

Chapter 1

INTRODUCTION
THE RECKONING

Introduction: The Reckoning

IT'S HARD NOT TO LOOK BACK ON THE LAST FEW YEARS WITHOUT A sense of deep regret. As both a nation and a people, we've maxed out our credit cards, mortgaged ourselves to the hilt and never quite gotten around to saving any money. And there was no shortage of willing enablers. When our mailboxes weren't stuffed with credit card offers, shady mortgage brokers were cold-calling us at dinnertime offering us six-figure loans with no money down, or a tantalizing home equity line of credit to fuel the next spending spree. In this gilded, get-it-now atmosphere, recessions were never an option; Wall Street bankers could always count on the Federal Reserve to open up the money spigots and keep the party going. In Washington, DC, our free-spending politicians convinced themselves that deficits needn't matter when there's a friendly overseas lender just a phone call away. In short, we've been living beyond our means for far too long, and now the bubble has burst. This book concerns itself with how we can cope with the painful national hangover that we can call Depression 2.0.

As we contemplate the future in this age of nail-biting uncertainty, perhaps our greatest challenges will be psychological in nature. Do we have the necessary mental toughness to persevere in the face of severe economic setbacks? Can we retain our sense of optimism when the nation is drowning in a sea of red ink? We've spent our entire lives living in a stable, prosperous consumer paradise, and it's all we've ever known. Do we possess the necessary resolve and determination that allowed our forebears to weather the privations of the Great Depression? Only time will tell. However, it is sincerely hoped that the present work will offer a positive step in the right direction by providing consumers with a valuable guidebook for these perilous economic times.

Practical and common sense strategies for surviving on less in an age of diminishing expectations are provided in the following pages. The current difficulties—though they do present formidable challenges—needn't be cause for fear, pessimism or despair. The crucible of adversity brings communities closer together, and can unleash our creative powers in ways we never thought possible. By and large, Americans are an optimistic, free-spirited and innovative people. These enduring qualities will play an important role in how we move forward from Depression 2.0.

Our nation is at a crossroads. Every facet of our existence—how and where we live, what we eat, where we work and even what forms of transportation we use—could be undergoing a seismic shift in the near future. While economic circumstances will certainly play a role in altering our present lifestyles, many of these changes may simply be inevitable. The looming threat of global warming, resource scarcity, a crumbling national infrastructure and a dysfunctional political culture may force us to part ways with the status quo and look for alternatives. It is highly likely that many of these innovations will occur on a local or community level as citizens start working together to find solutions to the problems we face.

Those who are adequately prepared and able to seamlessly make the transition to a more sustainable way of living will have a decisive advantage. It is hoped that this book will provide the necessary knowledge, guidance and inspiration to those seeking to adapt to our present circumstances. In the popular mind, living with less means a life of near-constant misery and perpetual want. However, a satisfying, purposeful life needn't be shackled to the bottom line. Above all else, hopefully this book will foster a spirit of free-wheeling experimentation. While each of us will likely experience numerous false starts and missteps on the road to self-sufficiency, every setback has the potential to plant the seeds of future successes.

So, how exactly did our supercharged economy go off the rails? This question is of no small significance. Many Americans have been completely taken aback by the sheer magnitude of the current financial crisis. Yet there were already a number of ominous signs indicating that we were treading on thin ice. Unfortunately, we made the mistake of trusting our financial and governmental institutions to responsibly safeguard our nation's wealth. This isn't an option anymore. Each of us needs to take the time to become better informed about economic matters. Perhaps it is well worth our time to briefly examine the roots of the current crisis, and illuminate a couple of dangerous trends that could impact our financial future.

The Dollar in Decline

THE SIGNING OF THE BRETTON WOODS AGREEMENTS, IN JULY 1944, was a pivotal moment in U.S. economic history. The historic accords would allow the dollar to play a uniquely influential role in the postwar economic order. The majority of the world's currencies would be pegged to the dollar, and U.S. currency would become the preferred medium of exchange for key commodities like oil, natural gas and precious metals. The dollar would become indispensable to the world economy. Moreover, every dollar in circulation at that time was backed by a percentage of the nation's formidable gold reserves held inside the legendary Fort Knox Bullion Depository in Northern Kentucky. One fateful decision changed all that.

