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Savings Limits

Save and invest, month in, month out--it sounds like a grind, especially now, when many Americans are cutting back and saving more for retirement. At it ***is*** a grind, but if you turn it around, you realize that just being allowed to save money and keep for yourself some of what you earn is ***a privilege that not everybody enjoys***.

A case in point is the North Koreans, our neighbors to the west, who are now participating in a government-sponsored currency exchange program. All citizens of North Korea will be required to trade in all of their savings--that is, the bills and coins that they have collected from private activities like sewing clothes or growing food in their back lawns. These savings are always in the form of actual money, kept in jars or boxes, because the Korean banking system doesn't take individual deposits the way banks do in the U.S., and there is no stock exchange for local citizens--or, of course, access to global investment opportunities.

At the end of this month, the old North Korean money will no longer be accepted anywhere. It must be traded for new bills which depict the log cabin where the Dear Leader and former Communist strongman Kim Il Sung was born.

Here's the catch. Each family will only be allowed to exchange 100,000 won--the equivalent of about $30. That, astonishingly, represents the most any private citizen will be allowed to have in total savings after the exchange, no matter how much they had before – pretty unbelievable.

This is a great time to consider how lucky we are to live in a country where we are encouraged--and allowed--to save and invest for our future. Nobody will ever knock on our door and tell us that after a lifetime of work, the money we have set aside is no good anymore--except 30 dollars, or roughly the amount it costs to buy a large bag of rice. Compared to that, the grind of saving has the sweet taste of freedom.

Breaks for Buyers

Lately, Congress has been obsessed with encouraging people to buy houses. The Economic Recovery Act of 2008, the American Recovery and Reinvestment Act of 2009 and the Worker, Homeownership and Business Assistance Act of 2009 all included tax credits for people who buy a home, each one more generous than the last.

The most recent credit, passed last November, would give any person who hasn't owned a home for the past three years a tax credit equal to 10% of the purchase price, up to $8,000, so long as 1) the contract is signed before May 1 of this year and 2) the buyers subsequently live in the house as their principal residence for at least three years.

Of course, this is all subject to income restrictions. The full credit is available to single taxpayers with income of less than $125,000; joint filers earning up to $225,000; it phases out altogether at incomes above $145,000 and $245,000 respectively.

There's a smaller $6,500 credit for anybody who has owned and lived in the same home for five consecutive years during the eight years before buying a new residence. This credit might be appropriate for families who are looking to move into a larger home, or retired persons who might want to downsize their residence. (They, too, must live in the purchased house for the next three years in order to claim the credit, and the same income restrictions apply.)

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Mind you, these are all moot points for most of us, because foreign property is totally excluded from theses tax breaks.

There seems to be a rule in Congress that no tax initiative can ever be simple. To qualify for the credit, you can't buy a house from a relative, and you can't claim the credit if you can be claimed as a dependent on another person's tax return. The buyer or buyer's spouse must be at least 18 years of age, and the price of the home being purchased cannot exceed $800,000--which won't be a problem for people living in Youngstown, OH (median home price: $70,700, according to the National Association of Realtors) or Saginaw, MI ($61,400 median price), but might cause discomfort for some people living in San Jose, CA ($566,000) or White Plains, NY ($450,000). Another complexity: if you qualify for the credit, you can claim it on your 2010 tax return, or jump in the time machine and and claim it on your 2009 return.

If there is more than one buyer, and they are not married, the IRS allows them to give the full credit to whichever buyer qualifies for it. Thus, parents who earn more than the threshold income can buy a house for their son or daughter. If the kids pay something toward the purchase price, they'll be able to claim the full credit on their tax returns.

If you extend this trend a year or two, it's easy to imagine that eventually Congress will be buying everybody a nice house with taxpayer dollars. But is further stimulus necessary? Mortgage rates are near record lows, and home mortgage interest is still deductible. The National Association of Realtors, which tracks home sales, found that existing home sales were up 5% in 2009 over 2008; overall market activity is up 21% from the bottom. According to statistics from the Department of Housing and Urban Development and the U.S. Census Bureau, a supply of 7.2 months worth of new homes is available for purchase--close to the 6 month level that is normal for a healthy market. The average sale price dropped 12% last year, but gained 1.5% in December, which means your home may finally be gaining in value again, as buyers finance their purchases with tax dollars.

