The Economic Crisis: 
*Is there a Middle Ground?* II

*Economic Development Council 2013 Winter Conference, 2/5/13*

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Major points

(1) Problem: Massive debt in all sectors

(2) Cause: Bank de-reg in 1999, overleveraged
   Same as in the depression
   Additional factors including energy

(3) Consequences: Stagnant eco lasting 10 yrs or more
   Until heavy debt is paid down
   Another recession near by
   Unemployment lingering
   Political melt down
#1: How We Got Here: Financial Mismanagement & Meltdown

*Financial Crisis Commission, January 2011*

1. Failure by two administrations
2. Corporate mismanagement
3. Heedless risks by Wall Street
   - $40 in assets, $1 in capital
   - Shoddy mortgage lending
4. Failure in government regulations
   - Failed capital restrictions
## Banking Industry Leverage Example

<table>
<thead>
<tr>
<th>Total invest</th>
<th>% down</th>
<th>Bank Invest</th>
<th>Indiv invest</th>
<th>Bank Profit(1%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. $200,000</td>
<td>50%</td>
<td>$100,000</td>
<td>$100,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>2. $400,000</td>
<td>25%</td>
<td>$300,000</td>
<td>$100,000</td>
<td>$4,000</td>
</tr>
<tr>
<td>3. $1,000,000</td>
<td>10%</td>
<td>$900,000</td>
<td>$100,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>4. $2,000,000</td>
<td>5%</td>
<td>$1,900,000</td>
<td>$100,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>5. $5,000,000</td>
<td>2%</td>
<td>$4,900,000</td>
<td>$100,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>6. $10,000,000</td>
<td>1%</td>
<td>$9,900,000</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
</tbody>
</table>
“Have Done Little to Prevent a Repeat of These Events in Near Future”
– Thomas Hoenig, President, KC Federal Reserve Bank, Summer 2011

<table>
<thead>
<tr>
<th>Year</th>
<th>Commercial Banks</th>
<th>Largest</th>
<th>Control Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913</td>
<td>21,000</td>
<td>5</td>
<td>2.5%</td>
</tr>
<tr>
<td>1980</td>
<td>14,000</td>
<td>5</td>
<td>14.0%</td>
</tr>
<tr>
<td>2010</td>
<td>7,000</td>
<td>5</td>
<td>60.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>20</td>
<td>86.0%</td>
</tr>
</tbody>
</table>

Several of the 20 largest nearly brought the economy down
#2. How Bad Is It?: Total Market Credit Debt

380% of GDP in 2009 ($52.3 trillion)
U.S. Total Credit Market Debt as % of GDP, 1929 – 2008

& Sector Share Breakdown

<table>
<thead>
<tr>
<th>President</th>
<th>1933 Share</th>
<th>2008 Share</th>
<th>Net Increase Amount ($T)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDR</td>
<td>24%</td>
<td>33%</td>
<td>$4.4</td>
</tr>
<tr>
<td>HST</td>
<td>7%</td>
<td>27%</td>
<td>1.9</td>
</tr>
<tr>
<td>IKE</td>
<td>51%</td>
<td>22%</td>
<td>8.8</td>
</tr>
<tr>
<td>JFK</td>
<td>7%</td>
<td>18%</td>
<td>8.5</td>
</tr>
</tbody>
</table>

Note: GSE (Government Sponsored Enterprises) debt includes various agency-backed mortgages; Source: Federal Reserve, Ben Waltemberg, The Statistical History of the United States, From Colonial Times to the Present, Morgan Stanley Research.
Level of Debt: Dominant Factor

Substantial Debt in all 4 Sectors of Economy
• Household Debt ------ Demand Side
• Corporate Debt ------ Supply Side
• Financial Debt ------ Loans and Services
• Government Debt ------ Services & Regs

No turn-around likely until paid down substantially – but at what level?
How Long Will it Last? Drop 50%?
“Consumer is Not Doing Very Well”
#3: Other Contributing Factors: What is the Government doing now?