In 1971, the Nixon administration was facing growing opposition to the Vietnam conflict. Sensing the public mood, a stubborn Congress refused to appropriate additional funding for the war, and a tax hike was simply out of the question. Desperate to carry out his policies in Vietnam, Nixon borrowed the money to continue the war. A spending spree ensued, and billions of dollars were injected into the economy, resulting in severe inflation. Hoping to head off a crisis, Nixon instituted wage and price freezes, implemented a tax on imports and, with one stroke of the presidential pen, took the U.S. off the gold standard. "This move ended the era of stability," explains currency historian Jack Weatherford, "and the period of greatest economic prosperity and productivity in the history of the American dollar."¹

It truly was the end of an era. The Bretton Woods agreements were thrown into disarray, and the once-mighty greenback was transformed from a value-based "hard" currency that enjoyed the supreme confidence of international investors to a "fiat" or "floating" currency. The dollar was now backed by little more than consumer faith and U.S. government promises. "Before anyone fully realized how it happened," recounts Weatherford, "the dollar was on a roller coaster, but the Japanese yen and the German mark seemed to be on an ever-upward track, while the dollar fluctuated in the short run but fell in the long run."²

Obviously there would be both winners and losers when Nixon fatefully severed the link between the dollar and the nation's gold reserves. As the dollar's precipitous fall spread through the world economy, currencies in Bolivia and Peru, which were pegged to the once rock-solid dollar, proved unable to withstand the wild fluctuations and crashed. American consumers would be hobbled with a constantly rising cost of living and diminished buying power; the same dollar that could buy 1/35 of an ounce of gold in 1970

buys less than 1/800 of an ounce today. However, politicians, government officials and well-connected business interests would reap huge benefits from the fiat currency system.

When a currency operates under a gold standard, governments can only spend what is backed by a percentage of the nation's gold reserves. By contrast, a floating currency is the equivalent of a moneymaking machine to cash-hungry government officials and politicians. Once the U.S. dropped the gold standard, the nation embarked on a spending spree unmatched in human history. A vast overseas empire, gargantuan defense budgets, farm subsidies, corporate stimulus packages and myriad other spending initiatives drove the national debt to record heights.

However, runaway government spending was only part of the problem. When there is greater political control over a given currency system, the temptation to tinker with the economy is all too often the result. The Federal Reserve system, formed in the aftermath of the historic 1907 liquidity crisis, was instituted in 1913 to oversee the nation's banking system, maintain an elastic currency and ensure price stability. However, in recent years, the Fed has become an altogether different animal.

Because the Federal Reserve controls the money supply, our nation's central bankers have a powerful tool at their disposal. When the Fed slashes interest rates or buys dollar-denominated securities on the open market, these actions increase the number of dollars in circulation and can provide an artificial, short-term boost to the economy. While these types of interventions may have helped us avoid recessions in the recent past, they come at a very high cost by diluting the dollar and eroding our purchasing power. Indeed, the dollar's declining value when compared to the Euro is but one indication of how the Federal Reserve's recent activities have impacted the lives of consumers.

While the more optimistic will argue that an artificially weakened dollar lowers the price of U.S. goods and spurs international trade, America's unproductive economy has shown few signs of capitalizing on this opportunity. Instead, we import hundreds of billions of dollars more than we export overseas. This is known as our "current account" deficit, and when we suffer from this type of trade imbalance, we are forced to borrow money from foreign lenders to make up the difference.

Between our \$10 trillion national debt and growing current account deficit, which runs into the hundreds of billions, we have now become reliant on the largesse of foreign lenders like China, Japan and various oil-rich Gulf states to maintain our way of life. In 2008, James Fallows reported in the *Atlantic Monthly* that "Every person in the (rich) United States has over the past ten years or so borrowed about \$4,000 from someone in the (poor) People's

Republic of China."³ Yet this cannot go on indefinitely. The dollar's status as the world's reserve currency has bought us some time, but at some point the rest of the world might decide that they can no longer bet on the productive capacity of the U.S. economy or our ability to pay off our monumental debts, and start jettisoning dollar holdings.

The precarious position of the dollar also leaves us uniquely vulnerable to economic warfare. Indeed, there is already historical precedent for such a strategy. During the 1956 Suez Crisis, President Eisenhower pressured the British into withdrawing from their campaign against Egypt by threatening to dump America's pound holdings onto the open market, which would have precipitated a British currency crisis.

