Explaining Capitalism

Debunking anti-capitalist propaganda, including the hysteria about U.S. wealth and income inequality, as well as fighting the creep of socialism.

The Truth About U.S. Inequality

An Occupy protest against economic inequality. Photo Credit: Brian Sims

By Jesse Colombo

Rising economic inequality and how to address it has been one of the most important issues in the United States since the Great Recession ended in 2009. Rising inequality has spurred a powerful left-wing economic movement that kicked off with Occupy Wall Street in 2011, led to the 2016 presidential campaign of socialist Bernie Sanders (which was very popular with young Americans), and has now contributed to the rise and growing clout of far-left politicians including Elizabeth Warren and millennial socialist Alexandria Ocasio-Cortez, who are both calling for wealth redistribution policies.

At the core of this left-wing economic movement is a growing disbelief and distrust in capitalism itself, as well as the belief that an excessive rich-poor gap is an inevitable outcome of capitalism. As a result, young Americans now favor socialism over capitalism. Even 45% of Republican voters support Alexandria Ocasio-Cortez's 70% top-tax-rate proposal, while "conservative" Fox News host Tucker Carlson threw in the towel on capitalism.

The report you are reading – "*The Truth About U.S. Inequality*" – completely turns the conventional wisdom (i.e., the left-biased explanation) about growing U.S. wealth and income inequality on its head. Here's the reality in a nutshell: **growing U.S. economic inequality is not the fault of capitalism**, but the byproduct of unbacked fiat (aka "paper") currency, central banking/the Federal Reserve, and a massive wealth bubble that has been inflated by the Fed. **Instituting free market capitalism and sound money is actually the only solution to America's growing economic inequality.**

You can use the links below to skip to different chapters of this report:

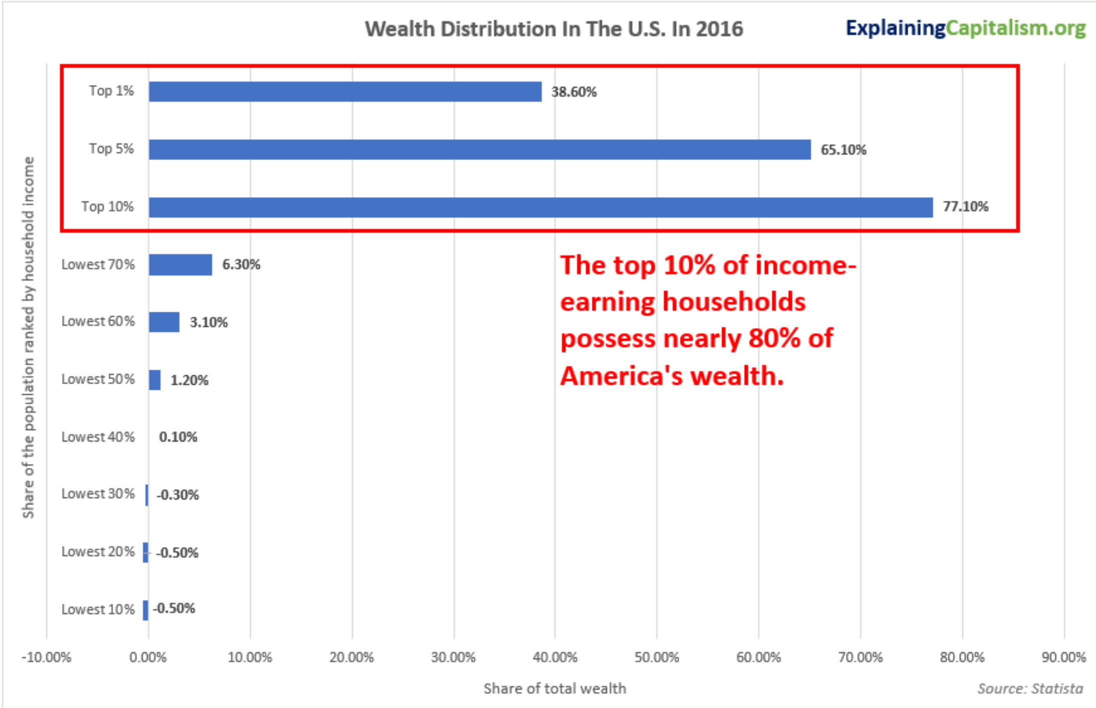
Here Are The Key Truths About U.S. Economic Inequality:

- Rising U.S. economic inequality is not the fault of capitalism, but the fault of the Federal Reserve and unbacked fiat (aka "paper") currency.
- Fiat currency and central bank market interference go against the very principles of capitalism.
- The left is using growing U.S. wealth and income inequality alarmism as a ploy to attack the straw man of "capitalism" for the purpose of instituting socialism.
- U.S. wealth and income inequality is the result of a long-term Fed-driven bubble in household wealth (which is due, in turn, to bubbles in stocks and bonds).

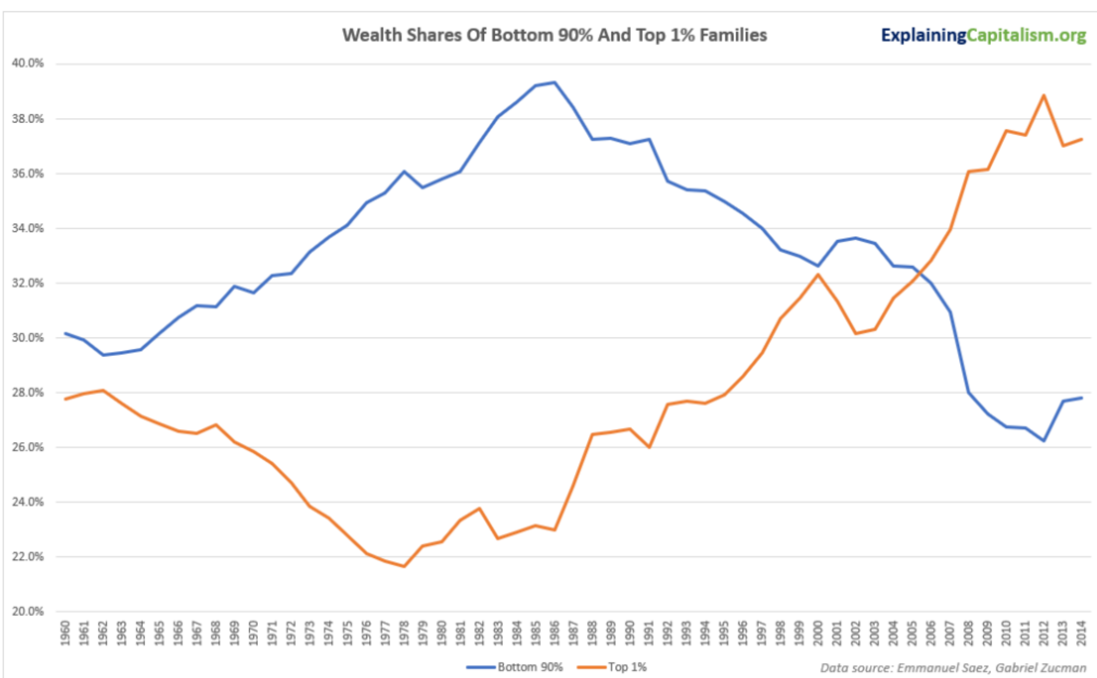
- The long-term U.S. stock and bond bubble started inflating in 1981/1982, which is exactly when the rich-poor gap started to increase (that is no coincidence!).
- The rich own a disproportionate share of the stock and bond market, making them the prime beneficiaries of the stock and bond bubble.
- U.S. wealth and income inequality are largely driven by the same factors: the rich make their living as owners of capital (stocks and bonds), the middle class make their living through salaried work, while the poor earn income through a combination of work and government transfer payments.
- The U.S. wealth bubble is not a permanent situation: it is actually going to burst, which will cause the rich-poor gap to shrink.
- Americans should spend more time worrying about the wealth bubble and the economic crisis that will occur when it bursts, rather than the temporary wealth inequality that it has created.
- Socialism is the wrong medicine because it doesn't strike at the root of the problem; free markets, ending central banking, and instituting sound money are the right medicine.
- The left/socialists do not address (*or even mention!*) the role of the Fed, fiat currency, and asset bubbles in driving U.S. inequality because they are completely disingenuous. They are not interested in genuine solutions – they are only interested in instituting socialism.

A Brief Introduction To U.S. Economic Inequality

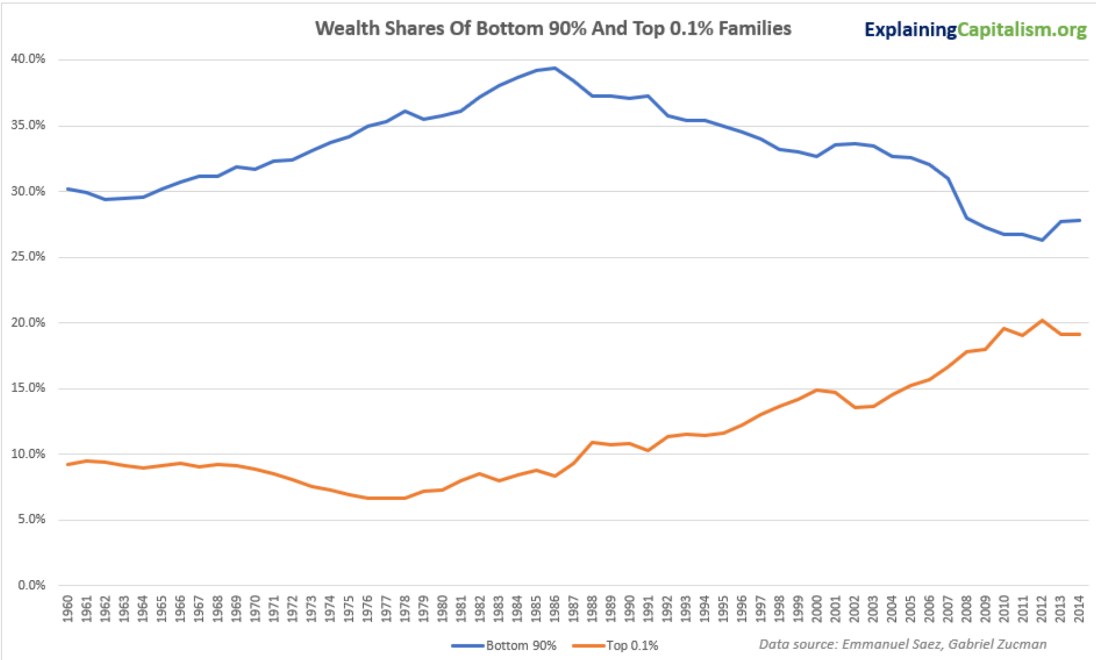
The first chart in this report shows the distribution of wealth in the U.S. in 2016. The key takeaway is that the majority of America's wealth is concentrated in the hands of a minority of the population. More specifically, the top 10% of households (ranked by income) possess nearly 80% of the country's wealth. Furthermore, the top 1% of households possess 38.6% of wealth, while the bottom 90% possess only 22.9% of wealth.



The distribution of U.S. wealth has not remained static over time, but has become increasingly unequal since the early-1980s (the significance of the early-1980s as the key turning point for U.S. wealth distribution will be discussed throughout this report, so please keep that in mind). Starting in the early-1980s, the wealthiest 1% of families have significantly increased their share of America's wealth, while the bottom 90% of families have experienced a decrease of their share of the country's wealth. Starting in the mid-2000s, the wealthiest 1% of families actually surpassed the bottom 90% of families in owning a greater proportion of America's wealth.



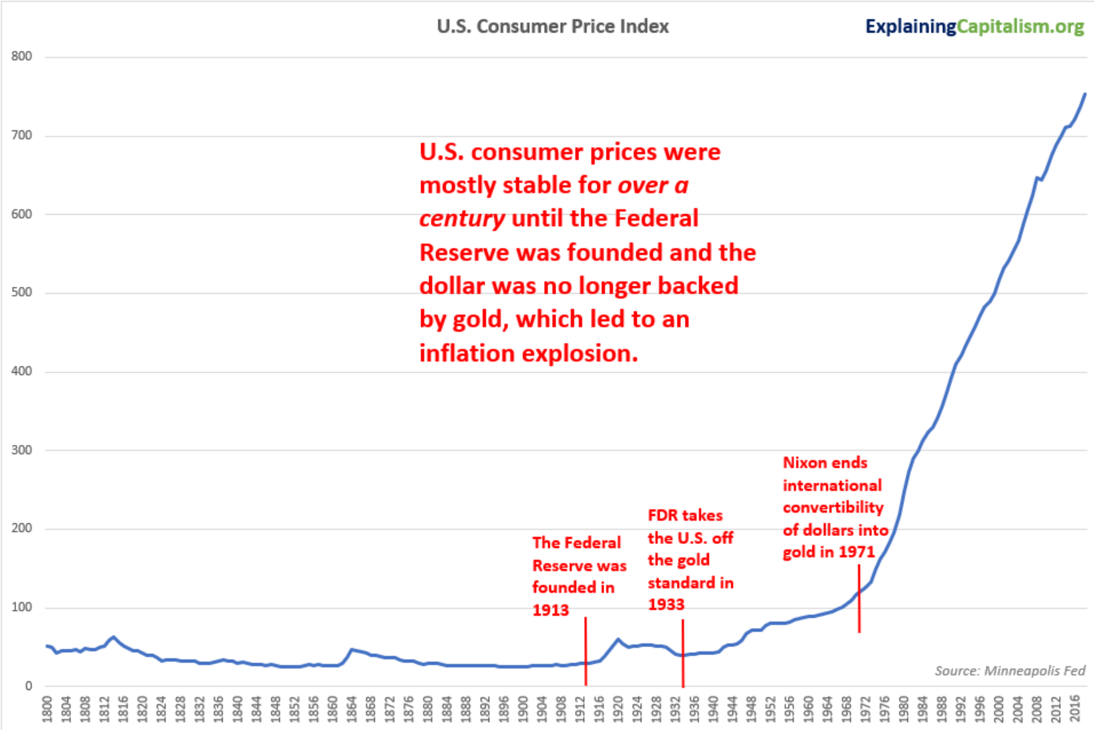
The chart below compares the share of U.S. wealth owned by the *wealthiest 0.1%* of families versus the bottom 90%. Before the early-1980s, the wealthiest 0.1% of families held less than 10% of America's wealth, while the bottom 90% held over one-third of the country's wealth. In recent years, however, the wealthiest 0.1% of families control nearly 20% of America's wealth, while the bottom 90% of families own less than 30% of the country's wealth.



How The Fed And Fiat Currency Cause Economic Inequality

In order to understand why America's rich-poor gap has grown so wide, it is important to first understand the serious changes that have been made to the U.S. dollar in the past century. In simple terms, the value and integrity of the U.S. dollar has been significantly eroded since the Federal Reserve – the "Fed" – was founded in 1913.

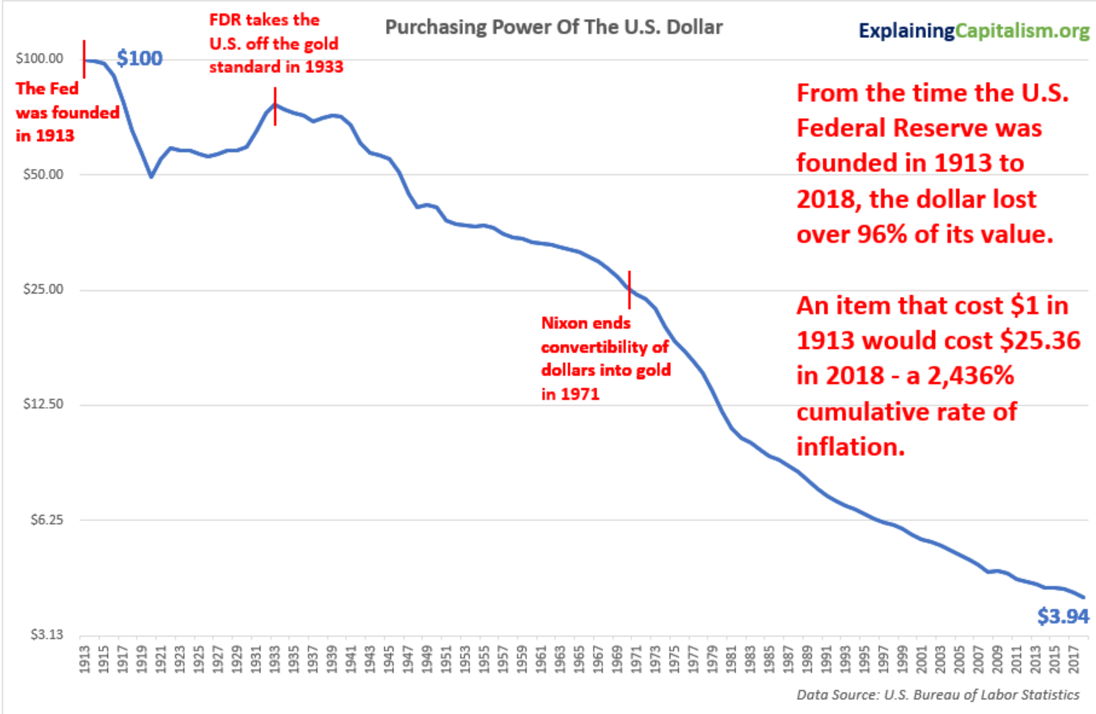
From the end of the Revolutionary War until 1913, the purchasing power of the dollar was largely stable, aside from relatively brief periods during the War of 1812 and the Civil War. Although it's hard to imagine, Americans did not experience the steady, long-term upward creep of living costs (i.e., inflation) the way we do today. In general, the cost of goods and services did not change much from the late-1700s until 1913, as the chart below shows:



The U.S. dollar's purchasing power remained stable from the late-1700s to the early-1900s for a very simple reason: it was backed by precious metals (gold and silver), which kept the total amount of dollars in existence relatively stable. Currencies that are not backed by precious metals, however, typically lose value over time because of the tendency of governments and central banks to incessantly expand the supply of the currency (whether by printing or other means). When more units of an unbacked currency are created, the entire currency loses value because it takes more units to buy the same amount of goods and services – that's what inflation is in a nutshell.