Hopefully they are not increasing the distortions in the housing market – distortions that need to be flushed out before things can get back to normal.

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The Terrorist Legacy

Conventional wisdom says that the terrorists were beaten back after 9/11 and ultimately lost their bid to disrupt or terrorize the United States. There have been no major incidents of violence in the US since that time (or Japan). But a recent column in The Economist magazine suggests that the terrorists may have won more than we realize. In addition to the hassle of removing your shoes, coat, gloves, hat, jacket, wallet, keys and belt at the security line at the airport, you also may be losing prosperity.

How? The magazine notes that in 2001, before the attack, 28% of all students who studied abroad did so at American universities. By 2008, that figure had shrunk to 21%. Foreigners and immigrants make up more than half of the scientific researchers in the U.S., and typically 60% of the post-doctoral students doing top-level research are foreign-born. But lately, the ordeal of getting a visa is prompting many of those brainiacs to take their ideas elsewhere. The article also says that organizers of international scientific conferences are increasingly reluctant to hold them in America, because it takes so long for the immigration service to approve short-term visas. An unrelated survey commissioned by the global travel industry found that the entry process into the U.S. was rated the most rude, unpleasant and intrusive.

The article offers one more thing to think about. A study by researchers at UCLA modeled the economic impact if immigration laws were made more welcoming. This is not likely, it said, because immigration officials live in fear of admitting the next Mohammad Atta, and because there is no penalty for excluding the next Einstein. The researchers assumed that Congress would create an immigration policy that would make it possible for some 12 million illegal immigrants already in the country to earn legal status and eventually citizenship--and pay taxes. And, second, they assumed the rigid cap on the number of visas issued to foreign citizens would be replaced by one that takes into account what the American labor market needs.

These two changes, the study estimated, would raise America's gross domestic product by $1.5 trillion over ten years--and that, the article suggests, ought to be counted as the

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price exacted by the terrorists. It says that the current immigration system, a result of policy changes in the wake of 9/11, is a recipe for stagnation, and poses a serious threat to America's status as the top nation of the world--which may have been the goal of the terrorists all along.

Fiduciary No More

In financial planning there is something called a "fiduciary standard", and most serious financial planners believe it is the very best framework for professionals to work with their clients. That's why we're so angry over something that happened in the Senate two weeks ago: Senator Tim Johnson of South Dakota inserted an amendment into the new regulatory reform bill--and, with the casual stroke of a pen, eliminated an important and powerful consumer protection.

This amendment cuts out a part of the original bill that would have required everybody who gives investment advice to the public to act as a fiduciary. Senator Johnson wants the Senate to "study" the issue instead.

Why should you care?

The fiduciary standard is a legal concept, but its core idea is not complicated. To act as a fiduciary means the professional has to put aside his own financial interests, and also put aside the business/financial interests of any company he works for, and give recommendations that are solely and completely in the best interests of people like you, our customers or clients.

In other words, our recommendations have to be made with only one question in mind: is this the best thing I (the professional) can do for you? Given what I know about who you are and what you want and need, as a fiduciary, that is what I'm supposed to do. It's commonsensical, really.

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So what does it mean NOT to be a fiduciary? Here's an analogy: imagine that there were two kinds of health practitioners in the world. One group functions much like doctors do today: they work out of independent offices, meet with you, diagnose your ailments, prescribe a medical solution that they believe is the very best course of treatment, and you pay them directly for this service.

The other group of health care providers operates somewhat differently. They're employed in the branch office of a large multinational health conglomerate which requires its employees to recommend certain treatments which are most profitable to the company, so long as these treatments are considered to be "suitable."

