The Economic Crisis: Can we get out of this mess?

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December 15, 2010
Questions to Answer (Nationally)

– Why isn’t the economic recovery more robust?
– Is inflation a threat?
– Has the overconsumption problem eased?
– What has caused the federal deficit?
More Questions to Answer

– What about state and local governments?
– Why was Nevada’s economy not sustainable?
– How will Nevada ever recover?
– What should we do about the state budget?
The Great “Balance-Sheet” Recession

- Recessions - less common than they used to be.
- Depressions – much less common, much longer and deeper than normal recessions.
  - A recession caused by a financial crisis
  - A “balance sheet” recession: financial wealth collapses, banks collect reserves to offset bad debt, government becomes borrower of last resort, deflation and ZIR.
Fiscal Intervention

• Economic Stimulus Act of Feb. 2008:
  – Tax rebates for 2008, estimated $150B cost (about 1% of GDP) in 2008.

• American Recovery and Reinvestment Act of 2009:
  – Estimated $800B cost over several years, with less than $200B spent in FY 2009, and $400B in FY 2010 (about 3% of GDP).
  – About 40% in tax credits, 30% in state fiscal support, and 30% in infrastructure investment (education, energy, health care), and some extended benefit support.
  – How effective was this stimulus?
Bank Bailouts

• Emergency Economic Stabilization Act:
  – TARP funds began with plan for purchase of troubled MBS, but changed to an equity purchases approach, with restrictions over executive pay.
  – $270B went to AIG, GM, Wells Fargo, Citigroup, BoA, JPMorgan Chase, Morgan Stanley, and Goldman Sachs.
  – $27B went to over 600 banks ($300K-$968M)
  – Majority has already been paid back, with interest.
Monetary Intervention

• Federal Reserve authorized:
  – Quantitative easing: purchase of government bonds, helped drive yield to zero.
  – Purchase of private mortgage-backed securities.
  – Central bank currency swaps.
  – Target federal funds rate near zero.

• QE II is currently planned:
  – “Hail Mary pass” – to prevent deflationary expectations.
Monetary Base (Currency plus Bank Reserves)
Money Stock (M2)
But inflation hasn’t been a problem yet...
Spending as a Share of U.S. GDP

Private Consumption Spending

Federal Purchases

State and Local Government Purchases

Private Investment Purchases

Trade Deficits
Answers to Questions so far...

• Why isn’t the economic recovery more robust?
  – It’s a depression, dummy. They last a while. Banks stopped lending, and people stopped building houses. But the economy did not collapse.

• Is inflation a threat?
  – No, the bigger concern has been deflation. However, the Fed must be willing to unwind the monetary base, once banks start lending again.

• Has the overconsumption problem eased?
  – Yes, consumption spending plus residential investment has fallen – though as a nation we are still spending more than we make.
The Federal Deficit and the Debt

• The Federal Debt is almost $14T, about our annual GDP ($10T in 2008, less than $6T in 2000).
• About $8T is held by private, half by foreigners.
• The current deficit is temporary due to the recession, but there are serious structural problems: tax cuts, the growth of health care costs (i.e., Medicare).
• Borrowing for investment, or in bad times, makes sense. Borrowing in good times for consumption does not – IBGYBG.
The recession and the stimulus made big budget deficit projections even bigger.

It is disingenuous at best to extend current tax cuts and complain about the deficit.
Fifty Herbert Hoovers

- State and local governments are often ignored.
- SLGs purchase more goods and services, and employ more people, than the federal government.
- Most SLGs have balanced budget requirements, which means they must either cut spending or raise taxes during recessions.
- SLG financial crises lag the rest of the economy.
Spending cuts have more effect than tax increases.

It should therefore be no surprise that when SLGs are cutting as the Feds are spending, the economy does not recover very fast.
What happened to Nevada?

- Gaming was a sustainable model, until monopoly ended.
- Las Vegas maintained growth by building new properties, but gaming/hotels/tourism still a falling share of state economy.
- Rapid construction was not sustainable: building homes for other construction workers, dependent on California bubble.
- Low educational attainment: supply and demand.
- Relatively undiversified economy: little public investment.
- State and local government revenues reliant on gaming tax, narrow-based sales tax.
Nevada lagged California, and our initial housing stock was smaller.

They came here looking for deals.

Our construction sector was the country’s largest.

Underwater mortgages:
- USA 23%
- CAL 33%
- NEV 66%
Nevada was the fastest-growing state.

We became the fastest-falling economy (a net decline of 7.2%)
Unemployment Rate
Nevada, California, and USA Average

Unemployment Rate Chart for Nevada, California, and USA Average from 1976 to 2008.
Over last decade, K-12 plus Human Services have grown from 60% to 70% of the state general fund budget. Cuts hit other sectors harder.
What is the Prognosis Now?

- Housing prices are stabilizing nationwide.
- There is still a significant inventory of foreclosures and forced sales which are waiting to go on the market.
- Officially, the recession is over, but national recovery is slow.
- Unemployment lags growth, and acts as a brake.
What about Nevada?

- Nevada appears to have hit bottom, now showing some signs of stabilizing.
- Nevada continues to lose jobs, losing people to match.
- California is adding jobs, which will help in Nevada.
- Nevada underinvests in education and public investments, and is poised for more major cuts.
- People continue to hope for one more magic bullet.
So What Shall We Do?

• Nevada is a low tax state, no matter what NPRI says. The projected budget gap is only 1% of GSP.
• Few state employees, but once paid well on average.
• Local employees paid even better, on average.
• We can trade reforms which reduce the growth of future spending in return for tax restructuring now.
• Basic state services necessary for a decent present, but education is necessary for our economic future.