The founding of the U.S. Federal Reserve in 1913 set the stage for a series of assaults on the integrity of the U.S. dollar. As America's central bank, the Fed has a legal monopoly on the issuance of the dollar and management of the U.S. monetary system, which includes controlling both the money supply and short-term interest rates. By using those two levers, the Fed is able to manipulate the rate of inflation. The Fed seeks to maintain a steady 2% annual rate of inflation while trying to prevent deflation (i.e., falling prices of goods and services) and excessively high inflation.

Unfortunately, the Fed has been a terrible steward of the U.S. dollar as the currency has lost over 96% of its value on its watch from 1913 to 2018. To put that into perspective, an item that cost $1 in 1913 would have cost $25.36 in 2018, which is an incredible 2,436% cumulative rate of inflation.



Several key developments contributed to the sharp decline of the U.S. dollar's integrity and value in the past century:

- **The founding of the Federal Reserve in 1913**

As discussed earlier, the Fed seeks to maintain a steady 2% annual rate of inflation. While this may not seem like a high rate of inflation at first glance, it really adds up over the long-run due to the effects of compounding. In addition, there have been periods over the past century when inflation was running at a much higher rate (e.g., WWI, WWII, and the 1970s).

- **The Fed's funding of World War I**

Wars are very expensive, so governments throughout history have funded them via the printing press, which devalues the currency and creates inflation. The U.S. entered WWI in 1917, just four years after the Fed was founded, allowing the fledgling central bank to flex its muscles for the first time by helping to fund America's role in the war. Tragically, the dollar lost *half* of its purchasing power from 1914 to 1920 – a mere six years! In reality, it wasn't the Fed that actually paid for the war, but the hapless holders of dollars who were forced to pay a hefty "inflation tax." Simply stated, inflation is a form of wealth confiscation (i.e., theft).

- **FDR took the U.S. off the Gold Standard in 1933**

From 1834 until 1933, the United States was on the Gold Standard, which meant that the dollar was backed by and redeemable in gold. For 99 years, holders of dollars could trade $20.67 to receive an ounce of gold. The Gold Standard is the main reason why the dollar maintained its purchasing power for such a long time. The Gold Standard prevented unbridled expansion of the money supply because every dollar in existence had to be backed by a certain amount of gold, which is a substance that has a fixed supply on earth.

When the Great Depression hit in the early-1930s, the U.S. experienced deflation (i.e., falling consumer prices). In order to combat deflation, President Franklin Delano Roosevelt signed an executive order in 1933 that effectively ended the U.S. Gold Standard. Private American citizens were banned from owning gold and were forced to turn in their gold to the Federal Reserve for $20.67 per ounce or face a $10,000 fine (nearly $200,000 in 2019 dollars!), and/or five to ten years imprisonment. However, foreign governments could still redeem their dollars for gold.

Shortly after, the dollar-gold exchange rate was changed to $35 per ounce, which represented a 59% devaluation of the dollar. Essentially, the government committed a bait-and-switch on the unsuspecting Americans who were forced to turn in their gold. The intention of this currency devaluation was to create more dollars in order to counteract deflation and to set the U.S. back on its long-term inflationary course.

- **Nixon ended convertibility of dollars into gold in 1971**

Though private American citizens could no longer own gold after 1933, foreign governments could still redeem U.S. dollars for gold at a rate of $35 per ounce. This tie to gold still helped to prevent excessive creation of dollars. By the early-1970s, the U.S. government began to struggle with the tremendous costs of both the Vietnam War and the recently created Great Society programs. Inflation started mounting and foreign governments began to redeem their dollars for gold at a faster rate as they became increasingly distrustful of the U.S. government's ability to back the currency by the proper amount of gold.

On August 15th 1971, President Richard Nixon announced that foreign governments would no longer be able to redeem the U.S. dollar in gold. From that point on, the dollar floated freely against other currencies and became a pure fiat or "paper" currency that was unbacked by gold, silver, or any other commodity. This was the final step in the long-term severing of the dollar's link to gold. Throughout history, governments have sought to stealthily debase (i.e., devalue) their currencies so that their spending would not be constrained. Unfortunately, America finally fell victim to this terrible mistake after many years of discipline that resulted in our country's tremendous prosperity and living standards.

The dollar's conversion to a fiat currency led to the high inflation of the 1970s (the annual inflation rate reached over 12% in 1974, 1979, and 1980). West Texas Intermediate crude oil soared from $3.56 per barrel in 1971 to $39.50 per barrel in 1980 – an increase of over 1,000%. Gold surged from approximately $44 per ounce in 1971 to a high of $850 per ounce in 1980 – an increase of 1,832%. The impact of the 1970s inflation can be seen in the hockey stick-shaped trajectory of the long-term U.S. consumer price index chart shown earlier, as well as the strong decline in the chart of the U.S. dollar's purchasing power.

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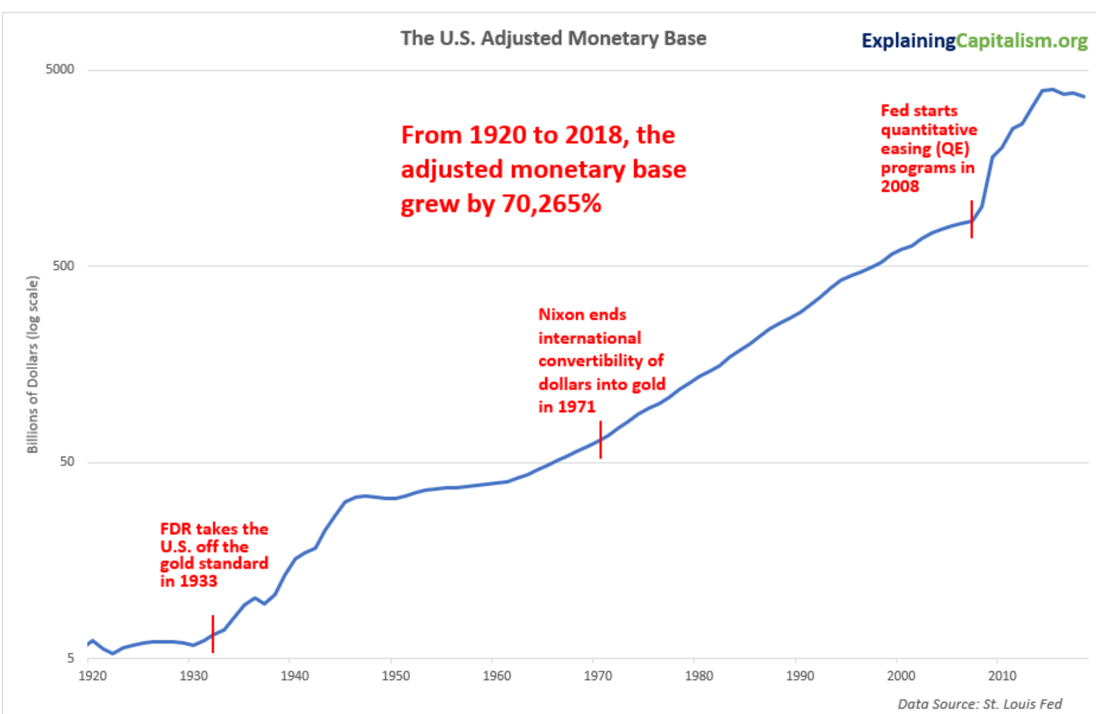
Each erosion of the U.S. dollar's integrity led to a corresponding increase in the money supply (i.e., the quantity of dollars in existence). From 1920 to 2018, the Adjusted Monetary Base grew by 70,265%. Though there are a number of different ways to measure the money supply, the Adjusted Monetary Base was chosen for the chart below simply because it has the longest history. According to the St. Louis Fed, the Adjusted Monetary Base is the sum of currency (including coin) in circulation outside of Federal Reserve banks and the U.S. Treasury, in addition to deposits held by depository institutions at Federal Reserve banks.



Now, it is time to explain why the Fed and the "paper" dollar are the main reasons for America's growing economic inequality. In simple terms, inflation benefits the rich while hurting the middle class and poor due to the way each group's finances are structured. In general, the rich receive much of their income from investments, the middle class rely on their own labor to earn salaries, while the poor receive income from a combination of work and government transfer payments.

The rich benefit from steady, moderate inflation because it helps to boost the value of their investments. Investing in the stock market has long been used as a way of keeping up with and outpacing inflation. There are two main reasons for this: 1.) as the money supply grows, some of that money is parked in the stock market, which helps to boost the stock market – this is one of the reasons why the Fed encourages a moderate amount of inflation each year. 2.) Publicly-traded corporations are able to pass inflation-driven price increases onto their customers, which allows their revenues and earnings to keep up with inflation. Though the rich experience rising living costs like everyone else, they still come out ahead as the gains from their investments typically surpass their higher living costs.

Members of the middle class typically earn salaries from their labor, but rarely have large stock and bond portfolios. For most middle class families, their home is by far their largest investment. Most members of the middle class are "house poor" because much of their income and wealth is tied up in their house. While highly skilled members of the middle class may receive regular salary increases to help keep up with inflation, the less skilled members of the middle class are helpless as they watch the steady erosion of their living standards. Middle class families are harmed most by inflation in healthcare and higher education costs, both of which have become outrageously expensive in the past couple decades.

On average, the poor receive income from a combination of work and government transfer payments. The poor typically have no investments or savings to speak of and generally rent their housing. The poor are hurt most by inflation in rents, food, transportation, entertainment, and healthcare. The middle class' home ownership shields them from inflating housing costs, while the poor are hit with rent increases every year. As unskilled members of the workforce, the poor lack the bargaining power to command sufficient wage increases to keep up with inflation.

Because inflation widens the rift between the rich and the poor and results in an overall weaker society, ensuring the integrity of a nation's money is of the utmost importance.

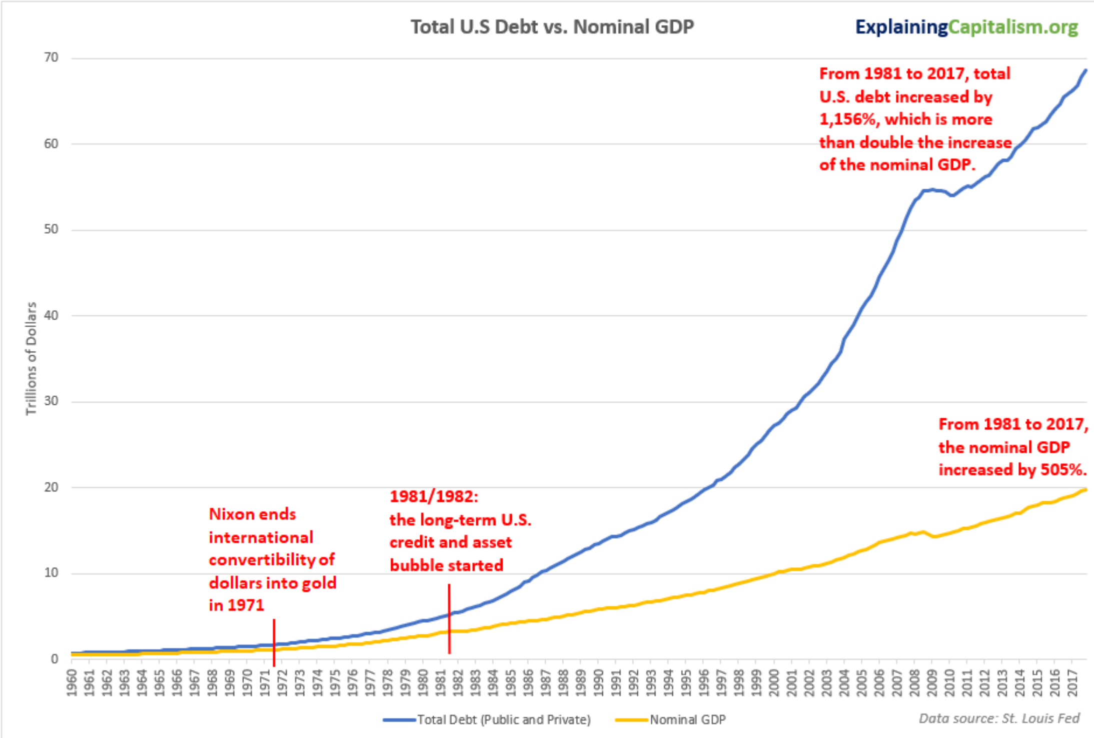
As economist John Maynard Keynes succinctly stated –

> *“Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some.”*

The Role Of Debt

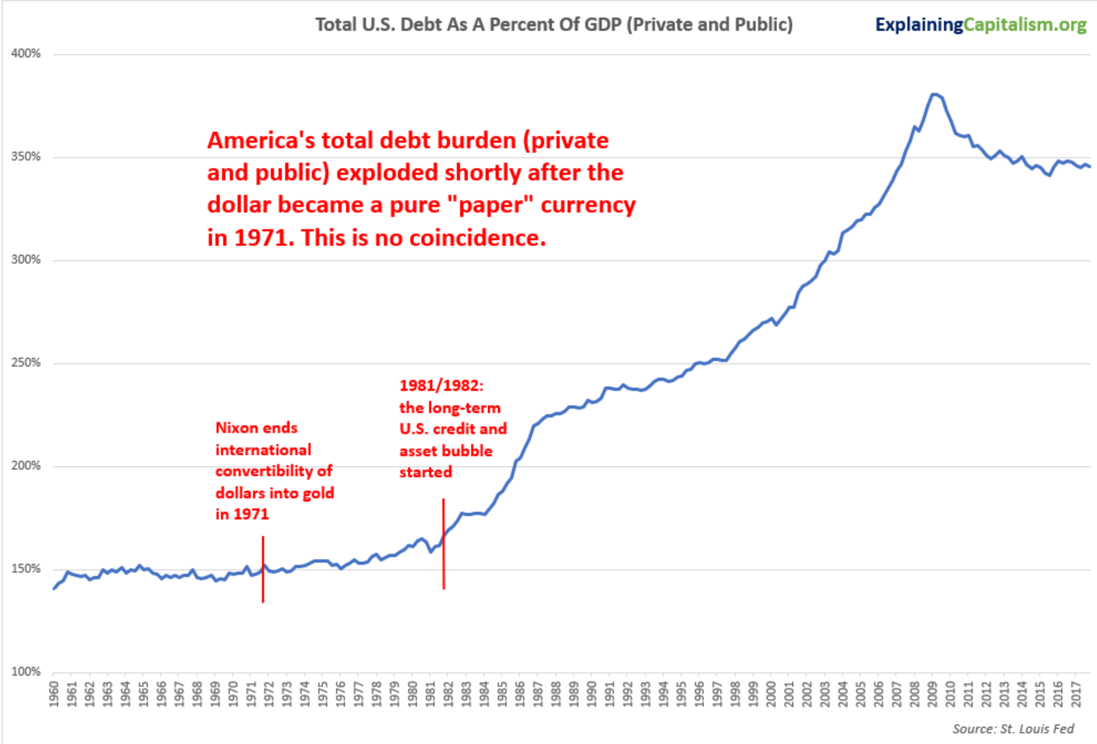
In a fractional reserve banking system such as ours, debt *is* money because money is created when banks make new loans (here is a good explanation of this process). The dollar’s conversion to a pure, unbacked fiat currency in 1971 set the stage for a veritable explosion of both private and public debt in the United States. Before 1971, the U.S. dollar’s gold backing prevented unchecked expansion of the money supply. After 1971, all bets were off as there was nothing to prevent the unlimited expansion of the supply of dollars/outstanding debt.

