

THE UNIVERSITY OF FINDLAY

ECONOMIC SUMMIT



NEW CHALLENGES • NEW SOLUTIONS



One Inequality we must maintain

- Where are we, how did we get here, how do we escape?
- Remember those math formulas we all learned in middle school?
- It boils down to a series of simple inequalities

Where Are We?

- How do you figure out where we are? How do you take our pulse?
 - CNBC of course...who's on the air these days? Retired generals? Retired CEOs? Central Bankers, Treasury Secretaries, Economists, Beleaguered CEOs
- We are in the deepest recession the country has faced in the last 50-60 years
- Name a part of the economy that isn't troubled. Health care, Energy, Housing/Real Estate, Transportation, Food, Finance—All are in rough shape
- Consumer confidence is as low as its been since the measure was created



Why is everyone so glum? What are the facts?

- Two-thirds of the companies covered by S&P have speculative-grade or junk-rated debt
- Home values have fallen by at least 25%. Many think they will fall by at least another 10%
- While we've approved a \$700 billion TARP, some estimates have the potential credit losses at \$2 trillion
- Investors, lured to take risks by the lust of non-correlated returns discovered that nearly every asset class became correlated in 2009



How did we get here?

Here's the public story:

- Sheila Bair (FDIC Chairman):

“Trillions of dollars of investor money funded millions of mortgages that borrowers had little chance of repaying. Investors relied heavily on ratings agencies, which in turn relied too heavily on mathematical models instead of analyzing the underlying loans...the problem was compounded by the fact that those ultimately holding the risk—the investors—did not look behind their investments at the quality of the mortgages themselves”

- Geoff Colvin, “Fortune” business writer:

“Financial geniuses cooked up new ways to buy, slice, dice, reconstitute, and sell mortgages as novel securities that no one really understood but that investors were willing to buy because rating agencies—clueless, conflicted, and unregulated—said they were solid.”



What really happened?

Wall Street gets some blame, but it certainly isn't the only one to blame:

- Somewhere on the way to work and pleasure, we got intoxicated as a country. We thought that making money with easy money was the right way to make a lot of money
- We came to prize financial engineering more than mechanical or computer engineering (another inequality we got wrong) when the best minds in our country go to wall street and not main street
- Name the last entrepreneur who created something like Sam Walton created



What really happened?

The Main Street Inequality – Basic Macroeconomics

- $I - C \geq 0$; otherwise you take on debt
But Consumers re-did the inequality and then barely kept it in balance
- $I + \text{Debt} - C \geq 0$; too much debt, what happens?
- The familiar phrase: when your outflow exceeds your income, your upkeep becomes your downfall



How do we escape?

The “Please help me” path:

- Clearly the path we are on is one of increased government investment and activism. By the end of 2008, the government had injected nearly \$200Bil into the largest banks, most of it to 5 particular banks
- Policy responses have been very aggressive, in the U.S., and in other countries
- Large deficit spending is not an option long-term because of the impact to our currency and interest rates (need to raise rates to make the debt attractive to investors—when that debt is bought by overseas investors, that props up the \$, making our exports less attractive) and options to work through future crises that aren’t even visible today
- Moral hazard of this approach is risky



How do we escape?

The “best help is ‘self-help’” path:

- The brutal but sustainable truth (the best sustainable solution if these were normal times):
 - We need to get the inequality right
 - We need to produce savings, not debt
 - To produce savings we need to de-lever our personal and corporate balance sheets
 - Increased savings is good medium and long-term, but deepens the economic contraction in the short-term as consumers and corporations cease spending



How do we escape?

The realistic path (because these are not normal times):

- Laying out the two extremes makes the point: You need both:
 - We need increased government spending, investment and bailout in the short-term
 - But to have only government spending without solving the fundamental problem of “the inequality” only results in an inter-generational inequality of the greatest proportion we could imagine saddling our children and grand-children
 - As we begin to recover, we need to correct “the inequality” and motivate people to save. This will right “the inequality” and enable us to repay what we’ve borrowed. Good news: as of October, 2008 US saved \$260 bil from personal disposable income, up almost four-fold from a year earlier
 - This approach yields a higher probability of long-term sustainability, for our country and the generations that follow us
 - The side benefit is that increased savings solves many other social issues we’re going to deal with



Why hope?

- The catalyst for a recovery is always risk-taking. It always occurs at the margin. It must begin to occur among investors, lenders, and especially individuals. Lenders cannot receive billions from the Federal government (aka “you and me”) and stuff it in their mattresses
- Past recessions were times of great innovations:
 - The 1930’s brought us innovations that lead to the very strong industrialization of the US Economy (we were prepared for a war by this crisis)
 - The 1980s brought us the microprocessor and then the personal computer that led to some of the greatest productivity improvements in factories and offices. It is hard to deny the impact on our economy of creating the internet
 - What will come from this recession? I believe we will see further innovation in health care and energy. Current cost structure for US health care is unsustainable in a global economy, and current energy prices do not match the future growing global demand



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