The U.S. could find itself in a similar situation should the oil-producing nations insist that the Euro replace the dollar as the dominant currency for all petroleum transactions. Should this come to pass, the rest of the world would have little reason to maintain stockpiles of U.S. currency that could drastically devalue the dollar. China has also amassed a significant stockpile of dollar-denominated securities that could severely undermine the U.S. economy should its leaders decide to exercise what is called "the nuclear option" and unload these sizeable holdings.

Like many fiat currencies throughout history, the dollar has long since lost its primary role as an effective medium of exchange. When our money became a theoretical plaything for economic central planners and a political instrument for politicians, the economic realities of the average consumer ceased to be a concern. The cost of a mismanaged currency isn't just the "stealth tax" we pay each year when our dollars buy less and our cost of living rises. Indeed, as we shall see in the next section, the Federal Reserve's currency policies are at least partially responsible for the current economic crisis.

Anatomy of a Meltdown

BACK IN 1995, WHEN MOST OF US WERE FIRST SURFING THE WEB USING primitive dial-up modems, then-Federal Reserve Chairman Alan Greenspan believed he'd seen the future. In his mind's eye, the revolutionary potential of computer technology was destined to usher in a new economic era. "When historians look back on the latter half of the 1990s," he would later remark, "I suspect that they will conclude that we are now living through a pivotal period in American economic history."⁴

Pivotal it was, but perhaps not in the way that the once-celebrated Fed Chief intended. However, the ever-optimistic monetary expert was not to be denied his vision. Indeed, for a while it seemed like he was on to some-

CHARLES HUGH SMITH ON THE POST-CONSUMER SOCIETY

Charles Hugh Smith is an entrepreneur, financial commentator, and the author of seven books. Smith's insightful musings on critical financial and economic issues can be found on his popular website/blog www.oftwominds.com.

Q: *You've advised your readers to avoid the "distraction" of inflationary and deflationary trends and pay closer attention to purchasing power. Are there any practical ways we can get more bang for our buck?*

CHS: Definitely. The problem with trying to reckon "deflation" and "inflation" is that the answer depends on what's being measured—assets, currency, commodities, etc.—and in what time frame. Was oil shooting from \$60 to \$147 deflationary or inflationary? How about when it dropped from \$147 to \$35? The deflation-inflation debate offers little practical help.

The key to maintaining purchasing power is to accept that high volatility will continue across assets, currencies and commodities, and the nimble and flexible will likely do much better than those seeking one "answer." In such an environment, it's practical to view all purchases and investments as hedges against future unknowns. For example, gold is a hedge against all paper currencies dropping in purchasing power, and hence its popularity as one more-or-less sure way of retaining purchasing power vis-à-vis paper currencies.

Some feel that there is no substitute for owning physical gold, while others who recall that the federal government appropriated all private physical gold in the 1930s prefer to own gold held elsewhere (such as Switzerland), via companies such as BullionVault.

thing. His message of constant growth and increased productivity coincided perfectly with the rise of the Internet and the advent of Silicon Valley as a nexus of American innovation. As talk of the "New Economy" spread, the public was duly informed that the brick-and-mortar businesses of the past were on the verge of being replaced by a vast array of lucrative technological products and services that would power the U.S. economy for years to come and transform the world.

Taking a cue from the visionary Fed Chairman, bullish investors went on a sustained buying binge. Soon, dozens of companies, many of which had yet to earn a profit, were financed with billions from speculators looking to cash in on "the next big thing." Internet-savvy baby boomers seeking a solid investment portfolio for their retirement years quickly jumped on board, and the sheer influx of cash drove the stock market to record heights. The Dow Jones Industrial Average, which was under 4,000 in 1994, would catapult to over 11,000 in just a few short years.⁵ The NASDAQ would enjoy a similar rise, bounding from 500 to 6000 in the overheated 1990s.⁶

Greenspan would play a key role in the ensuing boom, repeatedly cutting interest rates to fuel the non-stop feeding frenzy. As skeptical investors began to question the surging stock prices, he defended the higher valuations on the basis of his belief in America's newfound productivity. When Long Term Capital Management, a billion-dollar hedge fund, failed in 1998, and the market began to cool, the Fed Chief stepped in with yet another cut in interest rates to keep the easy credit flowing. These efforts, according to author William Fleckenstein, "came to be viewed as the 'Greenspan Put,' meaning speculators could take enormous amounts of risk trusting that Greenspan would do anything to stop the market from a serious decline."⁷

However, as the millennium dawned, the signs of a speculative bubble (excess liquidity, overvalued stock) were there for all to see. By February 2000, the fast and furious stock trading was reaching dangerous levels. By that time, margin debt, which is money loaned by brokers to cover a percentage of stock purchases, exceeded \$265 billion.⁸ As margin debt is one of the leading indicators of a speculative bubble, the crash wasn't long in coming. By the middle of March 2000, stocks began heading south. Over the next two years, some \$5 trillion in paper profits would be effectively wiped out.