While the dollar’s conversion to a fiat currency in 1971 is what set the stage for America’s reckless debt binge, the actual debt binge began approximately a decade later in 1981/1982 (the reason for this delay will be discussed shortly). 1981/1982 is when total U.S. debt began to grow at a faster rate than the underlying economy. As shown in the chart below, the nominal GDP (yellow line) grew 505% from 1981 to 2017, while total debt (blue line) grew 1,156%, which is more than double the growth rate of the economy over that period of time. 1981/1982 is when America’s long-term credit and asset bubble began, and it is also when our rich-poor gap started to increase, which is not a coincidence (the connection between the two will be explained shortly).



The chart of total U.S. debt as a percentage of GDP, which uses the same inputs as the chart above, clearly shows that a long-term credit bubble began in the U.S. in 1981/1982. This credit bubble is the reason why debt has piled up in virtually every corner of our society over the past several decades. Our struggles with record amounts of government debt, the mortgage crisis a decade ago, student debt, medical debt, and credit card debt are all rooted in the credit bubble that began in the early-1980s.

Massive debt burdens like we have today are not the fault of capitalism; they are the fault and inevitable result of having a completely unbacked fiat currency like we've had since 1971. Unfortunately, the political left uses our growing debt burden to claim that capitalism is inherently flawed and unsustainable, which is a classic straw man fallacy.

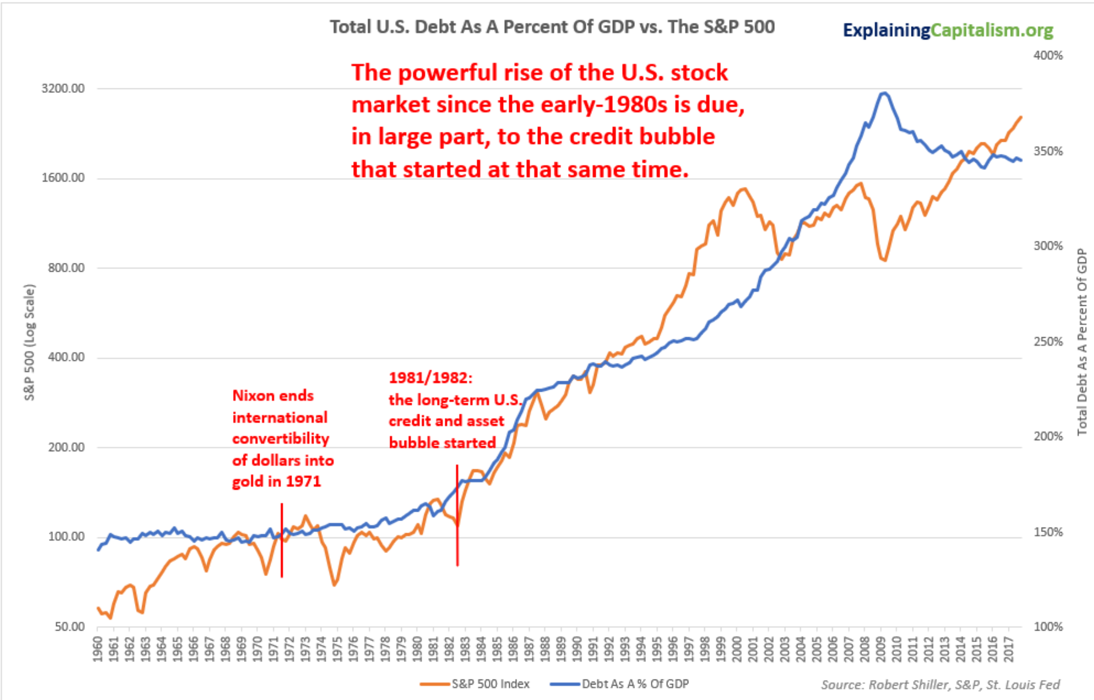


How America's Stock & Bond Bubbles Drive Wealth Inequality

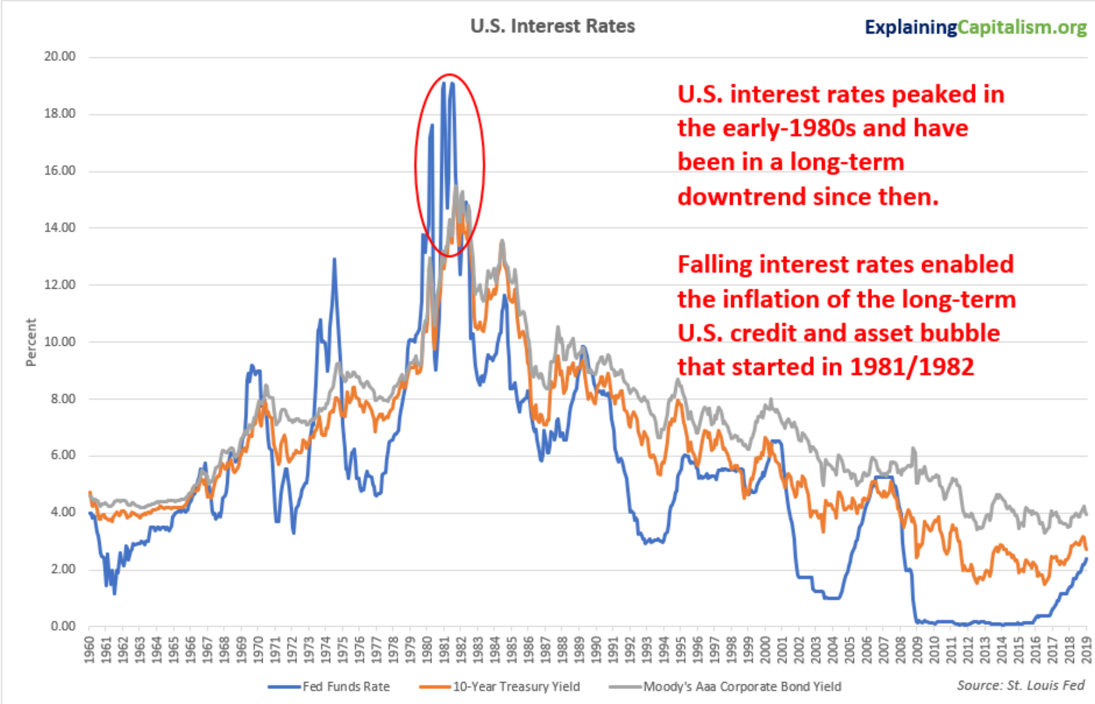
As discussed earlier, the rich receive much of their income from investments in stocks and bonds and, therefore, benefit when these assets appreciate. The middle class and poor, however, have very little of their wealth in stocks and bonds, so they don't directly benefit much from bull markets in those assets. Because of this disparity in asset ownership between the rich versus the middle class and the poor, bull markets in asset prices actually cause wealth inequality to *increase*.

The conversion of the U.S. dollar to a fiat currency in 1971 set the stage for a massive credit bubble that began in 1981/1982, and that credit bubble enabled a long-term boom in stocks and bonds at the same time. That long-term boom in stocks and bonds has been the primary driver of U.S. wealth and income inequality. A very good portion of that long-term boom in stocks and bonds is artificial and unhealthy because it was driven by a debt binge, which is something that would not have happened if we had free markets and a currency that was backed by gold.

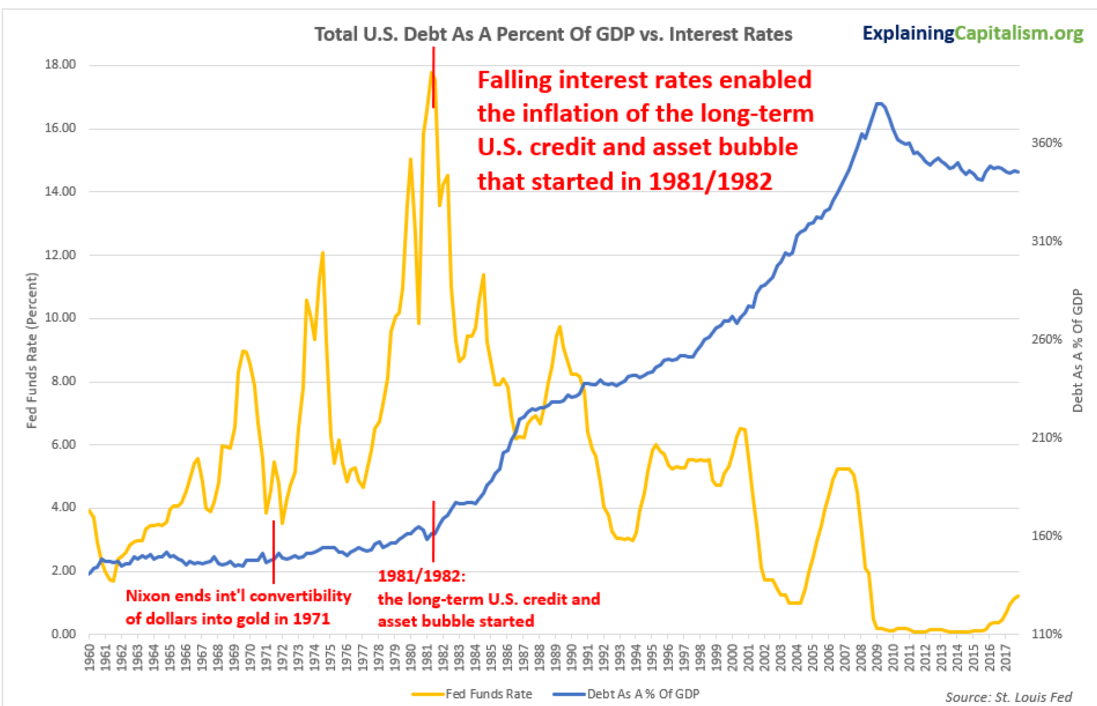
As the chart below shows, a powerful bull market began in U.S. stocks (orange line) in 1982 right around the same time that our credit bubble (blue line) began to inflate. Credit bubbles supercharge economic growth (and stock prices, by extension) by borrowing from the future. Credit bubbles always end badly, but they fund splendid growth parties in the meantime. Credit bubbles end when a society becomes overly saturated with debt and no longer has the capacity to take on enough new debt to continue fueling economic growth. For the most part, the U.S. has been in a state of debt saturation since the Great Recession, which is why the economy is growing so slowly despite massive amounts of Fed stimulus.



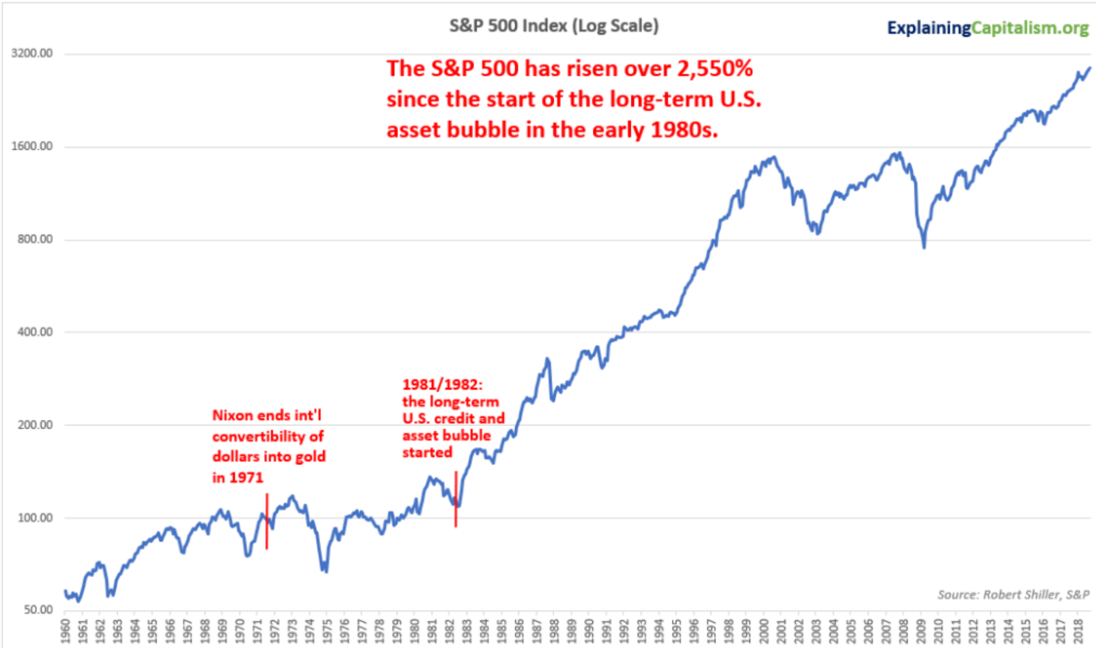
The U.S. dollar's conversion to a fiat currency in 1971 is what set the stage for America's credit bubble, but the actual credit bubble began approximately a decade later in 1981/1982. The reason for this is because U.S. interest rates were extremely high in the 1970s and early-1980s due to the high rates of inflation at that time. High interest rates stifle credit growth and created an effect similar to a basketball being held under water – once rates started dropping in 1981/1982, it gave the green light for the long-term U.S. asset and credit bubble to start growing.



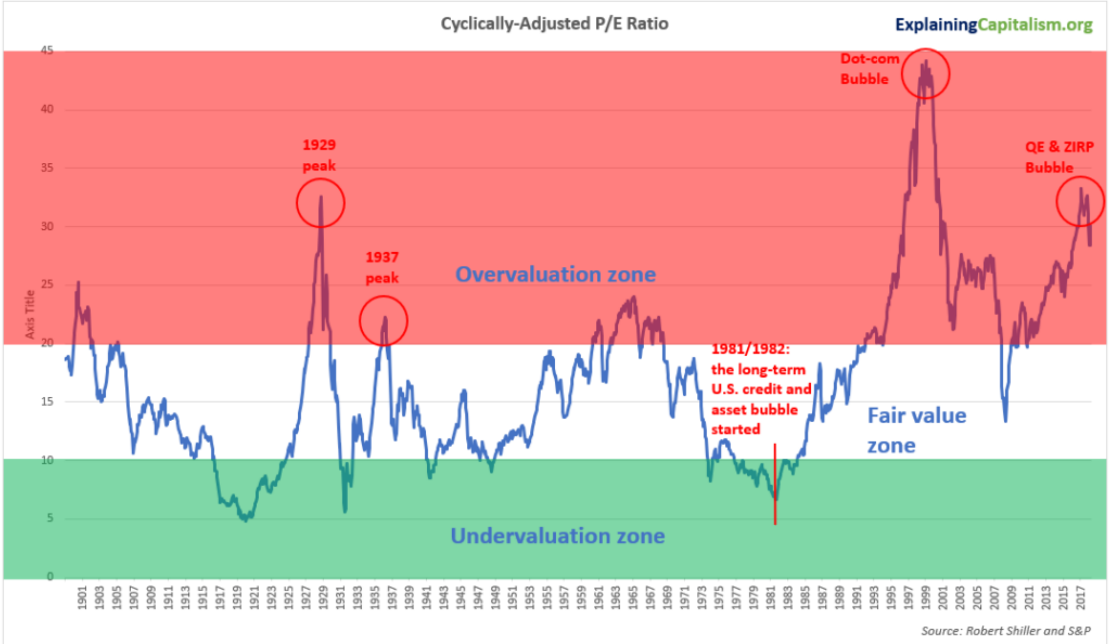
The chart below shows how the peak in interest rates (yellow line) in 1981/1982 coincided with the start of the long-term U.S. credit bubble (blue line):



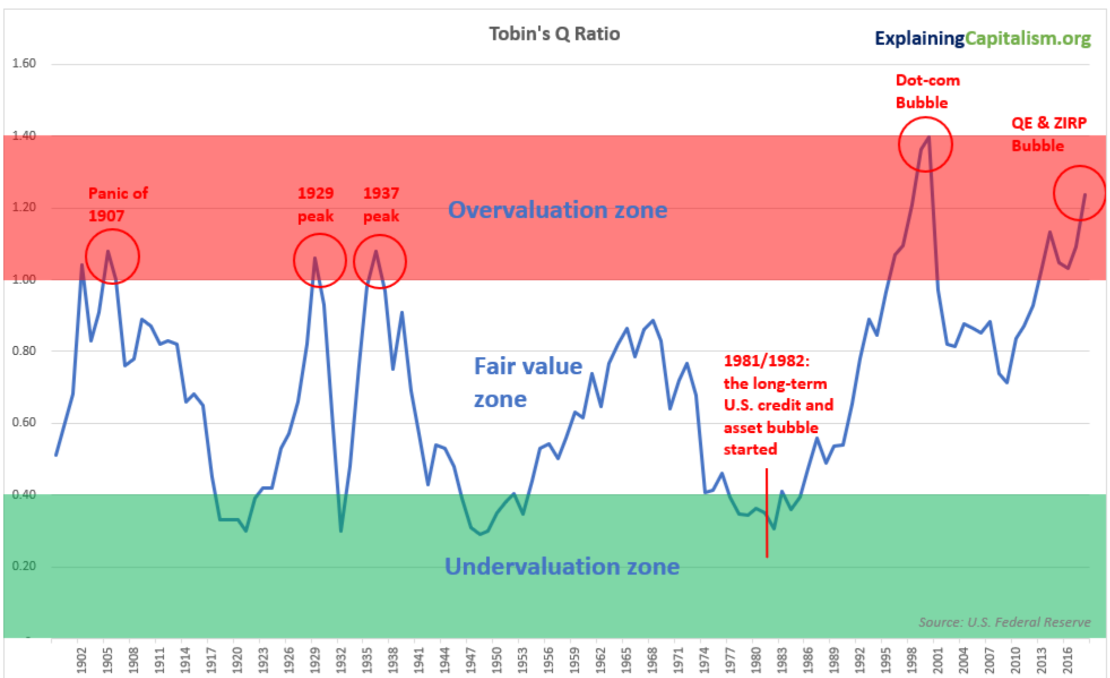
Falling interest rates and the U.S. credit bubble helped the S&P 500 to rise by over 2,550% since the early-1980s. The growth of the U.S. economy and stock market since the early-1980s is neither organic nor sustainable because it was and is driven by debt. Unfortunately, we will eventually give back a good portion of that growth in the next economic crisis. The 2008 financial crisis was just a preview of that ultimate crisis, but the Fed managed to kick the can further down the road with its massive stimulus programs.



