The Economic Crisis:  
*Is there a Middle Ground? III +*

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**Comments on the Economy:**  
Macro Indicators Based on Work in Progress

*Most severe recession since 1930s*  
• *How we got here:* Contributing factors  
• *How bad is it?:* Consequences  
• *How long before recovery*  
  • Current policies – lock down  
• *How to speed up recovery:* What can we learn from the past?  
  • Room for middle ground?  
  • 11 recessions since 1950
Level of Debt: Dominant Factor

Four legged stool: Level of Total Debt
• Household Debt
• Financial Debt
• Corporate Debt
• Government Debt

*No turn-around likely until paid down substantially – but at what level?*

Other Contributing Factors

• Consumer: 70% of economic activity
• Excessive unemployment
• Wealth and income distribution
• Increasing energy prices
• Macros: interest and exchange
• Global weather extremes
• Dueling philosophies – locked
• Where is the compromise?
  • Cut, spend, tax, invest, regulate
#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

How Bad Is It?: Total Market Credit Debt

380% of GDP in 2009 ($52.3 trillion)

*Figure 1: This chart compares total debt (or "credit") in the U.S. to GDP (or Gross Domestic Product) on percentage basis. Current total credit-market debt stands at more than 340 percent of total GDP.*
“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
Neil Barofsky, Special Inspector General for TARPS (Troubled Asset Relief Programs)

“The same ‘too-big-to-fail’ firms that nearly brought down the U.S. financial system in 2008 have become more interconnected and continue to maintain an unfair advantage over small competitors.”

-- Neil Barofsky, Special Inspector General for TARP, commenting on the state of the U.S. financial system on his last day as Inspector General (Wall Street Journal, March 31, 2011)

Rising Unemployment Rates Will Limit the Recovery

Unemployment Rate 2007 Monthly Average

Source: Bureau of Labor Statistics
Rising Unemployment Rates Will Limit the Recovery

Unemployment Rate
2008 Monthly Average

Source: Bureau of Labor Statistics

Rising Unemployment Rates Will Limit the Recovery

Unemployment Rate
2009 Monthly Average

Source: Bureau of Labor Statistics
#2: Other Contributing Factors: Distribution of Wealth and Income

- Economy Turns on Consumer Spending
  - About 70% of GDP
- Distribution of Wealth in 2004
  - Top 10% of households own 70%
  - Middle 50% own 29%
  - Bottom 40% own 1%

80% households < 50% income

40% of Families < 12% Household Income
60% of Families < 30% Household Income
80% of Families < 50% Household Income
How Long Will it Last? Drop 50%?
“Consumer is Not Doing Very Well”

#3: Other Contributing Factors

- Interest rate
- Exchange rate
- Energy – crude oil
- Global labor competition and manufacturing
World Primary Energy Demand

Global energy demand grows by average 1.5% per year to 2030; 22% more oil, 42% more gas, 53% more coal than today

Possible Economic Trouble Ahead if Recent Price Gains are Sustained

#4: Other Contributing Factors: Mother Nature

*Droughts, floods, hurricanes, tornados, tsunamis*

How Bad Is It?: No Quick Recovery Likely

*Climate Ripe for Additional Pressures*

- 74% Production Capacity  (-10%)
- 10% + 7.5% Unemployment  (-18%)
- 1 in 7 on Food Stamps  (14%)
- Public & Private Debt/GDP  (370%)
- 70% of Wealth Held by  (10%)
- Exchange Rate (China)  (20-40%)
- Energy/Income  ($50-150; GDP -8%)
- Household Debt/Income  (116%)
- Banking Regulation  (Capital?)
Global Industrial Production at Pre-Crisis Peak but Well Below Pre-Crisis Trend

Source: Organisation for Economic Cooperation and Development.
#5: Other Contributing Factors: Government Response

- Trouble Assets Relief Program (TARP): $700 billion authorized
- Stimulus: $787 billion (6% of GDP)
- Federal Reserve: low interest
- $400 billion government bailout
- Stalemate in D.C. — cut taxes and government spending
- Feds printing $$$$$$ (1.5 trillion)

White House Data on Gross National Debt
#6: 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 Act
• Lowered taxes
• Weaker labor unions
• Social programs – Added Health Care
• Less government – more market signals
• 2 major wars

10% Unemployment (15 million)
+ 7.5% Part Time and Not Looking (25 million)
Federal Budget – Share of GDP

Option 1: Stay the Course – Banker Summary

- Deflation: “Several more years”
- Long-term decline in standard of living
- Unwinding of commercial and real estate will be painful
- Serious wealth destruction
- Lending money – doing the same thing
- Another bubble
Option 2: Lessons from the Past

- 1950-1979: 7 Recessions
- 1980-2008: 4 Recessions
- Strengths and weaknesses in both philosophies
- Take the best from both and fix the weaknesses
- Blending philosophies: “A faster way to recovery and job growth”

Been There Before: High Debt and Unemployment

- New Deal
- Marshall Plan
- Interstate highway system
- Space program
- Deregulations (banks), more regulations (environment), and lower taxes
- Blending philosophies
Blending Philosophies: What We Can Do

Public Levers Used in the Past

• Investment
• Regulate/Deregulate
• Cut spending
• Re-examination of tax codes

How can we use them for job creation?

