

US Economy...Easing on Down?

Washington peep show dominates news

Still jobs, jobs, jobs

While the entire political structure of the US Government has wrangled numbingly on over the inadequacy of its \$14 trillion debt-ceiling, little attention is being paid to the fact that America's number one problem is still jobs, jobs, jobs. Contrary to universally believed recovery expectations, the problem is recently growing. June numbers tell us that the current 58% employed population is actually below the level of two years ago. Well over 20 million of us need a job, or a better-paying one.

Jobs are not just another four-letter statistical word. Nor are jobs a mantle to be worn by politicians who are uniformly powerless to create them. Instead, jobs are the lifeblood of all developed societies. Rather than merely an additive, each job in a capitalist society is a powerful economic multiplier. Sadly, because the world's leading jobs-engine has been sputtering for almost three years and its current outlook is still soft, the volume of per capita global business transactions may actually be shrinking.

It's about the property

Other than sworn dedication to the Jobs-Cause by politicians, what must happen that will prime the complex US economic pump? There seems to be a fairly simple answer: *the heavy, overhanging inventory of unsold, reposessed, mortgaged-up residential housing must go away* in order to unlock consumption and job creation... a classic chicken-and-egg dilemma. It will happen in due course, but can the gaggle of global, debt-riddled societies that depend on its relief wait for it to unwind? We think there are two likely answers: (1) No, they can't wait. The recession among world trading partners will compound, forcing another round of business (jobs)

cutbacks, or (2) Yes, they can wait, but the disposal of unsold debt-ridden housing should be accelerated, via (more) aggressive mortgage write-downs and perhaps drastic means, such as condemnation and destruction of ruined and mostly-ruined buildings.

QE3 anyone?

IF, there is a market Armageddon, or something that appears headed in that direction for whatever reason, we assume that big daddy Ben Bernanke will once again become Money-Printer-in-Chief. Although the Fed's Open Markets Committee publishes concerns of some of its members about pending inflation, a new, general economic rescue operation (QE3) would logically take place, despite its twin, negative side effects: (1) further devaluation of the US Dollar and (2) continued commodity price inflation. Actually, a moderate round of US inflation would not be unintended. The Fed recognizes that recent circumstances have properly turned its normal garden-tending job... killing off the sprouting weeds of inflation... into a hairy DeflationBusters role. The country could surely use a horse-dose injection of housing price inflation in order to reverse the persistent tidal wave of underwater mortgages. Now would not be too soon. But the Fed is understandably circumspect about starting another dollar-printing exercise, probably because its recent QE and QE2 periods seem to have jolted the US stock market, but little else... not bank lending, and certainly not job creation. In fact, not even Wall Street jobs are safe; a fresh round of layoffs in that sector was recently announced, despite The Street's generally robust earnings and a budding, bubble-looking investor appetite for tech IPOs that looks a lot like a mini-1999.

Waiting it out

The long daisy-chain of jobs that were eventually sucked down the steep slopes of the housing abyss is too severe to mount a cyclical bounce-back recovery. An avalanche of businesses that have no direct relationship to housing and commercial construction have been deeply affected. The skittishness of their managements toward hiring people at this time is understandable. To be sure, there is significant uncertainty about the major regulatory outcomes of “reform” legislation, ranging from Dodd-Frank to healthcare. But, the fundamental cause of today’s recovery-without-jobs is the same as it was in 2003: productivity increases. Each new hire represents a significant commitment to training and other payroll costs, while temp, part-time and outsourcing (often non-US), is usually more efficient and allows management a key benefit: flexibility. In addition, there is a psychological aspect: business owners who are enjoying robust, early post-recession profitability, without hiring, just feel so elated that they tend to believe they can push productivity to unrealistic levels.

The jobs-stagnation syndrome is not only driving politicians batty, it will predictably take a heavy toll on non-Tea Party incumbents’ re-election efforts next year. And history shows that their Congressional replacements will undeservedly reap the credit for any economic recovery.

Overtime at the sausage factory

At this writing, we have no idea how the Great 2011 Washington debt/deficit rumble will finally play out, but there is increasing indication that reputationally damaged Standard & Poor’s and Moody’s, are set to downgrade the US’s credit rating from triple-A to double-A, whether or not Congress hikes the US’s imaginary debt ceiling. According to some bond investment luminaries, a downgrade would actually be welcome, because it would push US bonds to more appropriate/attractive interest yields than their puny recent level, compared to other bonds for the past two years.