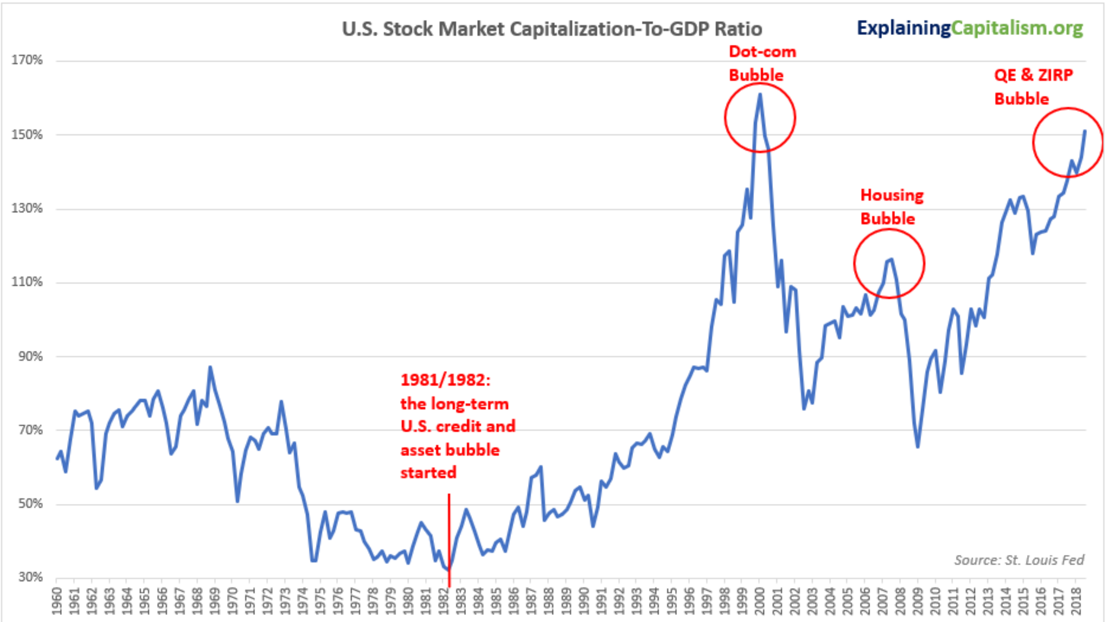
Bull markets begin when the stock market is undervalued (i.e., cheap) relative to its fundamentals such as earnings, revenues, assets, etc., and end when the stock market is overvalued (i.e., expensive). For example, the cyclically-adjusted price-to-earnings ratio (a smoothed price-to-earnings ratio) shows that the S&P 500 was undervalued at the time that the long-term stock market boom began in 1982. Investors who bought at that time and held for the next few decades made fortunes. Disturbingly, the U.S. stock market is currently about as overvalued as it was in 1929, right before the stock market crash and Great Depression. Today's high market valuation is one of the many signs that we are experiencing a bubble that is going burst.



Tobin's Q ratio (the total U.S. stock market value divided by the total replacement cost of assets) is another market valuation measure that confirms that the stock market is currently overvalued like it was at major historic peaks. Tobin's Q ratio also shows that the long-term U.S. stock market boom began in 1982.

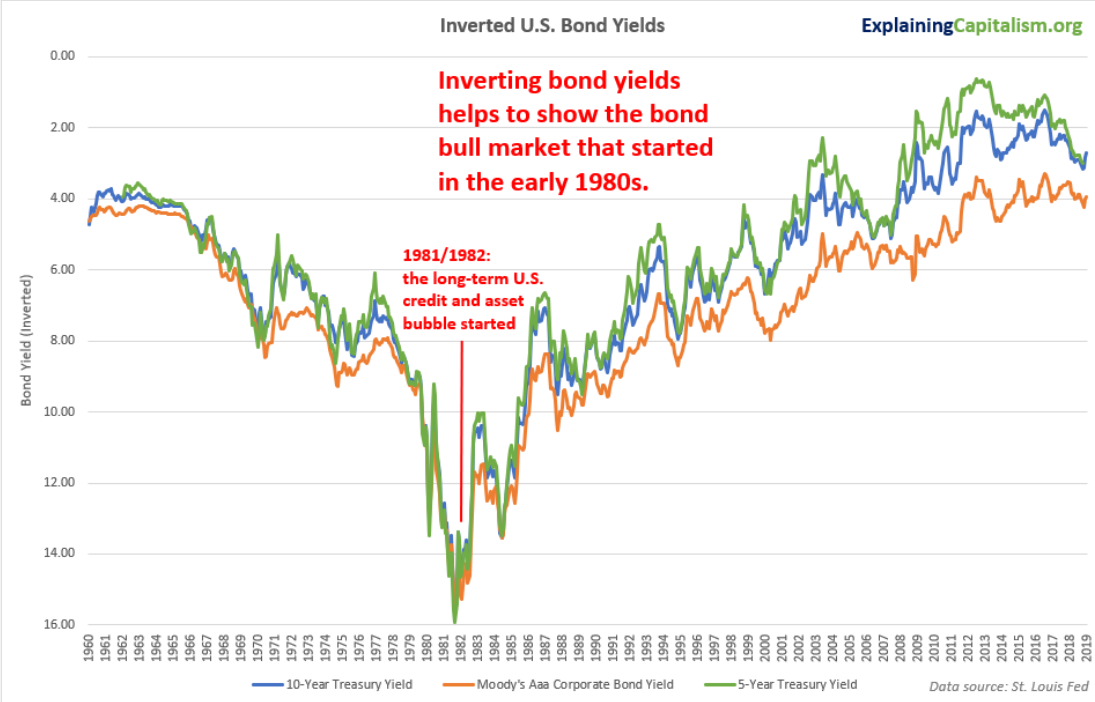


The U.S. stock market capitalization-to-GDP ratio (the total value of the U.S. stock market divided by the GDP) also shows that the stock market is quite stretched relative to the actual economy, which is a bad omen for the market going forward. This indicator is known as Warren Buffett's "favorite indicator" because he claimed that it is "probably the best single measure of where valuations stand at any given moment." This indicator also clearly shows that the long-term U.S. stock market boom began in 1982.



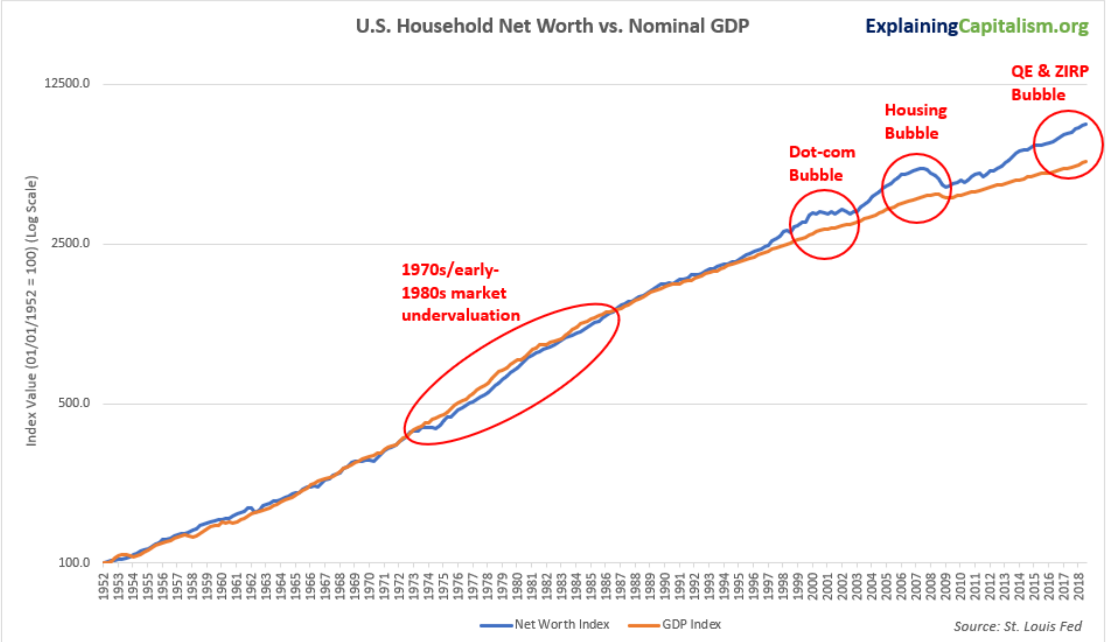
Like stocks, U.S. bonds have been in a tremendous bull market since 1981/1982 as well. The bull market in bonds began at the same time that U.S. interest rates peaked because bond prices move inversely with bond yields/interest rates. Investors who bought bonds in the 1980s and 1990s, and held them, have done extremely well.

Unfortunately, this bond bull market is at risk due to the debt saturation discussed earlier. In a normal environment, such an explosion of debt would cause bond investors to demand higher yields to compensate for the higher risk that they are taking on. In the current "market" (which is not an actual free market), central banks like the Fed have been buying bonds hand over fist, which is what has supported the bond market and kept yields low. This situation cannot go on forever; central bank interference in markets *always* backfires.

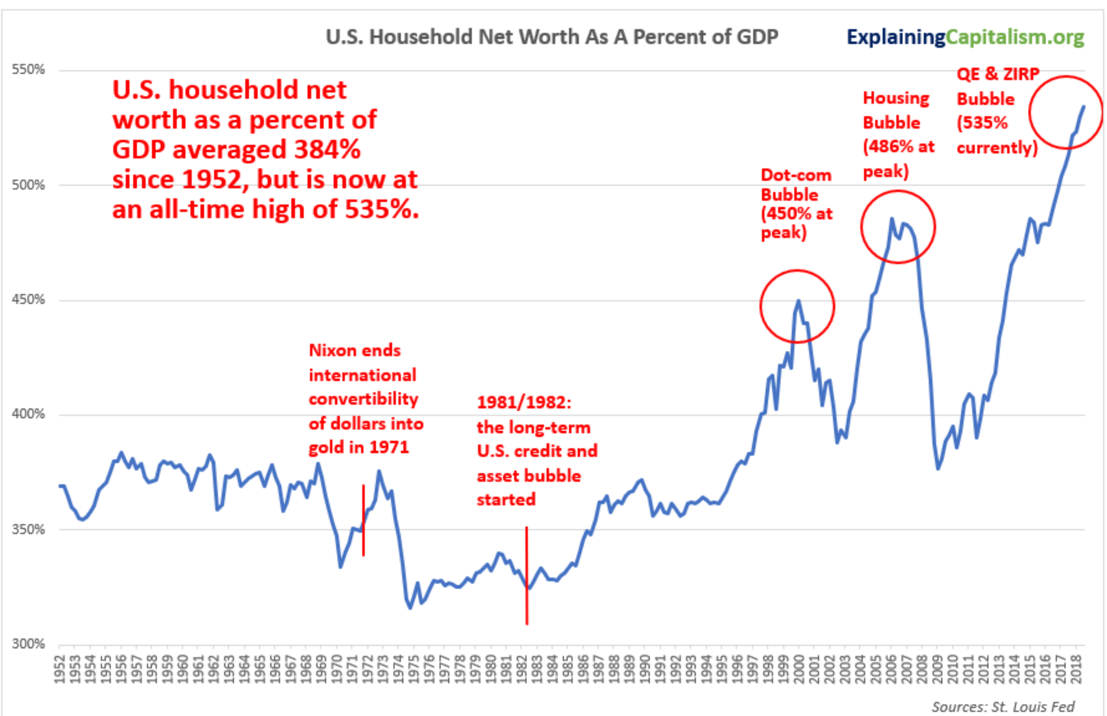


The debt-driven bubbles in stocks and bonds that have been progressively growing over the past few decades have led to a bubble in U.S. household wealth (click here to watch my video presentation about this). These bubbles expanded significantly since 2009 due to the Fed's desperate attempts to boost asset prices after the Great Recession. By cutting interest rates to virtually zero and flooding the financial system with trillions of dollars worth of liquidity via quantitative easing programs, the Fed succeeded in boosting asset prices. As a result, U.S. household wealth soared by $51 trillion or 90% to an all-time high of $108 trillion. It is important to remember that while U.S. household wealth has surged, it has primarily benefited the *wealthy* who possess the vast majority of this household wealth. Of course, the artificial nature of this wealth boom means that it is unsustainable and heading for another bust.

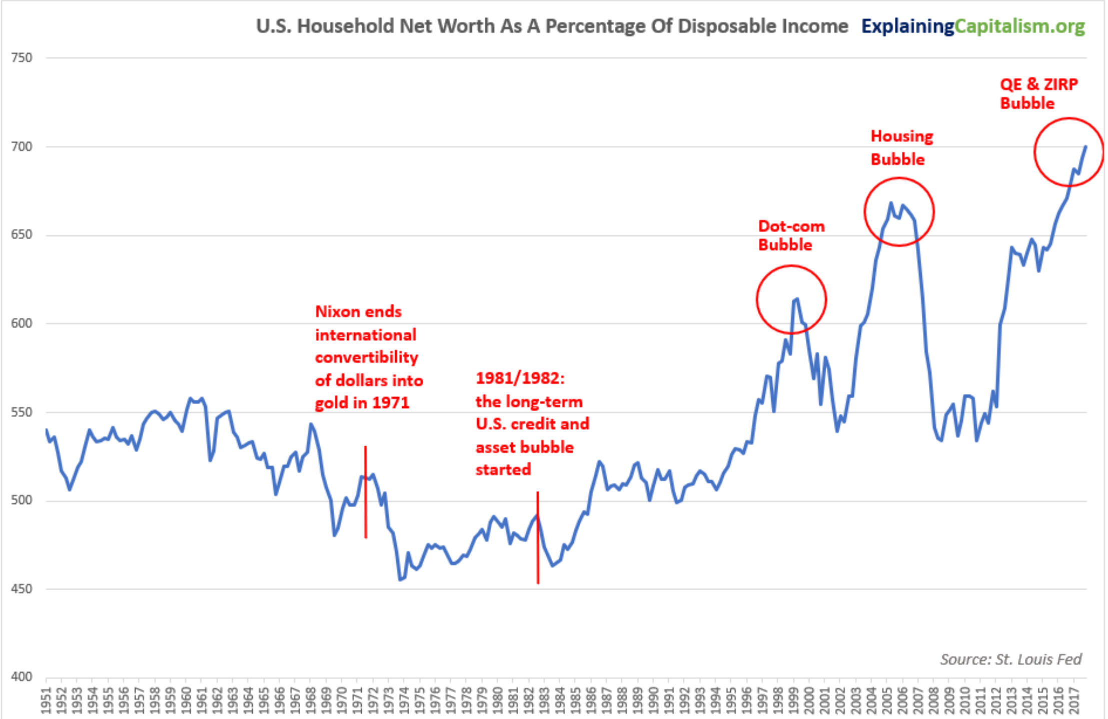
The chart below compares U.S. household wealth (blue line) to the underlying economy or GDP (orange line). In wealth booms that are genuine and sustainable, household wealth tracks GDP very closely. Beginning in the late-1990s, however, household wealth started to grow faster than the GDP because of the tech stock bubble. Of course, the tech bubble burst in the early-2000s and dragged American stock portfolios down with it. Next, the development of the U.S. housing bubble created an even larger bubble in household wealth until that also came crashing down in 2008. The latest wealth bubble surpasses the last two by far, and its inevitable crash will make the last two crashes look like walks in the park simply due to how overextended it has become.