These might not be the best treatments, but under a set of very complicated regulations, these less-than-ideal prescriptions are deemed to be legally-defensible ways to address certain medical problems. These other health care providers are paid by the company according to how many of these treatments they can sell.

Now imagine that these larger companies, because of the very high profits they're making on these treatments, are able to gain a lot of influence over the process that decides which treatments are "suitable." In fact, their executives sit on the governing board of the organization that makes these determinations.

Finally, imagine that something went horribly wrong. Several of the most popular treatments that these non-fiduciary medical professionals were eagerly peddling to their "patients" were not at all as their companies had portrayed them. The result: catastrophic consequences, pain and suffering throughout the world. An enormous mess.

To bring the analogy back to the financial world, these terrible treatments (investments) actually DID bring the global economy to the brink of financial collapse, a mess that required our taxpayer money to fix. These companies had become so entwined in the system that the government had no choice but to help them recoup the staggering losses they brought upon themselves.

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Not surprisingly, an outraged public demanded that this must never happen again. To the real fiduciary practitioners, the solution is obvious: require everybody to act in the best interests of their customers/clients by imposing a fiduciary standard. No more shady "suitable" treatments.

We were encouraged when Congress drafted legislation which, among other things, would bring every provider of financial advice under a fiduciary standard.

So here's why professional financial services providers are angry. Now that the catastrophic global meltdown, TARP, massive losses in the stock market and the longest recession since the 1930s is beginning to fade from memory, those companies that provide "suitable" non-fiduciary advice have gone back to business as usual--and very quietly, a Senator from South Dakota has now inserted a provision into the reform bill saying that instead of imposing this fiduciary requirement, that instead Congress will "study" the issue.

The Senate has decided to leave fiduciary out of the final bill. Even the Wall Street Journal is outraged--here's a link to a strongly-worded column that clearly explains what happened: http://online.wsj.com/article/SB10001424052748703940704575089413832399630.html

And here's a link to another article which talks about how the legislative process favors the organizations that take the most money out of the pockets of their customers: http://www.financial-planning.com/fp_issues/2010_1/angels-and-demons-2665124-1.html

It would be nice if everybody called their Senator and Congressperson and said that they were just as angry as we are in the professional community. A groundswell of public opinion might make our elected representatives understand that we haven't forgotten TARP and all the rest of it. Right now, the only people lobbying on your behalf are the professionals themselves, and there apparently aren't enough of us to get the attention of the Congressional representatives who may be looking out for their own interests more than ours.

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Budget Alarms

If you've been watching NHK lately, or following the global credit crisis in the Japan Times, you've probably been hearing a lot about Greece, and before that about Dubai--two countries that have been in danger of defaulting on what economic talking heads call 'sovereign debt,' which basically means their country's equivalent of Treasury bonds. Dubai's problem was $26 billion in debt issued by Nakheel, its most prominent real estate developer, which was tacitly backed by the government. Order was restored last December when neighboring Abu Dhabi provided Nakheel with a $10 billion loan. Greece, meanwhile, has $28 billion in government debt due in April and May, and as you read this, the European Union is debating when and how to come to its rescue.

What you probably aren't hearing is that Portugal, Ireland, Italy and Spain are having similar troubles, and that in all cases, the problems were visible, and warnings were raised by economists, years before the budget crises came to a head. According to a report by The Economist, Greece's debt is now up to 112.6% of its gross domestic product. Ireland's is 65.8%, Spain's is 54.3%, Portugal's is 77.4% and Italy's is 114.6%. What makes Greece stand out is that suddenly foreign buyers are shying away from its government securities, sending the yield on ten-year notes soaring to 7.1%, and raising the cost of rolling over the debt--sending deficits even higher.