The huge productivity gains envisioned by Greenspan and his starry-eyed acolytes never materialized. While the '90s was a decade of impressive innovation, and a commendable uptick in corporate performance, there was little evidence of the revolutionary gains predicting by Greenspan. In the meantime, trillions of dollars that could have been invested in more sustainable, productive ventures was funneled down the dot.com sinkhole. By 2001, the economy

CHARLES HUGH SMITH continued

But the essential commodities—oil, grain and other food—can fluctuate wildly even if priced in gold. Thus it makes sense to buy the essentials of life such as food and energy when prices are low (in terms of dollars or gold), as a hedge against future higher prices. Oil can be traded via futures contracts or ETFs like XLE or OIL, or via oil/natural gas/exploration/refining companies.

Volatile markets in currencies and essential commodities make for a very difficult environment. The owner of dollars might be losing, but the holder of dollars invested in oil/energy stocks might be beating the holder of gold. The person with a hundred pounds of rice and fifty pounds of dried beans on hand will at least be hedged against temporary food shortages.

Q: *In the future, you believe consumers are more likely to view housing as simply a form of shelter as opposed to a long-term investment. In the interim, do you see co-housing arrangements, eco-villages, micro-homes and other alternatives emerging as a free market response to outsized rents and mortgages?*

CHS: Absolutely. One theme I have addressed repeatedly is the reversal of housing density—the trend toward one person, one dwelling shifting back to multi-person households. The reason is obvious: The cost of housing in the U.S. is very high compared to a generation or two ago, as measured by “hours of labor needed to rent an apartment.” As Depression 2.0 takes hold, incomes will shrink or disappear and people will move to cheaper or free lodging. Choices include moving in with family members who own a dwelling that’s free and clear (some twenty-five million homes have no mortgage), renting one of the millions of spare bedrooms that will be available for rent/trade (perhaps elderly homeowners will be trading shelter for help with chores/meal prep, etc.) or occupying (i.e., squatting) some of the eighteen million unoccupied dwellings in the U.S.

began to falter and a long overdue hangover from the excesses of the 1990s drove the market toward a recession.

At this juncture the public had long grown wary of investing in the stock market. Yet suddenly a new opportunity arose. All that residual dot.com wealth and a new trend in subprime home mortgages led to a white-hot real estate market. Once again, Greenspan acted as head cheerleader for the ensuing bubble by cutting interest rates below two percent and publicly touting the new opportunities available to homeowners. By 2004, consumers had amassed nearly \$7 trillion in mortgage debt as popular home equity loans and questionable subprime mortgages kept the flagging economy going.⁹

Innovations in finance allowed the majority of America’s consumer mortgages to be bundled and repackaged as tradable securities. As the demand for these newly minted bond offerings escalated, the system began to break down. Brokers were pressured to increase the number of home loans in circulation to fuel the traffic in mortgage-backed securities. Soon the loan approval process became little more than a formality. Consumers with little collateral and poor credit histories could apply online for lucrative loans and get approved within minutes.

The excess liquidity pushed home prices to unsustainable heights. Yet this was only part of the problem. Wall Street’s self-professed “Masters of the Universe” began wildly trafficking in mortgage-backed securities and using these dubious assets as collateral to leverage their sizeable financial speculations. As these “off-balance-sheet” holdings mounted, there were insufficient controls in place to gauge the risks the firms were taking on. The advent of credit default swaps, a type of derivative that acts as a form of insurance if a given financial institution can’t cover its trading positions, only further complicated the picture and hastened the ensuing meltdown when an epidemic of mortgage defaults in 2007–08 left our nation’s most revered investment banks and institutions holding trillions in worthless paper and unable to cover their debts. As the ensuing crisis spread, the world’s credit system was plunged into an unprecedented crisis that has now spread throughout the economy.