Another way of visualizing the household wealth bubble is to plot it as a percentage of GDP, which also confirms that the current wealth bubble is much larger than the last two. The dot-com bubble peaked with household wealth hitting 450% of GDP, household wealth reached an even higher 486% of GDP during the housing bubble, and the current bubble has inflated household wealth to an unprecedented 535% of GDP. Since 1952, household wealth has averaged 384% of the GDP, so the current bubble's 535% figure is in rarefied territory.



Plotting U.S. household wealth as a percentage of disposable income also confirms that household wealth is at extremely elevated levels:



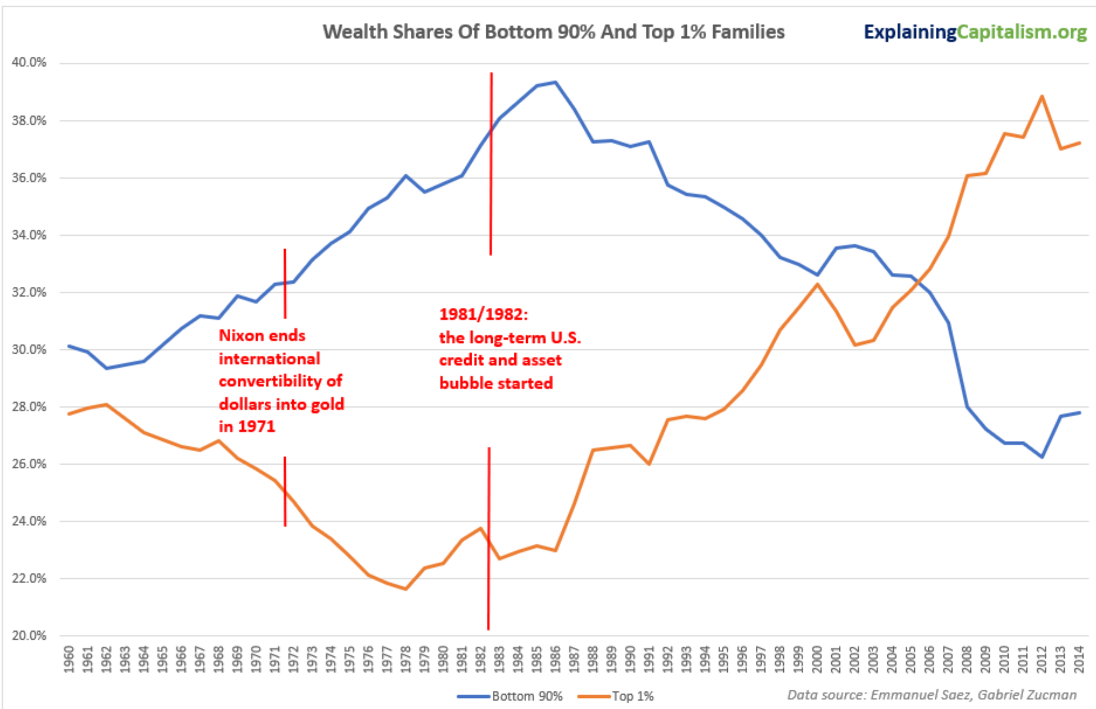
Please note that all of the household wealth charts shown earlier bottomed out in 1981/1982, which is the same time that the long-term boom/bubble in stocks and bonds began. These household wealth charts and the stock market valuation charts show a clear pattern: U.S. asset prices, valuations, and household wealth were at unusually low levels for much of the 1970s due to the high interest rates during that period. Since 1981/1982, however, U.S. asset prices and household wealth have continued to climb in a seemingly unstoppable manner and are now at unusually high levels (which is the opposite of what occurred in the 1970s).

Today's household wealth bubble is the very reason for America's wealth and income inequality that has created so much tension in our society. Because the rich own the largest share of household wealth, their fortunes have ballooned (on paper) along with the household wealth bubble. But what ultimately happens to bubbles? They burst! And the current household wealth bubble will prove to be no different. Virtually all leftist warnings about U.S. economic inequality implicitly assume that U.S. wealth has reached a "permanently high plateau," which would mean that the current wealth gap is permanent. Those pundits have no clue that household wealth is in a bubble that is going to burst, which will cause the wealth and income inequality gap to shrink significantly.

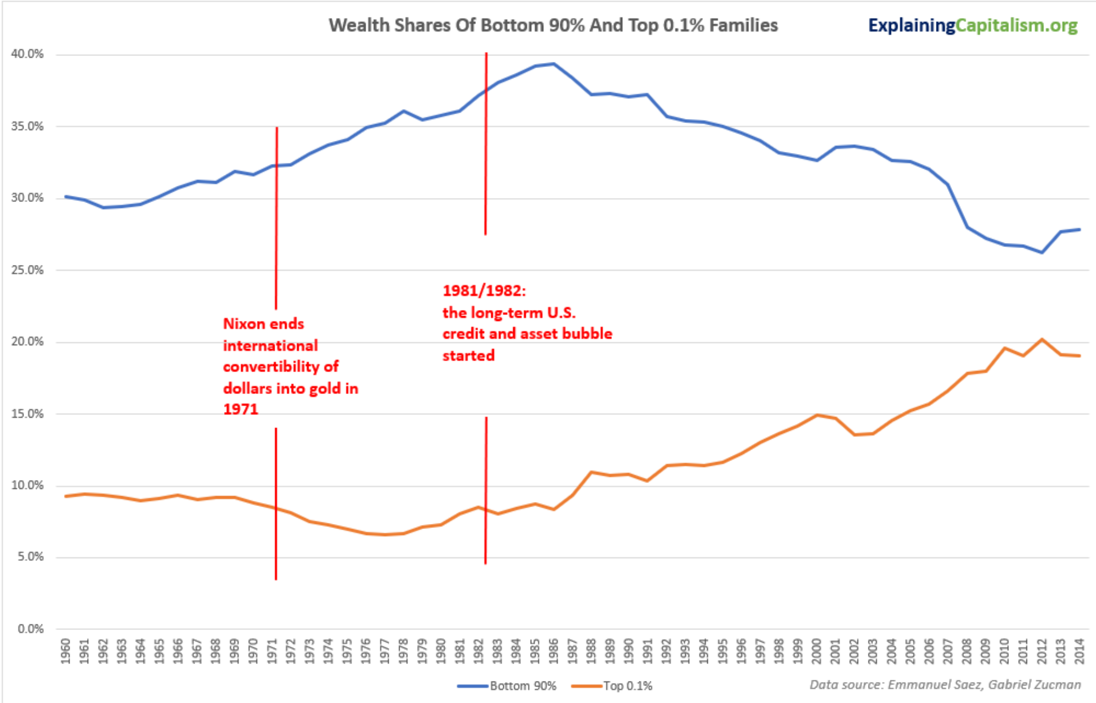
A More Detailed Look At U.S. Wealth Inequality Trends

This section will discuss U.S. wealth inequality trends in greater detail, as well as their connection to the long-term bubbles in stocks, bonds, and overall household wealth.

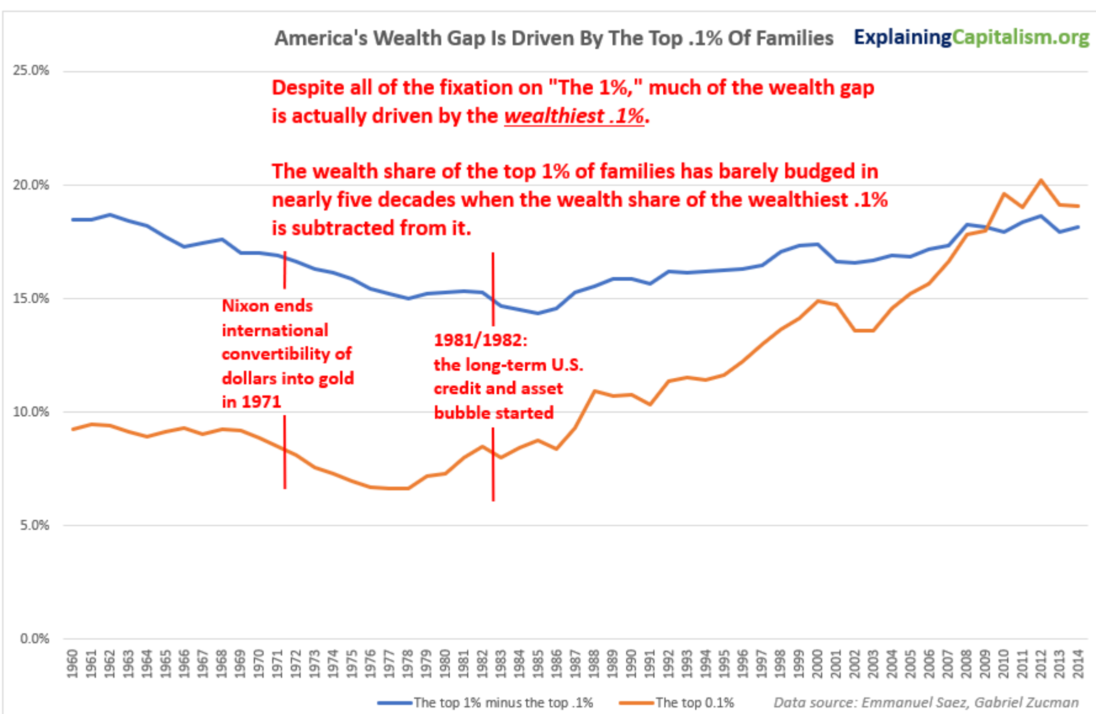
The chart below shows the wealth shares of both the bottom 90% and the wealthiest 1% of American families over time. This chart was also shown at the beginning of this report, but now has annotations on it. Remember the significance of 1981/1982? As a reminder, that was when the long-term U.S. credit bubble began, as well as the long-term bubbles in stocks, bonds, and household wealth. Shortly after those bubbles started to expand, the gap between the rich and poor started to grow as the rich benefited from rising stock and bond prices. Up until the early-1980s, however, the rich-poor gap had been shrinking for nearly two decades due to the anemic inflation-adjusted performance of the stock and bond markets during that time.



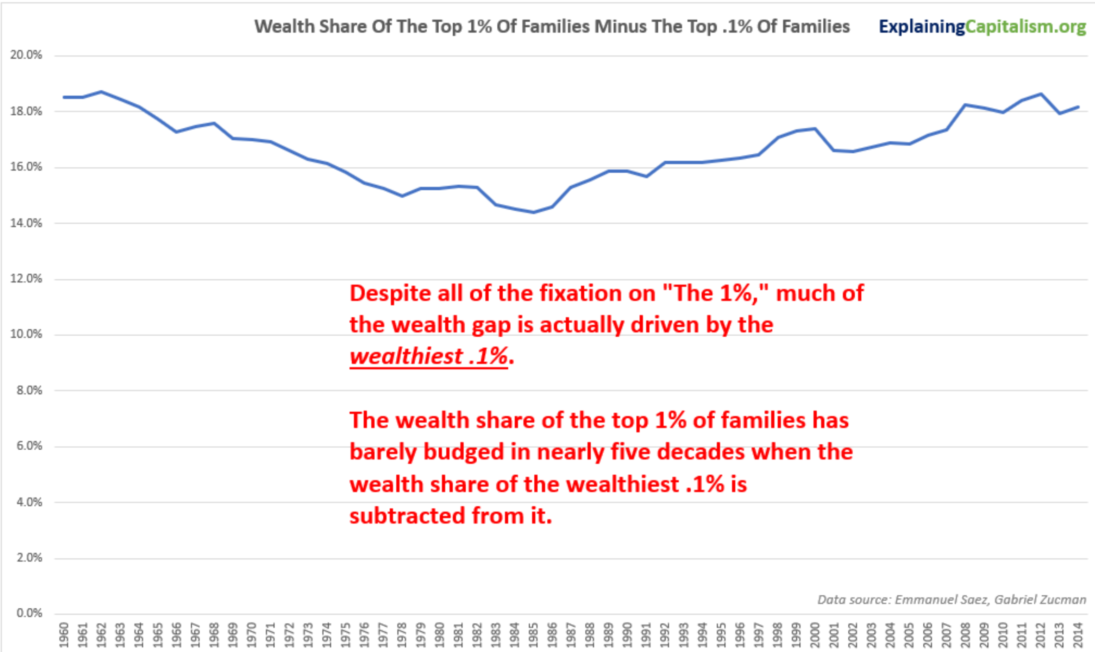
The chart of the wealth shares of both the bottom 90% and the wealthiest 0.1% of American families over time shows the same pattern:



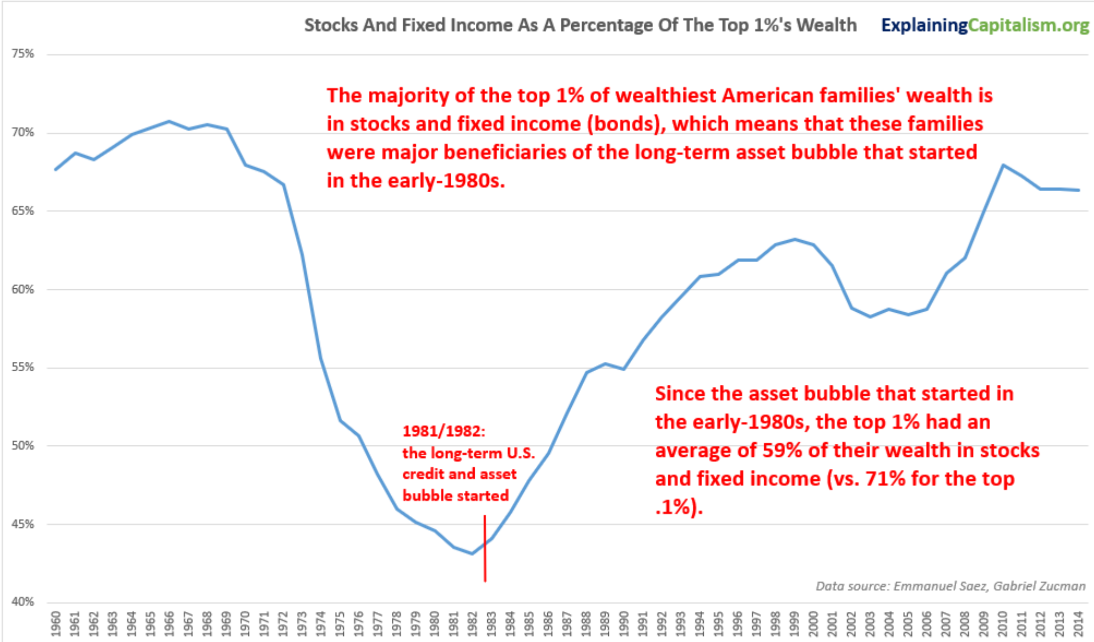
Interestingly, despite the tremendous fixation on the wealthiest 1% of American families (i.e., "The 1%"), they were *not* the primary beneficiaries of the growing wealth gap since the early-1980s – the *wealthiest 0.1%* were! When the wealth share of the wealthiest 0.1% (orange line) is subtracted from the wealth share of the wealthiest 1%, the wealth share of the remaining wealthiest 1% (blue line) has barely budged at all since the early-1960s. The chart below shows how the wealthiest 0.1% of families gained wealth share aggressively since the early-1980s. This group's share of total U.S. wealth was approximately 8% in the early-1980s, but grew to nearly 20% in the 2010s.



