

THE DOHMEN ECONOMIC PLAN

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I am often asked by clients what I think should be done. Well, public policy is not my area of expertise, but I haven't seen anyone in Washington present an intelligent plan, so let me add mine to that the collection. I am not privy to all the serious banking problems that have only been divulged to the government insiders. However, my estimates of the huge existing losses and future write-offs in the financial system, made in 2007, were on the mark. Allow me to present an outline of what might work.

The key to good solutions is usually simplicity. Resetting defaulted mortgages one by one, buying bad assets from banks, reworking mortgages – none of that will work. The focus has to be on (1) governmental guarantees, not handouts; (2) well targeted tax incentives. The way I see it, the government should start by fulfilling two great needs, capital for banks and the ultimate guarantee for bank deposits.

1. RESOLVING THE BANKING INSOLVENCY

The solvency of the banking system has been the major problem the past 18 months and it continues to worsen, in spite of the billions spent by Washington. The banks continue to need more capital because the value of their holdings continues to be destroyed. Washington is adding capital in chunks of \$20-\$30 billion at a time. This is a waste of money and it does nothing to enable banks to restart their normal business, which is lending. Look at Citigroup: government has put \$45 billion into the bank, but its worth today is only about \$19 billion. Value is pulverized faster than the government can pump in the money.

At the same time, big investment capital all over the world is desperately trying to find a safe haven to park its money. Tens of billions of dollars are flowing into short-term U.S. T-bills, with almost zero yield, just to get the safety, meaning the government's guarantee that stands behind the T-bills. There is no other safe place for this capital to go. These are not deposits of \$1000, but billions of dollars from large institutions and even governments.

If we combine the two situations above, then significant problems can be resolved, without the government spending a penny. **The U.S. Treasury should guarantee ALL deposits in current existing and operating banks, with no limits, no conditions** and none of the other complications it always likes to throw into its regulations. **Thus a deposit in a bank would become as safe as buying a T-bill.**

As a result, billions of dollars of deposits would flow into the U.S. banking system. Banks would have to put the money to work in order to make a profit. They would start lending to creditworthy borrowers, especially small businesses. The regulators would suspend for a period of one or two years the capital reserve requirements, because the governmental guarantee makes them superfluous. Or the Treasury could guarantee the value of all the troubled assets of the banks at 55% of face value for the purpose of capital calculations for a period such as three years. Thus you have a solution that costs nothing.

For decades, before banks began speculating with super-high leverage in the derivative markets, the business of a bank was to gather up the savings in the community, offering savers safety and interest, and then lend the money to the businesses in the community so they could expand and create jobs. Sounds a little quaint, but it worked.

Then Congress removed restrictions on banks, which had been in place for more than 70 years. The big banks got bigger by gobbling up the small local banks. Savings from the communities were sucked out and went into the giant pots of the large banks for their own speculations, or to finance huge private equity and hedge fund deals. Very little of the money went back into the same community where it came from. Congress was the ultimate culprit.

With my plan the solvency and capital shortages would be solved, while attracting capital from around the globe. Other countries may not like it as it would force them to offer the same guarantees if they didn't want to lose their deposits. With such guarantees around the world, the stability and safety of the global banking system would be assured.

2. RESOLVING THE DILEMMA OF THE RETIRED

No one talks about the plight of the retired person. Not only has the average retired person lost 30-50% of his retirement fund as the investments plunged, now he can't even get a decent rate of interest on CD's or money market funds. He has no income, no job, little chance of getting a job and his nest egg has been hit by a bomb. Will his Social Security check pay the mortgage and buy the food? Maybe not.

His dilemma is where to put the retirement funds he still has, without taking the chance that he will lose even more. I get that question all the time. And my proposal to help these people in a small way, and at the same time help banks raise deposits, is to **make the interest on all deposits under \$1 million tax exempt.**

Combined with proposal #1, depositors would now have ultimate safety plus a tax exempt return on their money. Cost to the government is just the tax on the interest income.

3. HOUSING

Deflation is often thought of as a decline in prices. But prices can even decline in an economic boom when the cost of production declines, goods are imported or there are great technological advances. We have seen all of these situations over the past 20 years, at different times and in different combinations.

Deflation is "a decline in demand," not a decline in prices, although the latter is often a result of the demand decline. In order to stop the never-ending decline in housing prices, which causes even more mortgage defaults – and thus a decline in the value of assets held by banks, and an increase in the fantastic number of empty homes – **demand must be created.** Forcing banks, via bankruptcy judges, to lower the principal on current mortgages outstanding, is abrogating private contract. We would expect that in communist countries, but not in the bastion of democracy. Yet, that's what Congress wants to do.

There is a better solution that I first proposed last summer. We know from all the foreclosure auctions that there is big demand for houses from those who are looking for a bargain. By offering significant tax advantages for new buyers, demand could be stimulated, which would stop the erosion of home prices. **A tax deduction of 20% of the purchase price of a house would be a great incentive.** Additionally, **make any future gains in the sale of the house after five years tax exempt.**

Such a program would bring thousands of bargain hunters out in droves. The demand would put a bottom on housing prices and people walking away from their mortgages. **Once again, the cost to government would be insignificant. It would create "demand" and that's what ending deflation is all about.**

I mentioned this idea to a CPA I know. He immediately said the "average" person couldn't use such a big tax deduction. That's probably how Washington thinks. Well, the "average" person is not the one who can buy a house in this economy. That person is more concerned about putting food on the table.

But there are people who have money to buy houses, if the incentives are lucrative enough. Those are the people an incentive should be designed for. It must be BIG!

4. LOWER THE CORPORATE INCOME TAX

For small businesses that are fortunate to have a profit sending 45% of those profits to Washington and the states really hurts. The business owner usually has a list of projects, marketing campaigns and expansions to undertake. It all takes money. And the tax checks sent to the bottomless pits in government rob him of these possibilities.

Therefore, it is necessary to have a substantial cut in corporate income taxes. Other countries are far ahead of us. The U.S. has the second or third highest corporate tax rates in the world. The tax should be lowered to 5% on income up 500,000, and 10% on income above that.

5. MAKE THE TAX CUTS OF 2003 PERMANENT

The 2003 tax cuts enabled the economy to recover from the severe 2000-2003 bear market in stocks. The cuts should be made permanent. Imagine, tax planners are telling clients they should plan to die in 2010 because the estate tax will take a big jump in 2011 when the tax cuts expire. This is ridiculous.

The President should announce his desire that these tax cuts become permanent. That alone will cause a big jump in confidence, as businesses and people could plan for the longer term. No one has to "plan" on dying in 2010.

There are other guarantees and tax incentives that I would enact, such as lowering the corporate tax rate to 12%, but the foregoing are the most important ones right now. It's time for bipartisan action, not for partisan class warfare, unless the politicians really welcome a second GREAT DEPRESSION.

Feel free to send this to your Congressman or Senator! For the address, go to <http://www.visi.com/juan/congress/>. Or Google "members of Congress."