President Obama and the two mega political parties have honed and tempered their partisan debt and deficit prescriptions, augmented by dozens of axe-grinding talking heads on cable TV. But, there is a

curious absence of direct reference by any of them to a comprehensive, 55-page report issued by a special (yes, “blue-ribbon”) body, generally known as the Debt/Deficit Commission, appointed by the President in February 2010. The Commission’s co-chairs were former Republican Senator Alan Simpson and President Clinton’s Chief of Staff, Erskine Bowles. The other 16 voting members were 12 current members of Congress (6 each of Democrats and Republicans), 2 corporate CEOs, a large labor union president and a former Director of the Office of Management & Budget. Their final report, issued *on schedule*, December 1, 2010 was prefaced with a disclosure emphasizing that its contents represent the product of extensive compromises by all of the Commission’s members.

The Task: The Commission was charged with developing a realistic framework for legislative action to bring the government’s bottom line to breakeven (before interest cost) by 2015. It accomplished that job with clarity and brevity. But then, the President curiously avoided mentioning the report in his January State of the Union message.

We think the report should be taken seriously, because (a) it contained reasonable specificity and timetables and (b) it was, after all, the consensus work-product of people with sharply divergent political views who are certified experts in the ropes of government. Accordingly, the following is our best effort to summarize the most dramatic elements of the report.

The sobering title page of the Commission’s report is “The Moment of Truth”; it quickly emphasizes that the time-context for action is at least urgent, if not emergency in nature. The report proposes a 6-part plan which would:

- reduce the annual deficit from an 8%-of-GDP shortfall now to 2.3% by 2015 and 1% by 2020,
- *increase total revenue to a 21%-of-GDP cap* (which is now 15%); reduce outlays to a 22% cap from the current 24% level... [probably too modest for current political acceptability], all of which would
- achieve a total deficit reduction of nearly \$4 trillion over the next ten years.

Details of any complex plan are always the wringer. The report contains a detailed *illustrative set of reforms and outcomes* (recognizing that Congress could enact a different combination and still meet the 21%/22% of GDP revenue/spending targets.) The illustration includes:

- Removing all of the \$1.1 trillion of “backdoor tax expenditures” from the Revenue Code (examples of current tax subsidies: deductions for home and 2nd home mortgage interest, charitable contributions, state/local income taxes, etc.),
- Condensing individual income tax brackets from 6 to 3 and *reducing the rates in all brackets* (max 29%), while (a) *replacing all itemized deductions with a universal standard deduction*, (b) *taxing capital gains and dividends at ordinary rates* and (c) repealing the alternative minimum tax,
- Making available a one-time 12% *tax credit* for charitable contributions,
- Lowering the corporate income tax rate from 35% to (max) 29%,
- Replacing the discontinued home mortgage interest deductions with a one-time 12% *tax credit* on a single, primary mortgage, up to \$500,000,
- Reducing Medicare payments to hospitals for medical education and uncollectible amounts due from patients’ portions of Medicare coverage,
- Enacting 7 specific adjustments to the Social Security System (presumably recommended, or endorsed by the System’s staff and trustees).

Rosy yardstick?

Everyone’s method of forecasting government revenues and outlays is logically displayed as a *ratio* to the nation’s GDP (in whatever year is being forecasted). But the all-important denominator for these ratios... *the forecasted annual GDP amounts and their assumed growth... are often unreported*; here are some of them: \$14.7 Trillion in 2010; \$18.6T in 2015 (27% growth from 2010) and \$23.1T in 2020 (24% growth from 2015). Overall, 10-year GDP growth is being assumed to be 58%. Rosy? Perhaps, but it’s certainly not “conservative”, given where the economy stands now. Robust economic

growth has in fact been the US pattern (1948 - 2000), but that past has little influence on 2010 - 2020. So, using a rosy baseline for computing impact of the Commission’s “reforms” makes it easier for the forecast to come out at the desired result with less austerity. Thus, in order to achieve its zero\$\$ deficit target in 2015, the Commission merely needed their projections to show a 2%-of-GDP bottom line improvement above the 2010 baseline (\$110 billion more revenue, plus \$267 billion less in outlays).

Conclusion

We need not impugn what may be the sincere motives and efforts of elected federal officeholders, in order to draw a generalized conclusion about the outcome of the Great 2011-12 Debt/Deficit Chicken Game. *It will likely result in another iteration of crafty forecasts and number-management wizardry, spun in the context of how things will allegedly look in 2021, as a result of changes that are mostly to be implemented years from now, by which time today’s most powerful people will have moved on and their 2011 forecasts long forgotten.* Cynical? Not really. History is telling, when outcomes depend on entrenched routines and procedures.

Footnote: a proposed lexicon ban

Below are *a few* of this year’s “poll-tested” Washington terms that we would banish, if we could, as a result of this year’s bewildering debt/deficit contest. Each of these phrases qualifies for the list because it is (a) numbingly overworked, (b) pejorative and (c) misleading:

Kick the can down the road
 Draconian cuts
 DEFAULT!!
 Small businesspeople
 Corporate jets
 Millionaires and billionaires
 No revenue problem
 Fair-share (of income taxes)