to the states through construction, military complexes, federal government employment, and social programs to stimulate economic growth in the different states. There is no Federal government in Europe, that can tax all the different countries and redistribute the funds to the different country's economies. Therefore the different countries must borrow money from the Euro countries that have surplus Euros. Excessive debt creates crisis, and higher interest rates for the country, if too much debt is created based on a country's GNP, and it's ability to repay the debt.

The US economy would be more efficient if all 51 states would adopt the 2% Policy. Instead of money moving to states that prices are increasing excessively to fuel more speculation, resulting in higher prices, money, instead would move to states in need a greater supply.

Conclusion

It makes no sense to maintain tax policies that push an economy so hard that it blows up during the high appreciation/inflation cycle, and then it has to go through a balancing process during a deep recession, creating untold misery. By automatically changing tax policy we can slow down the economy, without creating a deep recession or financial crisis, by using tax policy rather than higher interest rates.

The 2% Policy. is not designed to reduce billionaires taxes. The objective of the tax policy is to reduce the number of buyers in a market economy that is experiencing price increases of more than 2%. When prices are increasing more than 2% annually, people move from fixed income securities to hard capital assets. These new buyers increase demand in a market that already has

too much demand. Excess demand is why prices are increasing. the economy needs a greater supply.

The Idea of the 2% Appreciation/inflation tax policy is to encourage the holders of fixed income investments to stay in the debt securities so production has the time, and the money, at the lowest possible interest rate to increase supply to balance normal demand with supply. In this way we contain inflation expectation without raising cost. When the Fed causes, interest rates to rise, to encourage people to stay in fixed income securities, higher interest rates raises the cost of production and consumption. The Fed's monetary policy raises cost, slows down the economy, which creates unemployment, and less consumption from the bottom, and the middle of the economic ladder. The 2% Policy only stays in effect until the economy is experiencing 2% annual appreciation/inflation rates. After the economy returns to 2% annual appreciation/inflation rates, the tax rate on interest income automatically returns to it's previous rate, and the tax deduction of interest paid returns to 100%, to maintain demand.

You might think of the economy as an engine in a car. To make the car go faster, or slower you would give it more gas, or less gas. The amount of gasoline is the incentive for the motor to speed-up, or slow down. You would not raise the price of gasoline to slow the engine down.

Raising the cost of money to slow down an economy is also wrong. To slow down an economy that is over heating you need to reduce the number of buyers that are in the market place, and increase supply. You do not want to reduce buyers from the bottom, or from the middle of the economic ladder. You would want to reduce buyers from the top of the economic ladder first, because you want to maintain employment, to increase supply and maintain normal consumption.

The extra demand is coming from the top of the economic ladder when the economy is in the high appreciation/inflation cycle. Not from the bottom, or the middle of the economic ladder. We currently reduce demand from the bottom of the economic ladder first. There is a reason why this is occurring. It has to do with the income tax code. The tax code is structured to encourage people to hold their wealth in capital assets, and not in money (debt). This is fine during the recession cycle, or when the economy is in near balance, but if the tax incentives are continually applied to encourage people to hold capital assets as a store of wealth, the economy becomes too unbalanced, and then too much credit (money) is created in the private sector. High appreciation, and inflation rates begin to occur. And then inflation psychology is created (people protecting their money from inflation and taxation).

The more the economy becomes unbalanced, the more buyers from the top of the economic ladder enter the market place to increase their paper profits, to protect their money from inflation, to use the lower long term capital gains tax rate to lower their interest income tax bill, and to get a better return on their investment money. If this process continues for too long the banks start to make loans to unqualified buyers. The financial sector begins to make loans to unqualified buyers. Because of the high appreciation rates of the collateral, financial sector feels their loans are secure. They continue making riskier loans as prices increase further. It all comes to an end when nobody will increase the debt on the collateral, or people realize prices are not going to continue to rise.

The speculation and short term investment continues, because interest income is continually

taxed at the highest tax rate, currently approximately 39.6%, and long term capital gains is taxed at 20%, or at a lower tax rate. Also interest remains 100% tax deductible for businesses, investors, and homeowners. And there is easy "paper profit" money to be made which is taxed at the lower tax rate if the investment is held for one year.

The 2% Appreciation/Inflation Taxation Policy would correctly stabilize the value of money (debt). The 2% Policy would decrease the ability of banks, and other financial institutions to create too much money (debt) during the high appreciation/ inflation cycle, because the 2% Policy would automatically change tax policy, thereby reducing the number of people that want to obtain more debt during the high appreciation/inflation cycle.