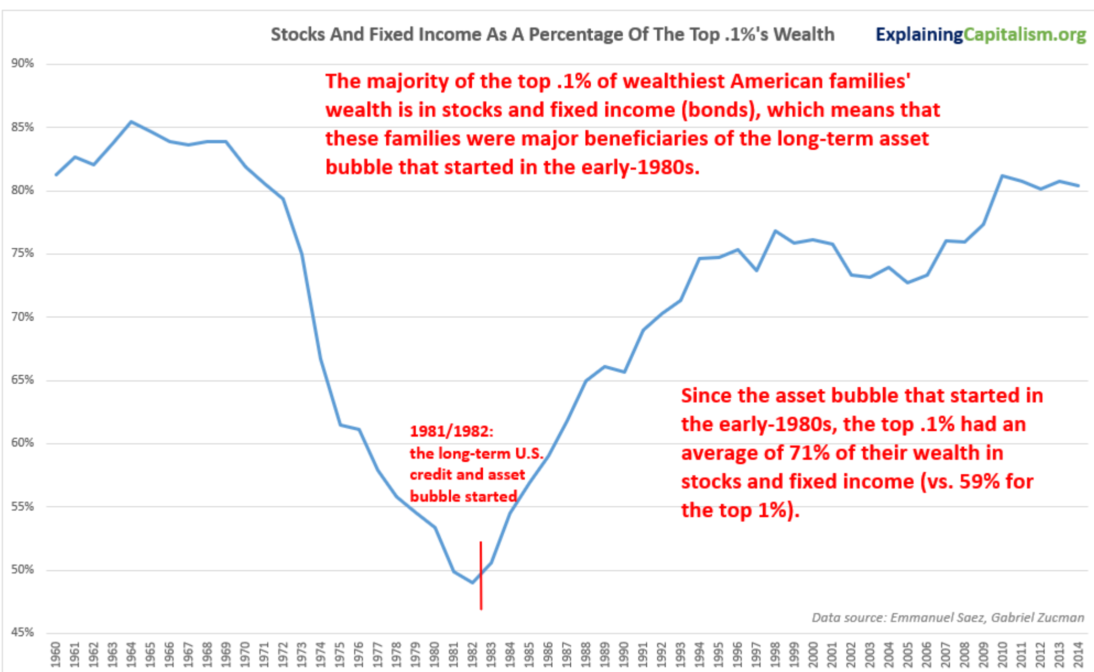
The chart below shows the wealth share of the wealthiest 1% of American families minus the wealth share of the wealthiest 0.1%. In the early-1960s, this group's wealth share was just over 18%, then it dipped to a low of just over 14% in the early-1980s, and rebounded back to approximately 18% in the 2010s. Once again, the significance of the early-1980s turning point can be seen in this chart:



As discussed throughout this report, bull markets in stocks and bonds help the rich become even richer due to their heavy ownership of these assets, while the middle class and poor do not receive much direct benefit. The chart below shows what proportion of the wealthiest 1% of American families' wealth is held in stocks and bonds over time. In the 1960s, this group held approximately 70% of its wealth in stocks and bonds, but reduced their holdings dramatically to approximately 43% during the 1970s due to the lackluster inflation-adjusted performance of these assets. Starting in the early-1980s, this group began to pile into stocks and bonds again. Since the early-1980s, the top 1% of families held an average of 59% of their wealth in stocks and bonds (vs. 71% for the top 0.1%), which confirms the assertion that the rich are heavy owners of these assets.

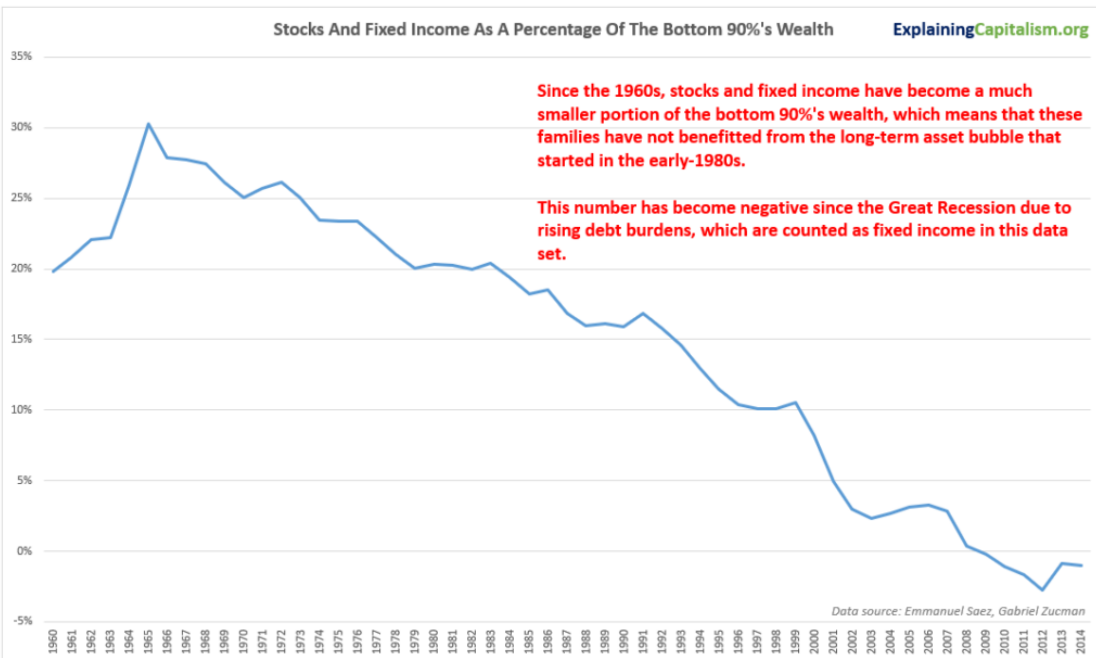


The wealthiest 0.1% of American families are allocated even more heavily toward stocks and bonds than the wealthiest 1%, which explains why their share of total U.S. wealth grew so significantly along with the long-term bubbles in stocks and bonds. In the early-1980s doldrums, the wealthiest 0.1% held just under 50% of their wealth in stocks and bonds, but increased their allocation to these assets aggressively during the bull market of the mid-1980s and 1990s. By the 2010s, the wealthiest 0.1% of American families held over 80% of their wealth in stocks and bonds (vs. approximately 66% for the wealthiest 1%).

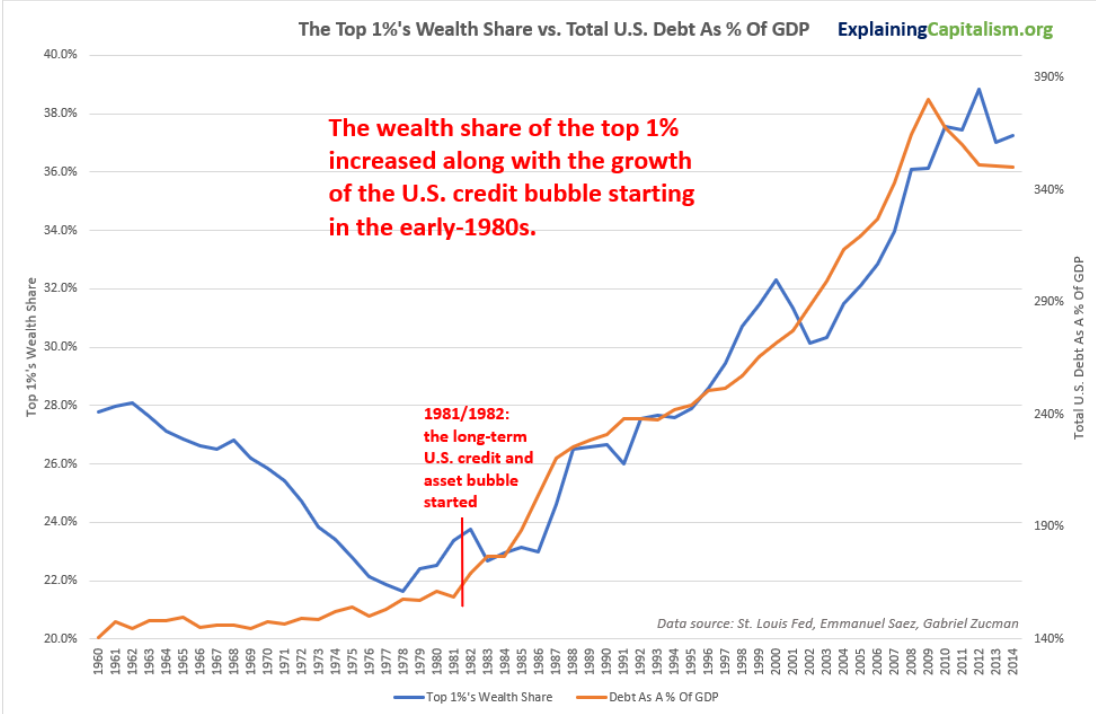


The middle class and poor, unlike the wealthy, hold a negligible amount of their wealth in stocks and bonds and, therefore, do not directly benefit from bull markets in these assets. Sadly, the middle class *used to* have some money to invest, but the growing financial stresses this group has experienced over the past several decades has made it even more difficult to save enough money to invest.

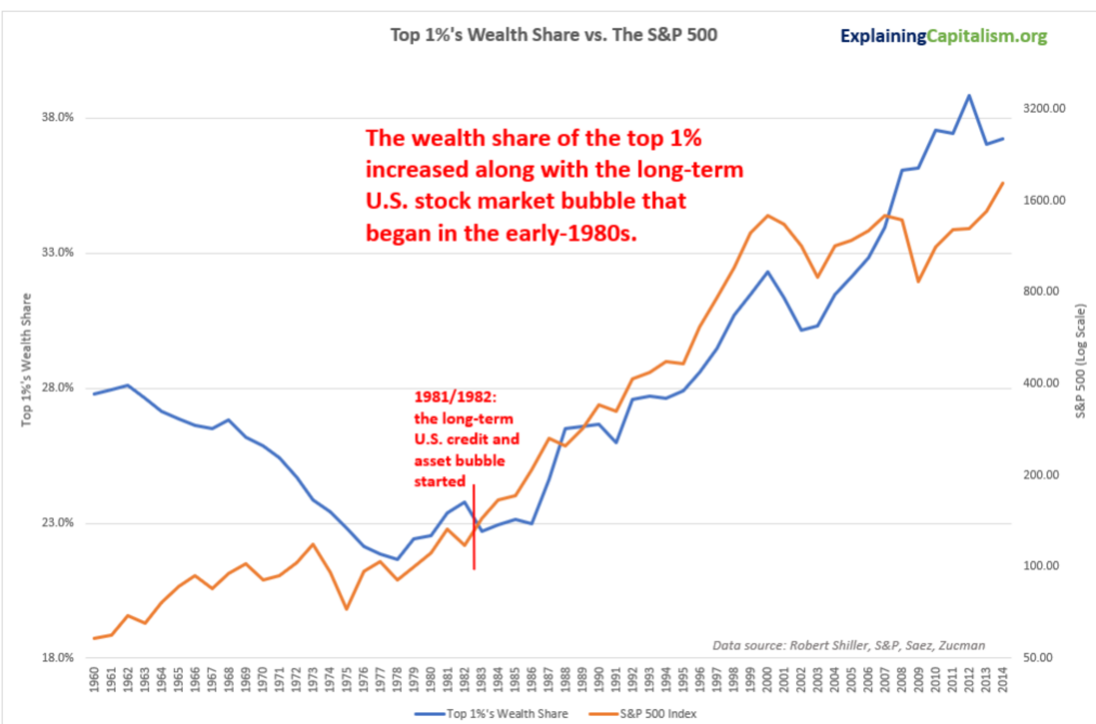
In the 1960s, the bottom 90% of American families held approximately 27% of their wealth in stocks and bonds, but that percentage has plunged steadily since then. After the Great Recession, the bottom 90% actually had *negative* wealth, which is the result of having more debt than assets. The aforementioned financial stresses that the bottom 90% of American families have faced over the past several decades are not the fault of capitalism (as the left claims), but a direct result of the government downgrading the U.S. dollar to an unbacked fiat currency in 1971. This tragic move caused the cost of living to skyrocket and saturated our society with debt, which harmed the middle class and poor much more than it harmed the rich.



The next chart shows how the wealthiest 1% of families' share of total U.S. wealth (blue line) increased in lock-step with the growth of the long-term U.S. credit bubble (orange line) that began in 1981/1982:

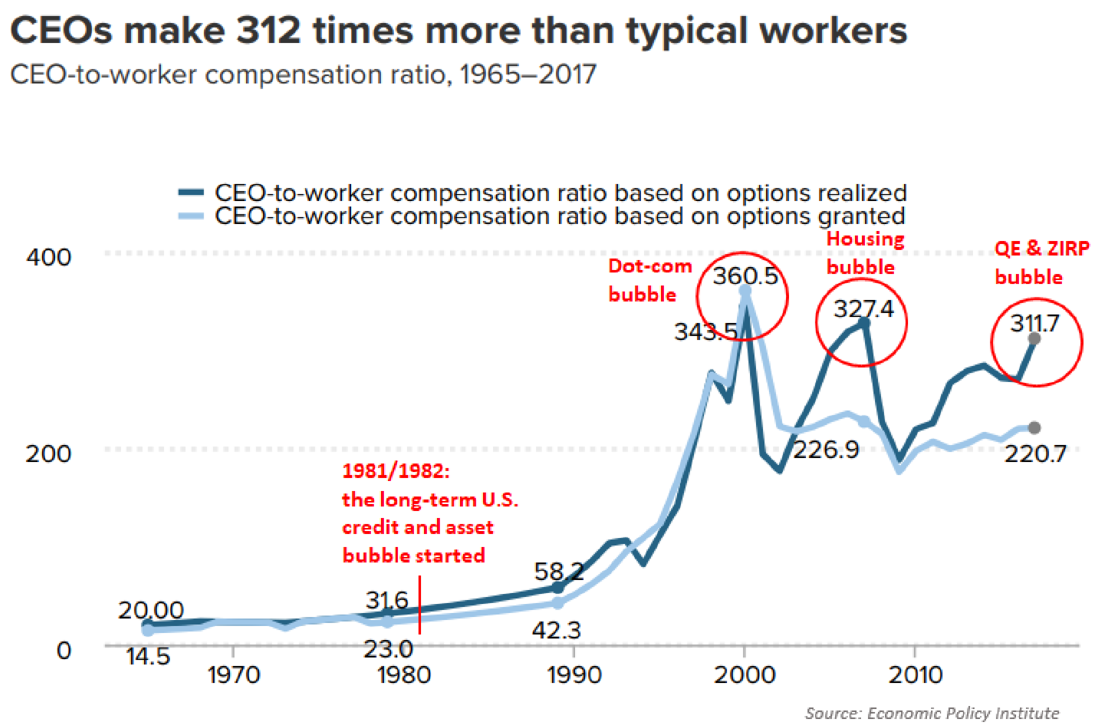


The chart below shows how the wealthiest 1% of families' share of total U.S. wealth (blue line) grew along with the long-term stock market bubble, as represented by the S&P 500 index (orange line). As stated earlier, the growth of the U.S. credit bubble contributed to the stock market boom since the early-1980s because credit bubbles temporarily supercharge economic growth and stock prices, even though they ultimately end in disaster.

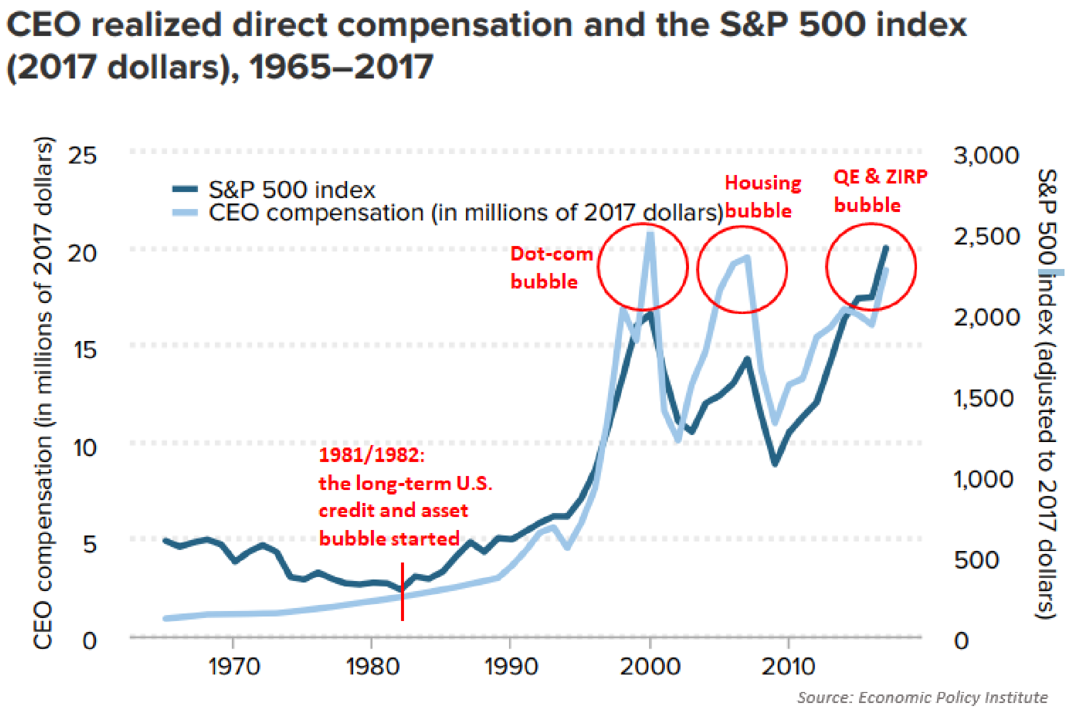


One of the most common complaints made by the left about the modern American economy is the very high CEO-to-worker compensation ratio and how much this ratio has increased over the last several decades. CEOs made 312 times more than the typical worker in 2017, which is up significantly from approximately 32 times in the early-1980s. This is yet another byproduct of the long-term U.S. stock market bubble because the CEOs of public corporations typically receive stock options as part of their compensation packages.