- **Trouble Assets Relief Program (TARP):** $700 billion authorized
- **Stimulus:** $787 billion (6% of GDP)
- **$440 billion government bailout ($425 recovered)**
- **Feds printing $$$$$$$ (1.5 trillion)**
- **Federal Reserve:** low interest
- **Stalemate in D.C.** – taxes and government spending
Government Expenditures

- National Defense
- Medicare
- Health care services (Medicaid?)
- Social security
- Unemployment compensation
- Food and nutrition assistance
- Agriculture
- Net Interest

1962:
- National Defense: 49%
- Medicare: 0%
- Health care services: 13%
- Social security: 4%
- Unemployment compensation: 0%
- Food and nutrition assistance: 3%
- Agriculture: 6%
- Net Interest: 23%

1970:
- National Defense: 42%
- Medicare: 3%
- Health care services: 15%
- Social security: 2%
- Unemployment compensation: 0%
- Food and nutrition assistance: 2%
- Agriculture: 3%
- Net Interest: 25%

1980:
- National Defense: 23%
- Medicare: 8%
- Health care services: 20%
- Social security: 5%
- Unemployment compensation: 0%
- Food and nutrition assistance: 2%
- Agriculture: 15%
- Net Interest: 33%

1990:
- National Defense: 26%
- Medicare: 15%
- Health care services: 24%
- Social security: 8%
- Unemployment compensation: 1%
- Food and nutrition assistance: 2%
- Agriculture: 20%
- Net Interest: 4%
### 2010 Government Expenditures

#### 2010 Government Expenditures (in billions of dollars)

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Defense</td>
<td>693.586</td>
<td>20%</td>
</tr>
<tr>
<td>Medicare</td>
<td>451.636</td>
<td>13%</td>
</tr>
<tr>
<td>Medicaid</td>
<td>330.71</td>
<td>10%</td>
</tr>
<tr>
<td>Social Security</td>
<td>706.737</td>
<td>20%</td>
</tr>
<tr>
<td>Net Interest</td>
<td>196.194</td>
<td>6%</td>
</tr>
<tr>
<td>Unemployment Compensation</td>
<td>160.145</td>
<td>5%</td>
</tr>
<tr>
<td>Nutrition Assistance</td>
<td>95.11</td>
<td>3%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>21.356</td>
<td>1%</td>
</tr>
<tr>
<td>Other Expenditures</td>
<td>800.739</td>
<td>23%</td>
</tr>
<tr>
<td><strong>Total Outlays</strong></td>
<td><strong>3456.213</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Nominal GDP</strong></td>
<td><strong>14,657.8</strong></td>
<td><strong>24%</strong></td>
</tr>
</tbody>
</table>
Health cost for growing older

- Knee Surgery: $4,500
- Knee Replacement: $45,000
- Hip Replacement: $39,000
- Open Heart Surgery: $100,000-$200,000
- Assisted Living: $2,000-$4,000 Mth
What has the Government done in the past?
White House Data on Gross National Debt

The National Debt as a Percent of Gross Domestic Product
(Data through 2007 is from Bush’s whitehouse.gov)

- Strong Regs, Graduated Taxes, Gov Invest Programs
- De Reg, Lower Taxes, Trickle Down
- Obama

Through May 15, 2010
87.6%

- WWII
- Marshall $25 Bi 9%GPP
- Highway $1.19 Bil 32%GDP
- Kennedy LBJ
- Space $20 Bil 4%GDP
- Nixon Ford
- Oil Shock
- Carter
- Military Expans
- Clinton
- Tech Gwt
- Bush
- Housing Boom
- W. Bush
- Oil Shock
- Obama
## Top 20 Countries by GDP