Instead of encouraging people to increase their debt, and reduce their savings rate during the high appreciation/inflation cycle, the enactment of the 2% Policy into the income tax code would encourage people to save money, and hold debt as an investment, thereby reducing the amount of money being created during the high appreciation/inflation cycle, without creating more unemployment and a recession, or raising the cost of production and consumption, as the higher interest rate monetary policies of the Federal Reserve do now.

The lower long term capital gains tax rate also devalues money (debt) in the domestic economy. When you continuously tax high appreciation/inflation derived profits at a lower tax rate than interest earned on a money investment (debt), money becomes worth less and less, because of the return on investment. Money is worth less, because of the higher tax on interest income, and the purchasing power that the money (debt) is losing as prices increase during the high appreciation/ inflation cycle. Less and less people are willing to hold money as an investment, so they become a buyer in the economy, increasing demand in an economy that already has too much demand in it. When the Fed raises interest rates, the value of all the debt (money) that was created at a lower interest rate loses value, which can make a long term money investment risky. Because of interest increase risk, this requires long term debt (30 year mortgages, and other long term debt) to have a higher than necessary interest rate.

When the high appreciation/inflation cycle is occurring in an economy, money (debt) is losing purchasing power. The 2% Policy is a way for borrowers, and the government to partially maintain the purchasing power of money (debt) without raising interest rates excessively. If the private sector, and the government create too much money (debt), which creates inflation, and unsustainable asset prices, the debt investor, or the saver will pay a little less income tax, with the 2% Policy in effect, at the end of the year. At the end of the year the borrower will pay a little more tax, with the 2% Policy in effect. There will be no loss of revenue to the government, because the exchange in value will take place between debt investors/savers, and borrowers.

With the 2% Policy enacted, employment will be maintained while the economy balances itself, therefore the States and Federal Governments will have less social expenditures maintaining the safety net, such as unemployment insurance, welfare, medical payments, food stamps, and many other programs that help people when they become unemployed, or if they cannot earn enough money to maintain a reasonable standard of living.

All people and businesses would be included in the 2% Policy. The same as they are when interest rates change. All debt investors, savers and borrower would be affected by the 2% Policy. It is more important for a capitalist economy to have stable interest rates than the tax

deduction of interest cost. After the economy slows down, all the stimuli the tax code has in it, to invest in capital assets, will return as the tax rate on interest earned on savings, and money investments increases to their previous tax rate, and the interest deduction becomes 100% tax deductible again. The tax code could include a tax credit equal to the tax deduction if the interest paid on the loan is paid on a loan used to increase the supply of a product, or housing during the high appreciation/inflation cycle.

If we want to make the financial sector more stable, the interest deduction, for lenders, should be reduced as the appreciation rate increases, so they will create less short term debt to finance long term loans. This change in our tax code will encourage the financial sector to make more loans by using capital obtained by stock sales. Using short term loans to finance long term debt can cause a financial crisis, as short term interest rates rise higher than the interest rate the long term loan is earning.

The debt investor, and the saver is as important as the borrower in a Capitalist economy. They both should be taxed appropriately depending on which cycle the economy is experiencing. It is important to note in which economic cycle people are saving and investing in money (debt) and then automatically have the tax code change when the economic cycle changes.

As the high appreciation/inflation cycle progresses there is an exchange of value between the asset purchaser and the debt investor. The debt investor is losing purchasing power and the asset purchaser is gaining purchasing power.

With the 2% Appreciation/Inflation Taxation Policy enacted, we would be correcting the balance of values between the borrower and the debt investor each year, rather than allowing the imbalances of value to increase year after year, until very few people will invest in debt.

When very few people will invest in other people's debt a deep recession, or a depression is created. The economy then has to go through years of large increases of Federal Government deficits, foreclosures, debt restructuring, debt refinance, business closures. law suites, criminal trials, high unemployment, and bankruptcies, and people experience years of misery, as millions have experienced the last 7 years, to re-balance itself.

In 1939 the world went to war. The war created enough employment to end the Great Depression. Considering the destruction, and death that occurred in the countries where the war was fought, we do not want to repeat history to rebalance our economy and the world's economies.
War and many of the things I have mentioned add to the incomes of the people at the top of the economic ladder, and reduce the wealth and life span of the middle income people, and the working poor.

It has been said, "A ounce of prevention is worth a pound of cure." Never again should we allow economic bubbles to be created, and then do what a Federal Reserve Chairman said, "If there is a housing bubble, we will clean up the mess after it pops." Too much misery is created if we wait for the financial crisis to occur. The income tax must automatically change before an economic bubble is created, and the Fed's monetary policy changes interest rates excessively.