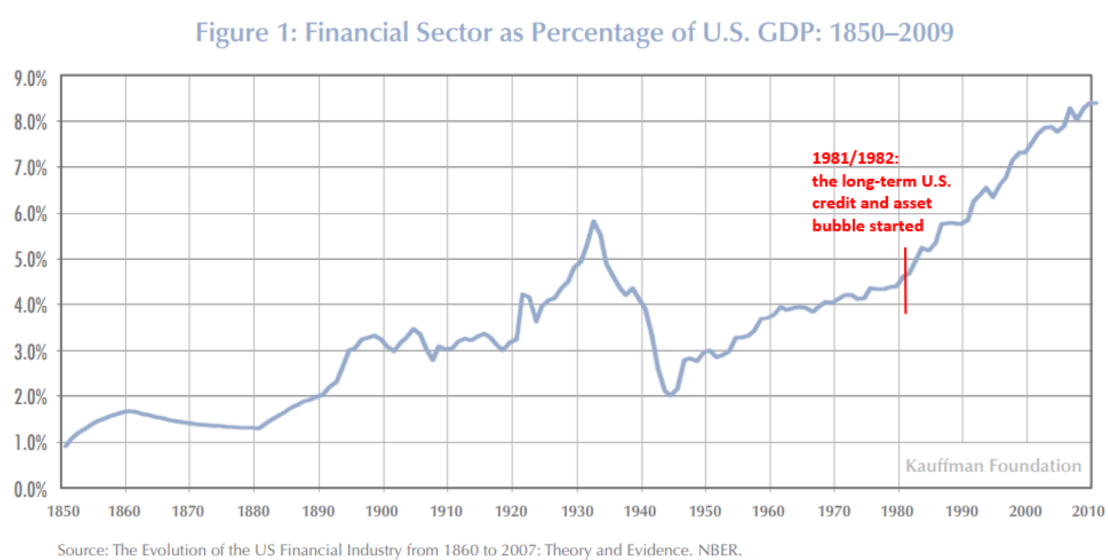
Due to the effects of financial leverage, relatively small stock price increases can cause a CEO's stock options to balloon in value, often resulting in multi-million dollar payouts. The powerful, debt-driven U.S. stock market bubble of the past several decades has enriched scores of CEOs and other corporate executives who received stock options. As a result, this group makes up a significant portion of the wealthiest 0.1% of Americans.



The next chart shows U.S. CEOs' realized direct compensation (which includes salary, bonus, and options) versus the S&P 500. Clearly, CEO compensation rises and falls with the value of the stock market, which is why CEO compensation spikes during bubbles and falls when the bubble bursts. In addition to the long-term stock market bubble that began in 1981/1982, the U.S. stock market has been experiencing a more recent phase of the bubble since 2009. Those who are fretting about excessive CEO compensation do not realize that the stock market is currently experiencing a bubble that will burst in the not-too-distant future, which will cause CEO compensation to fall along with the economic inequality that is a byproduct of it.



The next chart shows the financial sector as a percentage of the U.S. GDP, which shows the trend of increasing *financialization* of the economy. In simple terms, financialization means that finance and banking play an increasingly important and more sophisticated role in an economy. There's nothing inherently wrong with financialization if it occurs in a free market capitalist economy that has sound money backed by gold. In a non-free market economy with an unbacked fiat currency, however, it is as dangerous as pouring gasoline onto a flame.



Unfortunately, the dangerous version of financialization took hold in the U.S. economy as the result of the dollar's downgrade to an unbacked fiat currency in 1971. The resulting explosion of debt, inflation, and asset prices was a godsend to the U.S.

financial sector, which made a fortune from lending and in the trading of numerous types of financial products.

A portion of this fortune, of course, was paid out to the professionals who worked in the financial sector, making many of them wealthy beyond imagination and allowing them to join the ranks of the 1% and 0.1% wealthiest Americans. As with financialization, there is nothing inherently wrong or immoral about banking, finance, financial professionals, or even making vast fortunes in finance in a free market capitalist economy that has sound money. The problem is when a fiat currency allows an explosion of debt that enriches the financial sector at the rest of society's expense.

As the chart shows, U.S. financialization hit an inflection point when the long-term U.S. credit and asset bubble began in 1981/1982. The dangerous version of financialization, combined with the long-term U.S. credit and asset bubble, was the reason for the dot-com bubble, housing bubble and Great Recession, in addition to the bubble that has been inflating since 2009 (which will be explained in the next section).

How Our Latest Economic Bubble Worsens Inequality

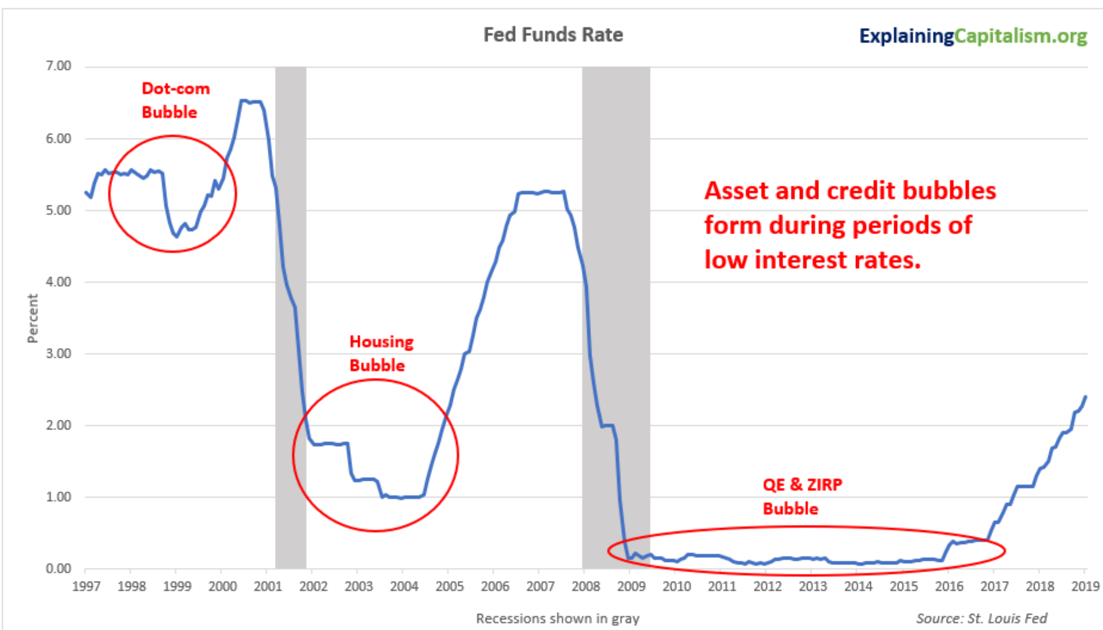
The dollar's downgrade to an unbacked fiat currency in 1971 led to a stealthy hollowing out of the U.S. economy in the subsequent decades. This hollowing out is the reason for the decline of the middle class and many other ills. As the economy deindustrialized, financial activities and debt-based consumption took its place. The U.S. economy became increasingly reliant on debt and bubbles for its growth, which led to the violent boom-bust cycle that we have experienced since the late-1990s.

Though this report has spent more time on the long-term U.S. credit and asset bubbles that began in 1981/1982, the current section will discuss the phase of this bubble that has been growing since 2009. Because the hollowed out U.S. economy has become reliant on debt and bubbles for its growth, the Federal Reserve has been creating new bubbles to replace the old bubbles that burst. Sadly, this is evidence of a very sick economy and an unethical central bank.

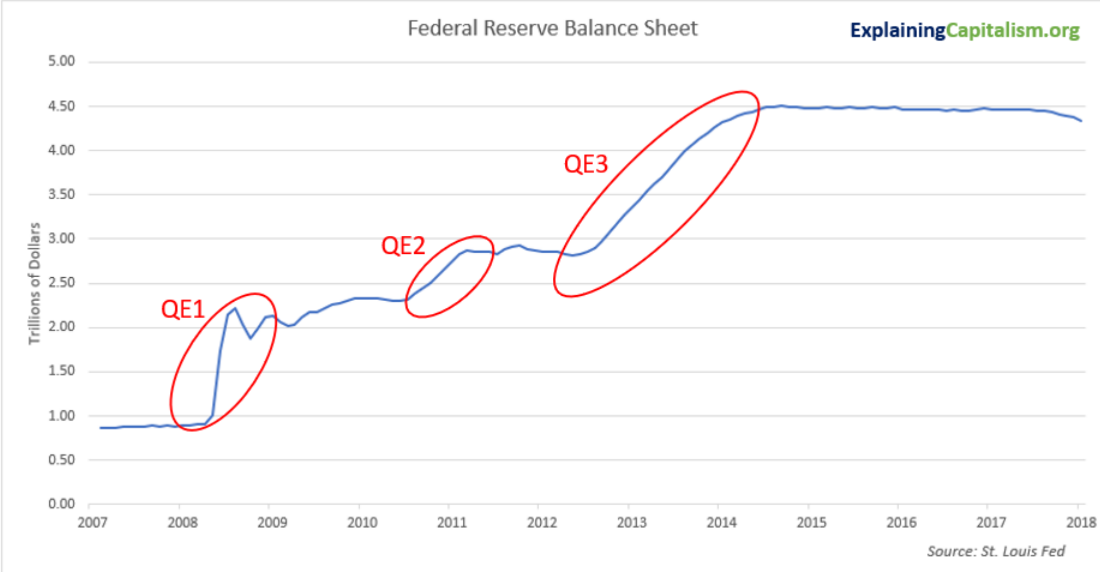
The dot-com bubble in the late-1990s created a temporary growth party until it burst and led to a recession in the early-2000s. In response, the Fed cut interest rates to ultra-low levels and created the housing bubble in the mid-2000s, which led to another temporary growth party until it burst in 2008. The bursting of the Fed's housing bubble resulted in the Great Recession, which cost 8.7 million Americans their jobs, caused untold human suffering, pushed our financial system to the brink, and cost the economy at least $22 trillion.

Did the Fed learn its lesson from the Great Recession? Of course not! The Fed went right back to its old playbook and has been blowing another massive bubble since 2009. Because of our record levels of debt and the hollowing of our economy, the Fed has resorted to more aggressive and unconventional tools to create new bubbles after each bust.

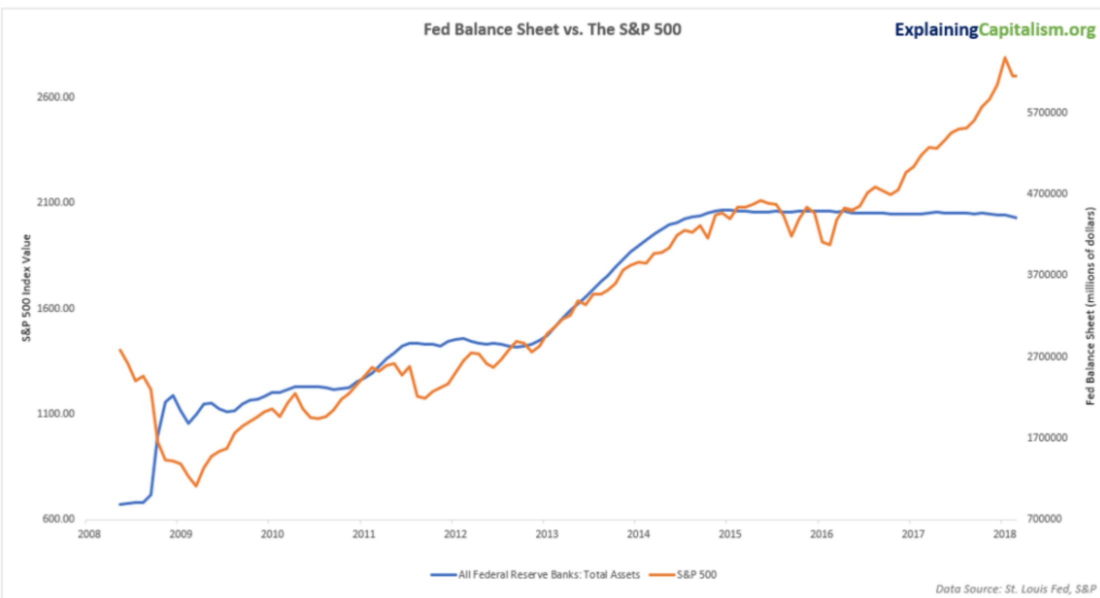
The Fed's first step during the 2008 financial crisis was to cut its benchmark interest rate (the Fed Funds rate) to virtually zero and hold rates at record low levels for a record length of time. This policy is known as zero interest rate policy or ZIRP. When central banks cut interest rates to artificially low levels, it typically leads to the creation of asset and credit bubbles. These artificially low interest rates cause bubbles by reducing the cost of borrowing, discouraging saving, encouraging speculation in riskier assets and endeavors, and causing inflation to rise.



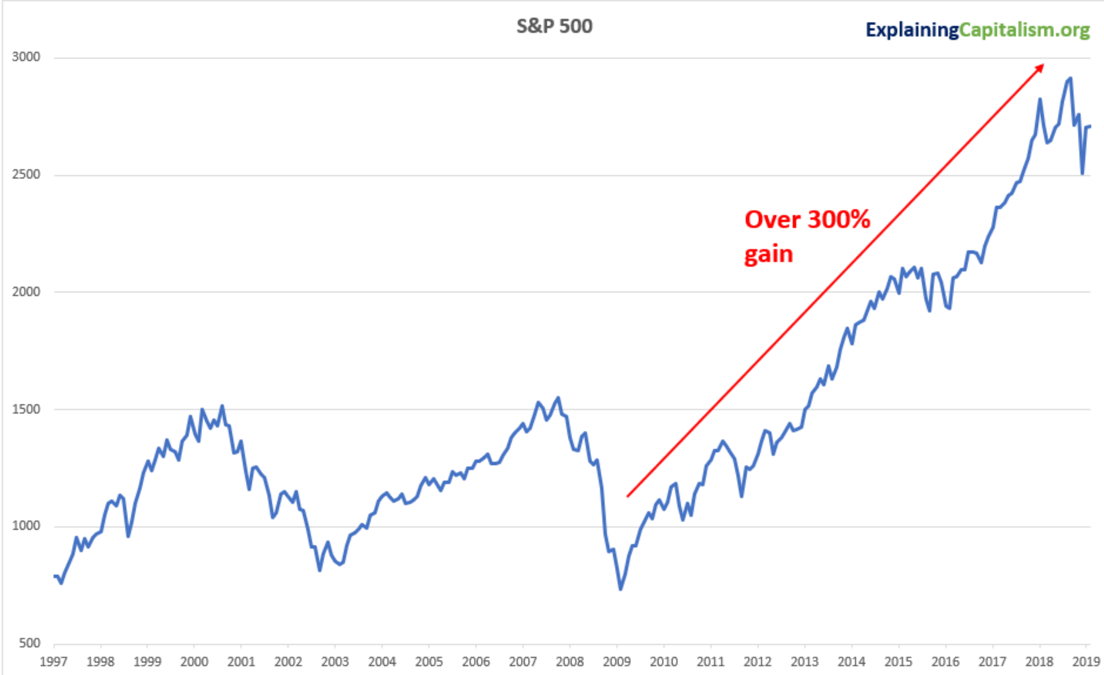
In addition to ZIRP, the Fed utilizes an unconventional monetary policy known as quantitative easing or "QE," which pumps liquidity into the financial system, boosts asset prices, and suppresses bond yields. When conducting QE policy, the Fed creates new dollars in digital form and uses them to buy Treasury bonds or other assets. The Fed performed three QE programs worth a total of $3.5 trillion dollars from 2008 to 2014, which can be seen in this chart of the Fed's balance sheet:



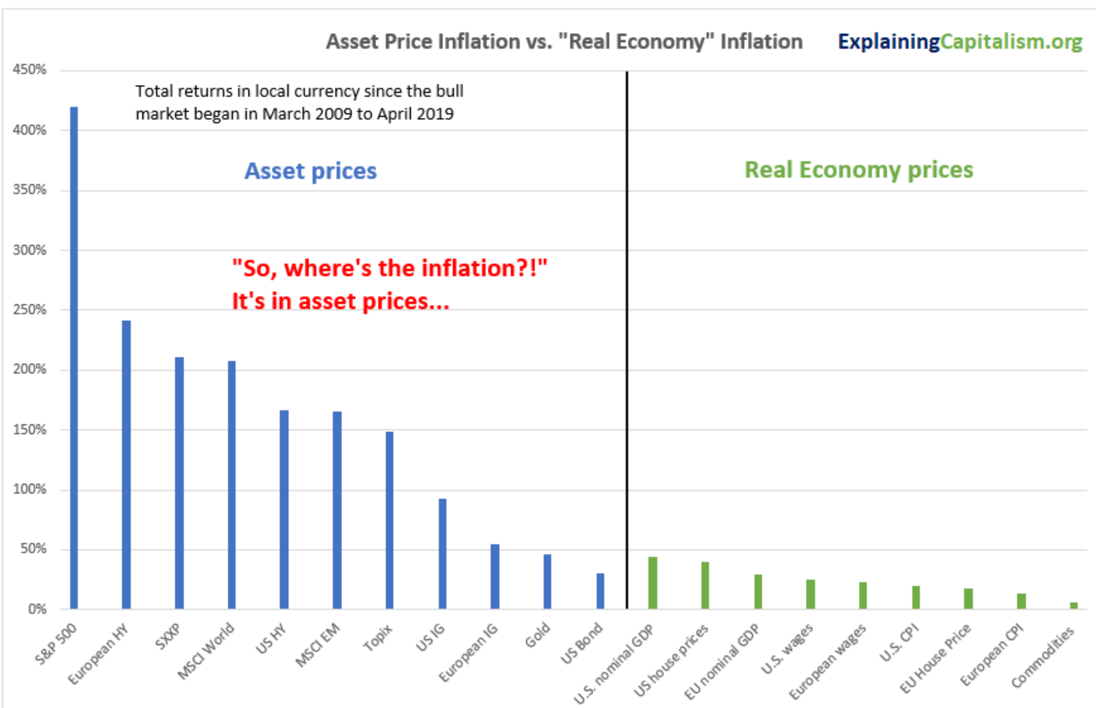
The chart below compares the Fed's balance sheet (blue line) to the S&P 500 (orange line). Each expansion of the Fed's balance sheet (due to QE) caused the S&P 500 to surge:



The Fed's aggressive ZIRP and QE policies caused the S&P 500 to soar over 300% from its 2009 low:



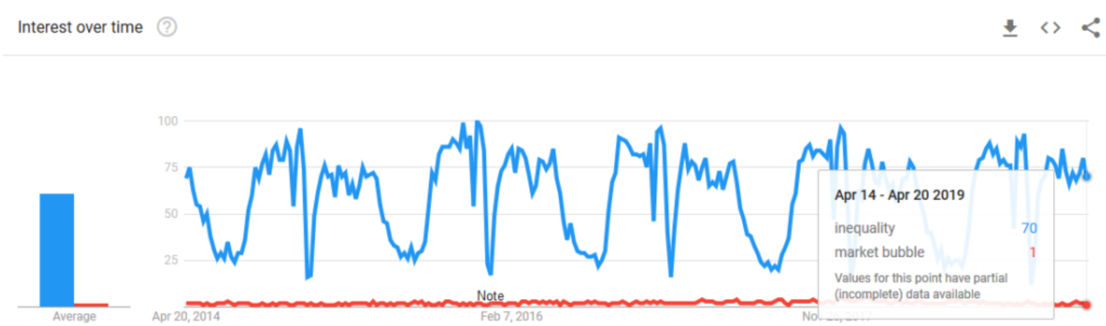
The Fed's QE policies have created a tremendous amount of inflation in asset prices even though conventional measures of inflation have remained subdued. This dichotomy is due to the fact that asset prices have been acting like a relief valve for inflationary pressures (read my detailed explanation).



The aggressive actions taken by the Fed since the Great Recession have created dangerous bubbles in stocks, bonds, and overall household wealth. These bubbles have exacerbated America's rich-poor gap and have helped spur the 2011 Occupy Wall Street movement, Bernie Sanders' 2016 presidential run, as well as the numerous far-left candidates who are running in the 2020 presidential race.

What the far-left doesn't realize is that today's inequality-worsening bubbles are going to burst, and the rich-poor gap is actually going to shrink as the rich watch their over-inflated stocks and bonds come back to planet earth. Unfortunately, the coming crash will result in a severe economic crisis – possibly even a full-blown depression. Because of this extremely concerning threat, our society should put far more energy into discussing and working to mitigate the effects of today's dangerous bubbles rather than worrying so much about the temporary inequality that is merely a side-effect of those bubbles.

According to Google Trends, there is currently *70 times more interest* in "inequality" versus "market bubbles" in the U.S., which means that our priorities are completely backwards. What else would you expect from a society that missed all of the obvious signs of the housing bubble that ended up devastating our economy?



Why Wealth Redistribution & Socialism Won't Solve Our Problems

As explained so far, worsening U.S. economic inequality, the soaring cost of living, rising indebtedness, the decline of the middle class, the hollowing out of the economy, and the devastating bubbles and busts are all direct byproducts of the terrible economic stewardship of the Federal Reserve and the destruction of the U.S. dollar's integrity. It is factually incorrect and morally unfair to blame free market capitalism for these ills that are in no way its fault.

The unfairness of blaming free market capitalism for the failings of the Federal Reserve and the fiat U.S. dollar can be explained with this simple parable:

> *Imagine you and a coworker are left in charge of your office for two weeks while your boss goes on vacation. You are the diligent employee who takes your work seriously, are very organized, and you go above and beyond what is required. Your coworker, on the other hand, comes*

> *to work late and often drunk, is more interested in texting than doing actual work, and constantly makes mistakes. When your boss comes back from vacation, she notices that numerous errors have been made and that customers are furious. Your boss then rages at both you and your coworker saying, "It's impossible to find good employees anymore! You're both fired!*

Today's anti-capitalist left is making the same mistake as the boss in the parable above. To demand another economic system like socialism or communism because "capitalism has failed" (as the left claims) is throwing the baby out with the bathwater. No other economic system has produced the widespread prosperity, living standards, and innovations that capitalism has. For all the fretting about economic inequality, even the poorest members of today's developed, capitalist societies live far better than actual royalty did just a couple hundred years ago, not to mention over 99.99% of humans who have ever existed in the past several hundred thousand years of history.

Here are some statistics that show how effective capitalism has been in fighting poverty and improving the overall human condition:

- Capitalism has made the world 120 times better off today than in 1800.
- 89% of people worldwide in 1820 lived in extreme poverty. By 2015, only 10% did.
- Before the Industrial Revolution began in the 1830s, most people were peasants or slaves – there was virtually no middle class. Now, nearly half the world's population or 3.7 billion people are considered to be middle class.
- Mortality rates for children under the age of five declined by 66% from 1980 to 2017.

Instituting wealth redistribution policies and/or socialism will never solve the economic problems that America is experiencing today because they fail to acknowledge, let alone strike at the root of, what is actually *causing* those problems. Wealth redistribution policies and socialism only focus on the *symptoms* that our sick economy is experiencing, such as rising inequality and soaring living costs, without ever addressing their causes, which are primarily the Federal Reserve and the destruction the U.S. dollar's integrity.

The implementation of socialism in America without rectifying the aforementioned issues would combine the worst aspects of our sick economy with the many undesirable consequences of socialism, such as the loss of economic vibrancy and individual freedom. To say that socialism is the wrong medicine is an understatement – it's more akin to *poison*. Implementing socialism would be like giving a mentally ill person pills that not only fail to treat their mental illness, but will actually give them cancer on top of their existing problems.

Here are some of the serious flaws of socialism:

- **It discourages striving and entrepreneurial risk-taking**

In socialist economies, income is taxed at a rate of 50%, 60%, 70%, or even more, which strongly discourages striving and entrepreneurial risk-taking. For example, why bother working 80 hours per week to build a business when you are only going to keep a third of the profit, while the rest is taken by the government? To make matters worse, the entrepreneur bears all of the risk if the business fails, yet the government will always show up to claim the majority of the profit if the business is profitable. As challenging as entrepreneurship inherently is, socialism warps the risk to reward ratio even *further* against entrepreneurs.

Similarly, why bother putting in extra effort and hours at your job to work on ambitious projects when most of the reward for those efforts will be taken by the government? Also, very high taxes certainly make it much less compelling to want to spend over a decade in grueling educational programs to become doctors, scientists, and other highly-trained professionals. Living in a heavily-taxed socialist society encourages people to take the "easy route" instead of working hard and sacrificing for greater future rewards. The socialist far-left do not understand these facts because they fail to understand basic human psychology and behavior.

- **It leads to slow economic growth and loss of economic vibrancy**

Because socialism discourages hard work, innovation, and risk-taking, it leads to slower economic growth and lower economic vibrancy. In turn, sluggish, non-competitive socialist economies have less potential to pull people out of poverty and create prosperous societies; instead of spreading prosperity, socialist economies spread mediocrity.

- **It causes capital to leave the country**

Wealth taxes, like the one Elizabeth Warren is proposing, along with other forms of wealth redistribution, cause both capital and the wealthy themselves to leave the country in favor of countries with less punitive tax regimes. The exodus of capital hurts entrepreneurship, job creation, and consumption, which ultimately weakens the overall economy.

Wealth taxes have been tried in the past and have had disastrous results. For example, France imposed a wealth tax on assets over 1.3 million euros, which caused 10,000 millionaires to leave France in 2015 and 12,000 in 2016. In 1990, twelve OECD countries had wealth taxes, but only four of those countries still do today. Sweden's wealth tax generated about $600 million a year in revenue at the expense of approximately $200 billion that flowed out of the country.

- **Nothing is truly "free" in a socialist economy**

Though socialist politicians are fond of making promises like "free healthcare" and "free college" on the campaign trail, the reality is that nothing that comes from the government is ever truly free. The government never *gives* you anything; it simply *transfers* it from other members of society. The funds that would be used to pay for these so-called "free" services would essentially be *stolen* from other productive members of society at gunpoint (via the tax collector).

- **It creates a slippery slope of government expansion**

The implementation of socialism in a society requires a dramatic expansion of the scope and power of government that creates the risk of a slippery slope in which the government will continue to expand until it becomes tyrannical. As the saying goes, "a government big enough to give you everything you want is a government big enough to take away everything that you have." Implementing socialism opens a door that may be impossible to close again.

Though modern socialist politicians like Bernie Sanders and Alexandria Ocasio-Cortez have tried to rebrand the type of socialism that they are promoting as "democratic socialism" in an attempt to downplay its philosophical link to the totalitarian socialist and communist regimes of the twentieth century, it still has the same Marxist DNA at the core.

It is extremely naive to think that the anti-capitalist left will stop at mere socialism – Vladimir Lenin said it himself, "The goal of socialism is communism." According to the Oxford Dictionary, socialism (in Marxist theory) is "a transitional social state between the overthrow of capitalism and the realization of communism." Marx even used the terms "socialism" and "communism" *interchangeably* in his writings.

The Rich Are Not The Enemy

One of the core beliefs of the anti-capitalist left is that the rich are greedy exploiters whose wealth and status is the byproduct of the inherent flaws of capitalism that cause the rich to grow richer at the expense of the poor. This thinking goes back at least 150 years to the time of Karl Marx and is kept alive by the modern far-left who believe that "every billionaire is a policy failure," and that the rich need to be "soaked" with taxes to redistribute their wealth to the rest of society.

The far-left's cynical, anti-rich stance incorrectly assumes that capitalism is a zero-sum game in which every dollar earned by the rich is essentially *taken* from the poor and the middle class. This is simply untrue: capitalism is a positive-sum game where wealth is actually *created*, which improves society's overall standard of living. Becoming wealthy is simply the potential reward for innovation and hard work.

In a free market capitalist economy, there is nothing unethical or wrong with becoming wealthy; it is actually a very good thing for both the individuals who become wealthy and society at large. The problems arise when a central bank, like the Federal Reserve, creates distortions in an economy that benefit the rich over the poor and middle class. The same applies when currencies are downgraded to pure unbacked fiat currencies, which allows credit bubbles and the dangerous version of financialization to take hold.

The latter conditions, which go against the very principles of free market capitalism, reward speculative and financial activities far more than a free market capitalist economy would. In comparison, a free market capitalist economy would reward scientific and technological innovations much more than financial activities. The only way to rectify this situation is to strike at the root; socialism and wealth redistribution do not address the reasons *why* our economy is so unhealthy and unbalanced.

Why The Left Is Disingenuous

It is axiomatic that any leader who is genuinely interested in solving our society's problems would keep an open mind to all possible explanations of the causes of those problems, as well as potential solutions. Individuals who take this approach possess both humility and intellectually curiosity, which are essential qualities found in successful public servants. Unfortunately, the far-left politicians who are trying to institute wealth redistribution and/or socialism in the U.S., including Alexandra Ocasio-Cortez, Elizabeth Warren, and Bernie Sanders, do not possess those qualities.

Today's influential far-left politicians refuse to acknowledge any of the explanations of the underlying causes of our economic problems that are discussed in this report, either put forth by myself or other like-minded individuals, and it's truly mind-boggling. Addressing how the Federal Reserve and fiat currency cause our economic problems is practically a third rail for these politicians – they simply *refuse* to touch these topics. Any explanation that doesn't fit their narrative that capitalism is an unethical and doomed system is completely ignored.

Simple Google searches of the names of today's most influential far-left politicians combined with the phrases "fiat currency" or "Federal Reserve" show that none of them have addressed or even mentioned those two drivers of America's soaring cost of living, rising indebtedness, inequality, and the bubble-bust cycle.

Click the links below to search the following keywords on Google:

- Elizabeth Warren + fiat currency
- Elizabeth Warren + Federal Reserve
- Bernie Sanders + fiat currency
- Bernie Sanders + Federal Reserve
- Alexandria Ocasio-Cortez + fiat currency
- Alexandria Ocasio-Cortez + Federal Reserve

Because today's most influential far-left politicians do not address, let alone attempt to refute, the type of pro-free market and sound currency arguments such as the ones made in this report, they fall into one of these three categories:

- If they are unaware of these concepts and are not open to learning them, then their lack of motivation to understand and find solutions to our society's problems makes them unfit to be political representatives who are responsible for shaping our society.
- If they simply don't understand these concepts, then they are neither educationally nor intellectually qualified to be political representatives who are responsible for shaping our society.
- If they understand these concepts, yet simply choose to ignore them, then they are morally unfit to be political representatives who are responsible for shaping our society.

The only logical conclusion that can be made is that the far-left are not genuinely interested in solving our economic problems and making our society a better place to live; their only goal is to implement socialism, which is ultimately about control and taking away both individual liberties and private property rights through the use of force.

One of the best ways to push back against the disingenuous anti-capitalist left is to ask them critical questions in public settings. This can be done on social media, in the comments section of online content, via open letters and blog posts, in town hall meetings and debates, in public encounters, etc.

Here are the kind of questions that should be asked:

- "Why do you constantly attack capitalism, yet you conveniently ignore the fact that the Federal Reserve and fiat currency are the main reasons for the soaring cost of living and economic inequality?"
- "Do you realize that we don't have free market capitalism when the Federal Reserve is constantly interfering in the financial markets?"
- "Why don't you ever mention the fact that the U.S. dollar lost over 96% of its purchasing power since the Federal Reserve was founded in 1913?"
- "How do you expect to solve the soaring cost of healthcare and higher education when you don't address the real reason for our inflation: the constant devaluation of our fiat currency – the unbacked "paper" dollar?"
- "Why do you always complain that the rich are getting richer, yet you never discuss how the Federal Reserve creates asset bubbles that temporarily benefit the rich until they burst?"

Asking members of the far-left these critical questions will undoubtedly cause them to stammer, become flustered, and beat around the bush as they are unprepared to answer these questions due to the fact that their very belief system doesn't even address these questions. Because the anti-capitalist left is so disingenuous and eager to force the rest of society into a faulty and unethical economic system (i.e., socialism), the only right thing to do is expose their ignorance and lack of interest in striking at the root of our problems.

Conclusion

To summarize, capitalism is being unfairly blamed for a whole host of ills that are actually the fault of the U.S. Federal Reserve and the unbacked fiat dollar. Due to the lack of understanding of these important nuances, U.S. public sentiment is rapidly turning against capitalism in favor of socialism, especially among the younger generations.

It is extremely important to prevent socialism from being instituted in the United States because it is an unethical and fatally flawed economic system that will never solve our problems. One of the most effective ways to prevent the U.S. from succumbing to socialism is to conduct widespread education campaigns to help defend capitalism and set the record straight about what is actually causing our economic problems (i.e., the explanations given in this report).

The only way to actually solve our society's economic problems is to end the Federal Reserve, make the U.S. dollar sound again by backing it with gold, allow and embrace free markets, and significantly scale back the government. Will it be easy to implement these measures? Of course not. But implementing socialism would be no small feat either, and it would take our society even further away from where we need to be, in addition to creating a whole new set of economic and ethical problems.

In order to successfully implement these pro-free market solutions, a critical mass of Americans must first understand that free market capitalism is actually the only viable solution to our problems, not the cause of them. Building this awareness and working to implement these solutions is the primary goal of the Explaining Capitalism project.

Please click the button below to donate to help wage a large-scale information campaign to defend capitalism and prevent the spread of socialism in the United States. We're in the eleventh hour and your help is greatly needed.

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