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>GDP (millions of USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>—</td>
<td>World</td>
<td>62,220,000</td>
</tr>
<tr>
<td>—</td>
<td>European Union</td>
<td>15,900,000</td>
</tr>
<tr>
<td>1</td>
<td>United States</td>
<td>14,620,000</td>
</tr>
<tr>
<td>2</td>
<td>China</td>
<td>5,745,000</td>
</tr>
<tr>
<td>3</td>
<td>Japan</td>
<td>5,391,000</td>
</tr>
<tr>
<td>4</td>
<td>Germany</td>
<td>3,306,000</td>
</tr>
<tr>
<td>5</td>
<td>France</td>
<td>2,555,000</td>
</tr>
<tr>
<td>6</td>
<td>United Kingdom</td>
<td>2,259,000</td>
</tr>
<tr>
<td>7</td>
<td>Italy</td>
<td>2,037,000</td>
</tr>
<tr>
<td>8</td>
<td>Brazil</td>
<td>2,024,000</td>
</tr>
<tr>
<td>9</td>
<td>Canada</td>
<td>1,564,000</td>
</tr>
<tr>
<td>10</td>
<td>Russia</td>
<td>1,477,000</td>
</tr>
<tr>
<td>11</td>
<td>India</td>
<td>1,430,000</td>
</tr>
<tr>
<td>12</td>
<td>Spain</td>
<td>1,375,000</td>
</tr>
<tr>
<td>13</td>
<td>Australia</td>
<td>1,220,000</td>
</tr>
<tr>
<td>14</td>
<td>Mexico</td>
<td>1,004,000</td>
</tr>
<tr>
<td>15</td>
<td>South Korea</td>
<td>986,300</td>
</tr>
<tr>
<td>16</td>
<td>Netherlands</td>
<td>770,300</td>
</tr>
<tr>
<td>17</td>
<td>Turkey</td>
<td>729,100</td>
</tr>
<tr>
<td>18</td>
<td>Indonesia</td>
<td>695,100</td>
</tr>
<tr>
<td>19</td>
<td>Switzerland</td>
<td>522,400</td>
</tr>
<tr>
<td>20</td>
<td>Belgium</td>
<td>461,300</td>
</tr>
</tbody>
</table>
2010  10% Unemployment (15 million) + 7.5% part time and marginal (27 million)
#4: Other Contributing Factors: Divergence of Wealth and Income

- Economy Turns on Consumer Spending - 70% of Eco Activity
- Top 1% have 35% of wealth, gained 15% since 1980
- Top 10% have 48% of income, gained 13% since 1980
Warren Buffett “A minimum tax for the wealthy” NYT, 11/26/12

- In 1992 highest federal and payroll tax paid by 400 highest incomes in the US: Avg income, $202 mil/yr or $97,000 per hr for a 40 hr week
  ¼ paid 15%
 ½ paid 20%
  many paid 0%

Change tax law: ( $1 to $10 mil pay 30%)
(Greater than $ 10 mil pay 35%)
(Limit raised from $250k to $500k)
ACTUAL DISTRIBUTION OF WEALTH

WHAT AMERICANS THINK IT IS

WHAT THEY WOULD LIKE IT TO BE

Source: Michael I. Norton, Harvard Business School; Dan Ariely, Duke University
#5: Other Contributing Factors - Macro’s

- Interest rate (+’s, -’s)
- Exchange rate (+’s, -’s)
- Energy – high crude oil prices
- Global labor competition, declining manufacturing sector
- Exchange rate with China
#6: Other Contributing Factors - Energy

U.S. energy use projected to grow slowly and become more carbon-intensive.

Figure 8. U.S. primary energy consumption by fuel, 1980-2035 (quadrillion Btu per year)

Possible Economic Trouble Ahead if Recent Price Gains are Sustained

#7. Other Contributing Factors - Global Weather – last 3 years

**U.S. Seasonal Drought Outlook**
Drought Tendency During the Valid Period
Valid for August 16 - November 30, 2012
Released August 16, 2012

**KEY:**
- Red: Drought to persist or intensify
- Orange: Drought ongoing, some improvement
- Green: Drought likely to improve, impacts ease
- Yellow: Drought development likely

Depicts large-scale trends based on subjectively derived probabilities guided by short- and long-range statistical and dynamical forecasts. Short-term events — such as individual storms — cannot be accurately forecast more than a few days in advance. Use caution for applications — such as crops — that can be affected by such events. "Ongoing" drought areas are approximated from the Drought Monitor (D1 to D4 intensity). For weekly drought updates, see the latest U.S. Drought Monitor. NOTE: the green improvement areas imply at least a 1-category improvement in the Drought Monitor intensity levels, but do not necessarily imply drought elimination.
Global Average Temperature and Carbon Dioxide Concentrations, 1880 - 2004

Data Source CO2 (Siple Ice Cores): http://cdiac.esd.ornl.gov/ftp/trends/co2/siple2.013
Data Source CO2 (Mauna Loa): http://cdiac.esd.ornl.gov/ftp/trends/co2/maunaloa.co2

Graphic Design: Michael Ernst, The Woods Hole Research Center
Ice core data for the past 400,000 years. Note length of glacial cycles averages ~100,000 years. Blue curve is temperature, green curve is CO₂, and red curve is windblown glacial dust (loess). Today's date is on the left side of the graph.
#8: Other Contributing Factors--Political Meltdown