This, of course, is exactly the fear that haunts U.S. economists: that at some point, the world's bond buyers will lose confidence that America will ever get its debt situation under control. It also may be one of the underlying fears among people who attend the Tea Party rallies around the country. The real deficit problems in the U.S., however, are not found in government spending, per se, but the amount of money promised to future retirees in various forms. Lately, various financial planning conferences have heard presentations by David Walker, former head of the U.S. Government Accounting Office, now president of the Peter G. Peterson Foundation. Walker gives a terrific speech on how America is executing a ***reverse transfer of wealth*** from the younger generation and unborn to the Baby Boom generation. He

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stresses the exact point that economists had been stressing in Greece for twenty years before the meltdown: that the longer we wait to solve the problems, the more likely we are to face an unsolvable crisis.

Perhaps the easiest example to understand is Social Security, which was enacted during the Great Depression, at a time when the average person's lifespan was 65. Sixty-five also happened to be the normal retirement year, which meant that most citizens collected no Social Security benefits at all; only those who lived an unusually long time would get back the money that was collected into the government retirement system. Fast-forward to today, when the average U.S. life expectancy is 78.2 years, and it is not uncommon for people to live to age 100. The same is true of Medicaid; when it was enacted, people were expected to receive benefits for a year or two, not additional decades. In all, according to "The Complete Idiot's Guide to Economics," 23% of the U.S. budget is spent on Social Security, 12% on Medicare, 7% on Medicaid; recently, Congressman Randy Forbes estimated that mandatory entitlements now represent 62% of all federal spending. Wealth is essentially flowing in the opposite direction than it normally should; normally wealth is passed down from older to younger generations.

Greece never went through anything like the current wave of Tea Parties and activism. This may be a chance to channel all the anger over budget deficits into a real solution. But, as we are learning from European countries that spent too much for too long, the solution is not anger or warnings, but concrete action that addresses the real sources of fiscal imbalance--and perhaps most importantly, a willingness to sacrifice our way back to a balanced budget. Walker proposes means testing for Social Security recipients, arguing that it makes no sense to send government checks to billionaires. That makes sense, but whoever has paid into the system should at least be able to get their money back, regardless of their income bracket. The government will have to ration health care and put it back on a budget. Walker tells people what you already know, what Greece and some of its neighbors are learning: it doesn't work any differently for governments than it does for people; the numbers are just a lot bigger.

Tax Bill Demonstrates That Social Security Benefits are at Risk

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On Dec. 15th, the President signed H.R. 4218 - The No Social Security for Prisoners Act of 2009. Upon reading the bill, it states (in part) that it's purpose is to "prohibit retroactive payments" to individuals who are incarcerated. Either this bill is intended to eliminate some perceived loophole in the current law or it is intended to prohibit social security benefits from being paid to felons. Either way, it is a reminder that the payment of Social Security benefits is at the discretion of the U.S. Congress. Benefits can be cut in a hundred devious ways -- such as eliminating benefits for felons. If Social Security was really an insurance program, no insurance company would be able to unilaterally decide to stop payments to people in jail.

Lost Offshore Taxes: A Curious Dichotomy

Senator Levin and others claim that the U.S. is losing $100 billion in annual tax revenues because of international tax havens and offshore tax fraud by Americans. But the pending Tax Extenders Act includes most of Obama's proposed offshore tax reform changes with an estimate of collecting about $8 billion over a period of ten years. And now a proposed jobs creation bill also includes similar international tax reform provisions that are claimed to raise $7 billion from a crackdown on international tax cheats. Let's see now...we are losing $100 billion per year, but the jobs bill only proposes to collect about $7 billion. I wonder why they aren't predicting they will collect $300 billion??

A Really, Really Long List of 2009 Proposed Tax Legislation

While doing some research, I stumbled onto a web site that seems to include a list (with links) to all of the various tax bills that have been introduced in 2009. And it is a HUGE list. Considering that the number of the extender bill is 4213, it's logical that there must have been about 4,212 previous bills. That works out to about 9.6 bills for each member of the House of Representatives during 2009. And if you assume they are in session for 250 days a year, that would work out to 16.8 bills per day. (I'm not sure how many days they take off but I don't think they are in session for 250 days a year.) Out of all those bills, it seems that only 11 were passed in 2009. For a list, go to the bottom of the page at GovTrack.com.