Blending Philosophies: Ike Level
Investment – Job Creation, Energy

• Well funded energy bill is the objective over next 50 years
  • Provide stable, efficient, equitable energy supply meeting environmental guidelines
  • Next generation of research and technology development
  • New hybrid products
• Transportation – all sectors
• Green – housing and corporate
• Water and sewage
• Education and research

Stimulates the Economy
Blending Philosophies: Regulate – Reckless Lending, Job Creation

- Too big to fail – has gotten bigger
- Capital lending base low
- Regulators lax in enforcing regulations
- Dodd-Frank Bill (does it plug the holes?)

Blending Philosophies: Cut Spending – Tame Program Costs

- Social Security and military get 40% of Federal budget
- Medicare and Medicaid get 23% of Federal budget
- Decrease rate of increase
Blending Philosophies: Regulate- Tariff to Balance Exchange Rate with China – Job Creation

- Risks
- Losing industry to China
- Losing jobs to China
- Detrimental to both U.S. and China
- Pressuring both labor forces
- Kick back-Concern will ask for $$ back

Blending Philosophies: Tax Code – Job Creation

- Serious examination of tax codes – billionaire advantage
- Direction of shift in wealth and income
- Off-shore tax advantage
Top 20 Countries by GDP

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>GDP (millions of USD)</th>
</tr>
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<tbody>
<tr>
<td>—</td>
<td>World</td>
<td>62,220,000</td>
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<tr>
<td>—</td>
<td>European Union</td>
<td>15,900,000</td>
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<tr>
<td>1</td>
<td>United States</td>
<td>14,620,000</td>
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<tr>
<td>2</td>
<td>China</td>
<td>5,745,000</td>
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<tr>
<td>3</td>
<td>Japan</td>
<td>5,391,000</td>
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<tr>
<td>4</td>
<td>Germany</td>
<td>3,206,000</td>
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<tr>
<td>5</td>
<td>France</td>
<td>2,550,000</td>
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<tr>
<td>6</td>
<td>United Kingdom</td>
<td>2,259,000</td>
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<td>7</td>
<td>Italy</td>
<td>2,037,000</td>
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<tr>
<td>8</td>
<td>Brazil</td>
<td>2,024,000</td>
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<tr>
<td>9</td>
<td>Canada</td>
<td>1,564,000</td>
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<tr>
<td>10</td>
<td>Russia</td>
<td>1,477,000</td>
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<tr>
<td>11</td>
<td>India</td>
<td>1,430,000</td>
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<tr>
<td>12</td>
<td>Spain</td>
<td>1,375,000</td>
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<tr>
<td>13</td>
<td>Australia</td>
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<td>14</td>
<td>Mexico</td>
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<td>15</td>
<td>South Korea</td>
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<td>16</td>
<td>Netherlands</td>
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<td>18</td>
<td>Indonesia</td>
<td>665,100</td>
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<tr>
<td>19</td>
<td>Switzerland</td>
<td>527,400</td>
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<tr>
<td>20</td>
<td>Belgium</td>
<td>461,200</td>
</tr>
</tbody>
</table>

Can the Public Sector Afford Investment?

Total Net Worth of U.S. Households and Nonprofit Organizations 1945-2009

- 10% own 70% of $38.5T in 2009
- 1% owns 35% of $19T in 2009
- 1% owned 20% of $11T in 1980

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Understand the Problems: First Step in Finding Answers

- Still have room to work our way out
- Not in a recession
- Not in a depression
- Stagnant – not moving for several more years
- Look back to look forward
- Take the best of philosophies

Optimistic We Can Find a Balance

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

- **Option (2): Find a Balance**  
  Accelerate the recovery  
  • Invest – Ike level?  
  • Regulations/Deregulations  
  • Cut & spend  
  • Tax code examination

- **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
While You’re Thinking

Unemployment Peaks: The post-World War II jobless rate

November 1982: 10.8%
June 2009: 9.5%

Federal Budget – Share of GDP

Source: Labor Department; National Bureau of Economic Research
While You’re Thinking

2007

2008

2009

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