This tragic destruction of our nation’s wealth offers a sobering reminder that even our most respected financial experts and Ivy League economists can fall victim to the kind of delusional groupthink we often ascribe to millenarian religious sects and exotic cargo cults. The mass psychosis that fueled both the dot.com boom and the housing bubble both rested on the groundless assumption that stock prices and home values were on a permanent upward track, and that recessions were a relic of the past. Yet the most fatal conceit of all was the widely-held belief that there was relative safety in wagering trillions of dollars that consumers wouldn’t default on their mortgages.

CHARLES HUGH SMITH continued

Having written about the co-housing movement since 1991, I see it as a model for group housing which offers a lifestyle that is far superior to living alone. Co-housing requires a serious investment of time and cooperation, which depends on trustworthy communication, completing tasks as assigned/agreed on and tolerance/listening skills. The payoffs are increased security and community—two assets of increasing value in hard times.

It's entirely possible that we will see heretofore unimaginable living arrangements, such as defunct mini-malls being taken over by co-ops and the retail spaces being used as residential lofts. The key will be proximity to services and functioning communities and the energy required to heat and light the spaces. Malls in the middle of nowhere may well be bulldozed as nuisances, if counties can spare the diesel fuel for the dozers.

Ironically, the best way to “look out for number one” will be to start looking out for numbers two through ten—those who share your neighborhood, house or community.

Q: *In your blog posts and commentaries, you emphasize that there is every reason to be optimistic about the future. What, in your opinion, are the positive benefits of living in a post-consumer society?*

CHS: As commentator/author Richard Metzger has noted, one of the biggest positives will be the reduction in stress. People assume the high-stress rat race they currently survive with anti-anxiety pills and other drugs is somehow easier than what they call “poverty.” But beyond shelter, electricity and basic healthy food, the real poverty is in the lives of those working soulless jobs to make enough money to pay for their SUV, ski trips charged on credit cards, low-quality furniture and gadgetry, bloated, energy-wasting McMansions and distracting electronics. Poverty as experienced in the third world—shelterless hunger—is somewhat unlikely in the U.S., which retains a wealth of agricultural resources, some oil/energy and eighteen million empty dwellings, but the “poverty” of no longer being able to afford the distractions of middle-class life may actually enhance people's lives.

It will likely take years to restore the nation's financial equilibrium after the excesses of the last few years, and history will not be kind to Alan Greenspan or his deluded flock. Unfortunately, we can't hit the reset button; the damage has already been done. While it is hoped that we are witnessing the dawning of a new era characterized by responsible investing, greater regulatory oversight and advanced risk management systems, if history is any guide, we needn't get our hopes up. In a few short years, we can be certain that Wall Street's best and brightest will begin marching in lockstep heralding the arrival of the “next big thing,” and the cycle will begin anew.

The Entitlement Time Bomb

IF THE SUCCESSIVE DEBACLES THAT HAVE PLAGUED THE FINANCIAL world have greatly imperiled our nation's economic future, our elected representatives have added to our difficulties. The profligate spending that has pushed our national debt to over \$10 trillion is just the tip of the iceberg. On January 1, 2011, the picture grows even darker. On that portentous date, the first members of America's baby boom generation will be eligible for retirement benefits, possibly unleashing a tidal wave of government debt that could send shudders through the U.S. economy for years to come.

At issue are two highly problematic government entitlement programs: Medicare and Social Security. The latter operates on what is called a pay-as-you-go basis; each year, payroll deductions from current employees and their employers are redirected toward retirees. Once these expenditures have been allocated, the remaining revenues are placed in the Social Security Trust Fund. However, this poses a major problem: Baby boomers are the biggest generation in the history of the U.S. In other words, there may not be enough people working and paying into the system to keep the Trust Fund solvent once the mass retirement begins. Although there is no exact date, sometime within the next few decades the Social Security Administration (SSA) will begin hemorrhaging cash and start drawing down the Trust Fund. When this day dawns, we will quickly learn that despite all the promises we often hear about the sanctity of our nation's retirement funds, our politicians have been raiding the till for years.

The federal government has run sizeable budget deficits for thirty-five of the last forty years. In the hopes of disguising these debts and covering expenses, our myopic elected officials have been siphoning money from the Social Security Fund like a degenerate gambler at a casino ATM machine. In less than ten years, 2017 to be exact, the government will begin paying out more in Social Security benefits than it takes in, and that's when the real

CHARLES HUGH SMITH continued

No more cable or satellite TV? That's an instant improvement in sanity and well-being. No more fat and sugar-loaded snacks and fast foods? Ditto. Self-reliance has a number of rewards—rewards those of us who baked bread and fixed our own bikes and cars in the late '60s/early '70s experienced firsthand. Home-cooked food is cheaper, better for you and tastes much better than greasy fast foods, for example—once a person is weaned by “poverty” from high-salt, high-fat, high-sugar packaged and fast food.