John Maynard Keynes, the British economist, whose writings advised President Roosevelt about improving the economy during the Great Depression, wrote that an economy gets into trouble

when it's members save excessively, all at the same time, for too long. My point is that if people are encouraged by the tax code to create too much debt (money) in the private sector, for too long, the economy also gets into trouble. Too much debt in the private sector can create a financial crisis. This point is supported by work by Professor Steve Keen, Professor Minsky, Professor Ann Pettifor, and other economist in the past, and present. Here is a video by Prof. Keen youtu.be/aWgjM31Ss5I?a (copy and then put in your browser). Ann Pettifor, and Prof. Keen have many other videos posted on UTube, and on the internet. Their books are also available at Amazon.com I will let them explain the technical basis of the argument about how money is created, and why money should be a part of our economic modeling. I present a possible cause, and solution to the problem of excessive debt (money) creation in the private sector. Main St. needs this information, and tax policy change now to create a sustainable recovery before the economy begins to heat up again. We also need to resolve the underwater mortgage problem that is creating a drag on Main Street's economy. The capital gains tax on primary homes should be taxed at the same rate as other long term gains income to prevent another bubble from forming in the primary home market.

Zero percent long term capital gains tax rates on homes, and low tax rates on other long term capital gains for low income people should be retained to increase their wealth, so they can move up the economic ladder.

Employee's wages and disposable income must be maintained to have a economy that produces opportunity for all. We need to enact the 2% Policy, so prices do not rise too fast. Prices in our economy have risen a thousand percent in the last 50 years. If prices had risen 2% a year in the same time period, prices would have risen 100% in the last 50 years. The wages we would have earned would have slowly increased, maintaining our wages' purchasing power, and our production capabilities in the USA. Our production jobs may not have been moved to other countries.

We still want to purchase products to have a reasonable standard of living, but we are purchasing them from other countries, improving their wealth, and standard of living, while our middle class is shrinking. If we had enacted the 2% Policy 50 years ago, our exports would be more competitive in the world market. We could reduce our trade deficit. Our nation's trade deficit is making our nation into a debtor nation, and most of us are becoming poorer.

The **People's Economic Recovery Plan** also presents a better procedure to dispose of the underwater mortgage situation without costing the taxpayers a dime. Perhaps, since the Fed now owns the Mortgage Back Securities (MBS) that include many of the underwater mortgages, not the banks or other entities, they could do the famous "helicopter money drop" recommended by former Fed Chairman Ben Bernanke for Japan's sluggish economy in the 1990s, by implementing the People's Economic Recovery Plan, which calls for a monthly reduction of underwater mortgage principal amount each month. The Fed can do this because the Fed is an independent private organization charged by the federal government to maintain stable prices, and maintain maximum employment. It could modify the underwater mortgages **without** government approval, or borrowing money in the capital markets. The money would come from the money the Fed returns to the Federal Government each year. In 2012 the amount of money the Fed returned to the Federal Government, after paying it's operating cost, was 77 billion dollars. The amount of money returned in 2013 was probably higher, because interest rates were higher in 2013, and QE continued in 2013 and 2014. Many of the MBSs the Fed has purchased

since it started QE have very low interest rates. The same low interest rates could be provided to struggling underwater home owners. The reduction in revenues the Fed returns to the Federal government each year would be replaced by the tax revenue collected from a more robust recovering economy.

When a recession occurs in an economy, interest rates decrease. To increase demand on Main St., to reduce the length, and depth of the recession, or financial crisis, all single family home mortgages should include a clause that lowers the interest rate, as the Federal Reserve lowers interest rates to the financial sector. This change will eliminate refinancing cost, and increase economic activity, and aggregate demand on Main St. rather than primarily increasing economic activity in the financial sector, increasing it's profits, and bonuses. As the economy improves, if the Fed has to increase the cost of funds to the financial sector, the interest rate should then increase slowly until it rises to the interest rate of the 30 year fix rate interest rate, or the prior interest rate the mortgage interest rate was prior to the interest rate being lowered, which ever is the lowest interest rate.

Please read the other articles on this blog at http://www.taxpolicyusa.com for more information.

The US Treasury also writes we have problems related to inflation, in the tax code. The US Treasury wrote this paper in 1986 outlining a tax policy that would reduce the harmful distortions of inflation on the tax code. click here

Please read the following article "Why The Dot Com Bubble Started And Why It Popped" Note the similarities between the Dot Com Bubble, and The Primary Home Bubble!

Leonard C. Tekaat is an author, a real estate investor, small business man, and working partner of Tax Policy USA.

11620 Traviso Ave. Bakersfield Ca. 93312 economysflaw@yahoo.com 661-619-4858

His book "INFLATION THE ECONOMY KILLER" How to Create, Control, and Stop High Inflation was written in 1982 when interest rates went to 18% to buy a home. It can happen again. Ask yourself, "Are we going to repeat the past, or are we going to make changes to improve our future? Will your children, and grand children have a better life experience than you. Will they be able to fulfill their perception of the American Dream?"