**1930s-1979**
- Keynesian – Counter Cyclical Approach
- TIGHT lending
- Glass Steagall Act
- Graduated taxes
- Strong labor unions
- Social programs – Medicare, Medicaid
- Structural investment programs – more govnmt
- 3 major wars

**1980-current**
- Supply side – Market approach; trickle down
- LENIENT lending
- Repealed Glass Steagall
- Lowered taxes
- Weaker labor unions
- Social programs – Added Health Care
- Less government – more market signals
- 2 major wars
Retail Sales, $billions

Source: U.S. Census

Overall

Ex-autos

CAFNR
College of Agriculture, Food and Natural Resources
Rising Unemployment Rates Will Limit the Recovery
Rising Unemployment Rates Will Limit the Recovery
Total unemployed + marginal attached + employed part time for economic reasons

Civilian labor force 155 Mil
Employed 142 Mil
Unemployed 13 Mil
Feb. 2012 bls.gov
How Bad Is It?: No Quick Recovery Likely

**Climate Ripe for Additional Pressures**

- Public & Private Debt—Banking Regs (380%-350% of GDP)
- Household debt/Income (133%-116%)
- Unemployment (10%-7.2%)
- all categories (18%-16%)
- food stamps (1 in 7)
- jobs available (1 to 4)
- wealth-income (1%-35%, 10%-48%)
- Energy –increasing prices (economic pressure)
- Interest rate-Exchange rate-labor (+’s & -’s)
- Political Stalemate (cut, spend, tax, regulate, invest)
Been There Before: High Debt and Unemployment, but Wealthiest Nation in the World by any Measure

- New Deal
- Marshall Plan
- Interstate highway system
- Space program
- Military Build Up
- Deregulations (banks), more regulations (environment), and lower taxes
Suggestion from working session:
(1) Sufficient regulations to prevent reckless lending again

• Too big to fail – has gotten bigger
• Low capital lending base
• Adequate regulations & enforcing regulators
• Dodd-Frank Bill (does it plug the holes?)
Suggestion from working session (2) Tame Program Costs

- Social Security and military get 40% of Federal budget
- Medicare and Medicaid get 23% of Federal budget
- *Decrease rate of increase*
- *Provide support to unemployed during recovery*
Suggestion from working session
(3) Serious examination of tax code

• Rebalance across households
• Direction of divergence in wealth and income
• Off-shore tax advantages
• Careful analytics on advantages and disadvantages
Suggestion from working session
(4) Balance macro’s in determining winner and losers

Careful assessment with implication nationally for:
- lower interest rates
- Lower exchange rate
- energy price implications
- exchange rates between major competitors-china
Suggestion from working session:
(5) Energy Priority program- investment for world leadership in energy production

- Well funded -- over next 20 years
- Energy Bill with spillover in related sectors
  - Provide stable, efficient, equitable energy supply meeting environmental guidelines
- World dominance in energy research
- Energy efficient transportation – all sectors
- Energy efficient – housing and corporate
- Energy efficient water and sewage

Stimulates the Economy
Optimistic that lessons learned from the past can serve as a basis for compromised middle ground

- **Option (1): Stay the Course**
  
  *Long, slow recovery until around 2018*

- **Option (2): Find a Balance**
  
  *Accelerate the recovery*
  
  - Invest – Ike level support for energy bill
  - Regulations/Deregulations – trade, banks, energy
  - Budget balance-Cut & spend
  - Tax code examination
  - Balancing macro’s- interest rates, exchange rates, trade

- **Analytics: 30-50 Year Footprint**

- **Cost Benefits for Longer Run Payback** – like models used in ag policy analysis
  
  - Across all four sectors – 4-legged stool
Major points

(1) Breaking loose: Requires massive eco recovery plan
   -Similar to several used by previous presidents

(2) Political Balance: -leaning too far in the chicken little-sky is falling direction
   -wealthiest nation in the world by several measures

   -can afford a well balance economic recovery program that stimulates all 4 sectors

   -other things need tightening-

   -China is using eco recovery plans to sustain employment, lesson learned from US policies
Understand the Problems:
First Step in Finding Answers

• Not in a recession
• Not in a depression
• Stagnant – not moving for several years
• Look back to look forward
• Stimulating territory for current opportunities
• Like to hear- your thoughts
  -what can you do?
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• 573 999 6035