People will have more free time in “poverty,” and they will then have the opportunity to do all the “good, creative things” they could never do when on the treadmill of middle-class “wealth.”

Some of my readers criticize what they see as a moralistic pleasure in the decline of the so-called “comforts” of middle-class American life, but I believe it is merely practical. Being overweight, addicted to pills/painkillers, eating wretched “food” you wouldn't in good conscience feed your pet, addicted to mindless, destructive videogames and TV and unable to do much for yourself in the real world does not seem appealing, regardless of “wealth” or income.

Q: *You're strongly critical of fiat currencies as a medium of exchange. Do you see community currencies or a sophisticated barter system playing a greater role in American life?*

CHS: I see the potential for local “scripts,” bartering currencies and international trading currencies based on either gold or on a basket of commodities such as oil and gold. In other words, we may see parallel systems rise alongside the current fiat national currencies.

Locally, there are already movements afoot in the U.S. to establish “scripts” that can be earned and traded for regional goods and services; while I am no expert, others see these as legal arrangements because the script is not currency.

Internationally, the gold ETF (exchange-traded fund) GLD probably has enough gold in its vaults to back an international trading currency, which could be used for transactions in which dollars (or any other paper currency) are no longer desired. In other words, the commercial interests of the global economy might establish a completely private currency for trading purposes.

trouble begins. Congress won't be able to tap the Fund to cover expenses, which will result in additional public spending, increased deficits and a greater percentage of our gross domestic product (GDP) allocated toward servicing our nation's mounting debts. Moreover, by the time that Generation X gets ready to retire, the Trust Fund may be exhausted.

Medicare, another program for retirees, is in even worse shape. The health insurance program is primarily funded through payroll deductions and insurance premiums, with the remaining revenue socked away in a trust fund. However, the skyrocketing health care costs of current retirees, massive fraud and other problems are pushing the program to the brink of insolvency. The program is currently paying out more in benefits than it takes in revenues, and the Medicare Trust Fund is expected to be exhausted as early as 2019—but this could come even sooner due to shrinking tax revenues and other complications.¹⁰

Although expert estimates vary, at the very least we can expect an overall debt burden somewhere in the ballpark of \$50 trillion to cover projected future retirement outlays.¹¹ Obviously the impending retirement crisis will pose a difficult challenge to a cash-strapped nation and the clock is already ticking. While there may still be time for reform, if we don't act soon, we may be sleepwalking into a period of severe economic instability characterized by massive government debt, exorbitant levels of taxation and a lowered standard of living. When the government is harnessed by debt, a reduction in critical services may also become a serious consideration. One must also keep in mind that America's economic standing will become that much more vulnerable to any sort of economic shock like war, severe natural disasters or serious fuel shortage.

The Oil Dilemma

OIL HAS OFTEN BEEN LIKENED TO OXYGEN: WE DON'T GIVE IT MUCH thought until the supply starts to run out. When oil prices soar, it seems difficult to ignore how much of modern life is directly linked to cheap and abundant fuel. We don't just burn it up driving on the freeway; an estimated 90% of all organic chemicals we use—like plastics, pharmaceuticals and fertilizers—are derived from petroleum.¹² Even the food we eat requires large amounts of fuel now that modern agriculture has become increasingly reliant on fossil fuels in order to run irrigation systems, for pesticides, and for shipping crops to market. For this reason, the belief that the world's largest oil fields are becoming dangerously depleted has become a serious cause for concern.

There is only a finite amount of oil we can extract from the earth—roughly two trillion barrels—and our problems will truly begin when the industrialized

CHARLES HUGH SMITH continued

There are also moves to create regional currencies in Asia and the Arabian Gulf that might be backed by a basket of commodities. Any of these currencies, if truly backed by oil or gold, would quickly find favor among those seeking to retain the purchasing power of their assets.

There is no reason such transnational currencies couldn't find favor locally as well. We might even see three prices for desirable goods: one in dollars, one in local script and one in quatloos (a gold or oil-backed currency).

Q: *We are often told that consumer spending is the only way we can keep the economy afloat and maintain our current standard of living. What would transpire if millions of Americans were to tear up their credit cards?*

CHS: In essence, that is what we're seeing. People are sensing that they will have to rely at least partially on their own means rather than count on government to provide pensions and health care. The reduction in debt and debt-fueled spending is re-ordering the economy—in terms of shrinking the economy, we call it a depression. But a shrinking GDP is not necessarily a destruction of happiness if we re-order the economy.

Ideally, we will replace an oil-dependent, exporting financial “instruments,” importing cheap-goods consumerist economy with one that spends \$10 trillion or so replacing the oil-energy complex with a new energy-efficient, non-fossil fuel economy. Abundant, reasonable-cost energy will make all sorts of other problems easier to resolve. High-cost, shortage-prone energy will make solving all the other problems more or less impossible.

When oil is \$30/barrel, few see a need for a new energy economy; when it's \$300/barrel, everyone will be wondering why we waited until the last minute to take concerted action.

Q: *Peak Oil remains a subject of contentious debate. Do you see any sort of consensus emerging anytime soon?*

world has reached the halfway point, or what is called “Peak Oil.” If we look upon global oil production as a bell curve, when we reach the peak or mid-point, the amount of available oil will begin to diminish with each passing year. Moreover, production will become more costly and difficult as existing reserves become exhausted and the crude becomes more difficult to extract from the earth.

There are severe economic consequences to such a development. Peak Oil theorists, who believe that we will reach this crisis point sometime within this decade, predict that gasoline would top \$8 a gallon and that food shortages could ensue, because of disrupted supply chains and a shortage of petroleum-based fertilizers. The market for inexpensive imports from China and Japan would vanish due to increased shipping costs, and some of the more pessimistic even believe that U.S. cities in locations that experience extreme weather conditions could become uninhabitable due to exorbitant heating or cooling costs.

Peak Oil theory is based on the predictions of the late M. King Hubbert, a Shell Oil geophysicist and world-renowned authority on the world's petroleum reserves. In the mid-1950s, the native Texan trained his formidable intellect on a single goal: determining the production capacity of America's oil fields. Deploying the time-tested methods of population biologists, who measure how populations affect the sustainability of natural resources, along with a mathematical model based on existing oil reserves and the average rates of production and consumption, Hubbert detected a distinct downward trend in how oil is extracted from the earth. At first production flows smoothly and then, over time, it peaks, and production rates slow down until existing supplies are exhausted.

Although he was initially ridiculed for his 1956 prediction that U.S. oil production would begin declining after 1970, Hubbert's estimates proved to be uncannily accurate. During the Nixon era, American oil companies topped out at over nine million barrels per day, and American oil extraction has been in decline ever since. Hubbert's methods (and other measures) have been applied to the world's existing oil fields by a new generation of scientists. While we have yet to see a serious consensus, a number of experts are growing concerned that the Age of Oil could be entering its final climactic stage.

This is not to say that there aren't skeptics. Some geologists base their estimates on the total amount of oil currently in the ground divided by the rate of consumption, which is known as the Reserves to Production or “R/P” ratio. Using this method, it is believed that industrial societies will enjoy an additional forty to a hundred years of available oil. Peak Oil detractors also point out that advanced technological methods for extracting oil, the growth and evolution of alternative fuels, and various changes in human behavior may

CHARLES HUGH SMITH continued

CHS: Yes—when depletion of the supergiant fields in Mexico, Saudi Arabia and elsewhere finally lower supply irrevocably below demand. That moment when denial ends and consensus solidifies will occur once the recent spate of new production ceases adding new supply to offset the declines in the supergiant fields which supply about half the world’s oil.

Then denialists will pin all their hopes on natural gas, but that has the same depletion curve as oil—as do coal and uranium, dashing the hopes of those pinning all their hopes for cheap and abundant energy on gas, coal or nuclear power. There will certainly be roles for fossil fuels and nuclear power in the future, but the era of cheap, abundant oil is over, and the era of cheap, abundant natural gas and coal is also ending. Once oil and its equivalents cost \$300/barrel in today’s dollars, then the alternatives will look cheap.

Many poorly-informed pundits are fond of extolling North America’s unlimited shale oil and tar sands, but a little research reveals that these require staggering amounts of natural gas and water to process, and they leave hundreds of square miles of wasteland in their wake. Even worse, experts suggest that these “alternative fossil fuels” will top out at about three million barrels a day in actual practical terms—about 15% of the twenty million barrels of oil the U.S. consumes each day. The real “pie in the sky” energy source isn’t solar energy—it’s shale oil and tar sands.

The problem is that scaling up alternatives and making our society energy-efficient will cost a stupendous amount of money. If we’re spending much of our capital buying oil for \$300/barrel, then there is that much less capital available to construct an alternative energy complex.

The sad irony is the consensus on Peak Oil will finally form after it’s too late to replace it without major sacrifices. •

alter the inexorable and often doom-laden Peak Oil hypothesis. Economists also point out that once oil becomes too costly, there will be financial incentives to devise alternatives that will forestall any serious crisis.

Unfortunately, the transition won’t happen overnight. MIT geologist David Goodstein believes it will take “years, perhaps decades to replace the vast infrastructure, distribution and consumption of the products of the twenty billion barrels of oil we Americans alone gobble up each day.”¹³ Meanwhile, America is also being outflanked by rising nations like China in the worldwide scramble to exploit the world’s petroleum reserves. Moreover, oil-producing nations that oppose U.S. policies—like Russia, Iran, Venezuela and others—are making overtures to fuel-thirsty rising economic powers like China and India in the hopes of limiting American influence among the world’s oil-producing nations.

The volatility of oil markets, instability caused by America’s diminishing role among oil-producing nations and the possible onset of Peak Oil could greatly impact American economic life in the immediate future. The modern economy has long been based on the assumption that inexpensive oil will long remain the prevailing norm. Moreover, when we take into account the looming issue of global warming, a radical change in our current energy policy seems inevitable. Whether the scenario envisioned by Peak Oil theorists is a certainty or a rough draft of the future depends on many variables that are difficult to predict. However, we can be certain that the issue of energy dependence will profoundly impact the American economy for years to come.

Entering the Unknown

WHAT WE HAVE RECOUNTED ABOVE ARE THE PRIMARY SYMPTOMS OF Depression 2.0: a woefully mismanaged currency, runaway government spending, real estate and financial markets debilitated by speculative excess, and a slow-motion energy crisis. Nevertheless, it is well worth keeping in mind that people have been predicting the untimely demise of the U.S. economy for a number of years, yet the American marketplace possesses an almost supernatural resilience. While it is tempting to make comparisons with the Great Depression of the early 20th century, it is worth bearing in mind that we may have a decisive advantage over our 1930s counterparts.

The Americans of the early 20th century didn’t possess the tools we have at our fingertips. Today it is far easier to start a business, sell a product, market a new invention or merely solicit assistance than it was over half a century ago. The advent of the internet and the many social networking programs available are valuable assets that will prove vital to us in the immediate future. However, this is not to say that we can’t learn an important lesson

from America's greatest generation. As the Great Depression took its toll, and millions of Americans faced unprecedented poverty, many communities across the country mobilized and worked together forming barter networks, giving to charity, volunteering or simply helping out neighbors in need. This admirable tradition will play an important role in surmounting the difficulties of Depression 2.0. •

Notes

- 1 Weatherford, Jack. *The History of Money*, (New York: Three Rivers, 1997), p. 185.
- 2 Ibid., p. 186.
- 3 Fallows, James. "The \$1.4 Trillion Question," *Atlantic Monthly*, January/February 2008.
- 4 Congressional Testimony, March 6, 2000.
- 5 Morgenson, Gretchen. "Dow Surpasses 11,000 as Base of Rally Grows," *New York Times*, May 4, 1999.
- 6 Kelleher, Kevin. "Flashing Back to NASDAQ 5000," *TheStreet.com*, March 10, 2005.
- 7 Fleckenstein, William A. *Greenspan's Bubbles: The Age of Ignorance at the Federal Reserve*, (New York: McGraw-Hill, 2008), p. 55.
- 8 Ibid., p. 87.
- 9 Hagenbaugh, Barbara. "Consumer Debt Loads At Record," *USA Today*, March 17, 2004.
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- 11 Muhleisen, Martin and Christopher Towe, (eds.) *U.S. Fiscal Policies and Priorities for Long-Run Sustainability*, International Monetary Fund (IMF) Publications, January 7, 2004.
- 12 Goodstein, David. *Out of Gas: The End of the Age of Oil*, (New York: W.W. Norton & Company, 2004), p. 15.
- 13 Ibid., p. 18.