



L. R. Levin Consulting, L.L.C.

Newsletter

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Are We Headed Toward Another Great Depression?

Normally in our **Newsletters**, we talk about where the economy is going over the next 6 to 18 months. We discuss the 5 most likely economic scenarios that may occur during that period and the factors you should watch for in your sector of the economy.

We are currently in the second year of the economic cycle caused primarily by the dislocation in mortgage financing. The life span of an economic cycle, when we experience a dislocation in the economy, generally is about 3 to 4 years.

It takes about that long for all immediate effects of policy decisions, government actions or inactions, and the impact of the dislocation, to play out. Normally after 3 to 4 years, the economy has reacted fully to the changed conditions.

It is important to remember that there are also long run conse-

quences to major changes in our economic structure, whether as a result of government policy, general economic philosophy or adjustments to structural change in the forces within the economy of a nation and the world. To plan your business' future, it is useful to look not only at the next 6 to 18 months, but at what the economy's structural trends mean in the long run.

Today the consensus economists are debating whether over the next few months or a year we will have a double dip recession. Looking at the current basic economic data, and where we are in the current 3 year cycle, we have suggested that the "recovery" will continue through 2011, but it will continue to slow.

That would mean we have hit bottom, plateaued, and will very slowly see slightly increasing economic activity. Leveling off with only slow growth will be transformative in how the economy will perform after 2011. Our **Newsletters** have discussed, that we are in an "H" shaped recovery, and what a "have and have not" type of recovery could mean for you.

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We have discussed many factors that could cause the economy to change course over the next 12 months, resulting in modifying which of the 5 most likely scenarios will actually play out over that period. No one can really predict which course the economy will take, for better or worse.

The fact is few economists have talked about the longer term impact of the policies the government is currently pursuing. How government reacts to the current situation can profoundly affect where we are, not only in the short run, but in 20 years.

Since our birth as a nation, the U. S. has been the one economy in the world that has primarily allowed the free interplay of economic forces to work out the future of where we go. Because of this, our economy has normally digested economic dislocations and moved on, growing stronger and providing increasing broad based economic opportunity.

Intentional governmental regulation has primarily been designed to promote, rather than retard, the freedom of individuals to make decisions that affect their future and that pro-

mote the functioning of a free market economy.

Antitrust laws, for example, were designed to prevent monopolies that restrict a free market economy from working. By allowing many small entrepreneurs to make decisions on what will work best, those that made a “better mouse trap” could have the consumer “beat a path to their door step” and the economy grew and economic opportunities were created. Given many choices, it was the consumer that decided who won and who lost.

With this type of approach the U. S. promoted effective competition, and a dynamic innovative free market system. Free markets adjust and digest the economic dislocations that normally occur from time to time during regular economic cycles.

Economic philosophy referred to this approach as a vibrant consumer driven economy based on preserving a dynamic innovative free market system. This creates economic mobility and opportunity. People the world over have yearned for the opportunity to enjoy this type of environment. We often talk about risk reward scenarios and freedom to succeed or fail.

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It may well be that the U. S. is at a cross roads where we have to decide whether to maintain a free market economy. Our future may depend upon it. *So what does our future look like, given the path we are taking?*

Right now the government does not appear to have a coordinated approach to the recovery. It deals with problems in isolation, without consideration of the long term economic impact. There is a heavy emphasis on government influencing and controlling outcomes. If we continue down the road we are following, how will the U. S. economy look in 2030?

Our strategic partner, the Institute For Trend Research (“ITR”), said recently that by 2030, it believes we may have created the perfect storm and another Great Depression! There are 5 primary factors ITR cited for this startling prediction.

These factors are 1) continuing deficits, 2) inflation, 3) increasing taxes, 4) demographics, and 5) proven economic theory. We have discussed these factors and their short run impact in many of our **Newsletters** over the past two years.

We have also often talked about what we think these factors mean for

your business both in the short run and the long run. What is surprising is that few economists have begun to talk about what current economic trends portend for the future, looking out 20 years from now and what that means to you.

Why would a coalescing of the 5 factors cited by the ITR cause it to suggest we may have a depression by 2030, if not sooner? The federal government has been spending borrowed money at a rate that has geometrically increased our *deficit*. The indications are that this is expected to continue indefinitely.

The government’s spending has not been channeled through the private sector, with its multiplier effect, as tax cuts would, nor has it contributed very much long term infrastructure. Rather than supporting the private sector, the spending has been focused on *government determined outcomes*.

Even if the most current optimistic plans were put in place after this year, the conservative projection is for an annual federal deficit of more than one trillion per year indefinitely. Most consensus economists have come to realize that this level of deficit creation is unsustainable.

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The state governments are not doing much better. Under these conditions, the interest to service the debt, even at current low rates, will grow dramatically and become the largest single item in the budget.

The need to borrow such large sums will inevitably and materially increase interest rates and substantially exacerbate the problem. High federal borrowing and interest rates will take liquidity out of the economy and increasingly inhibit the private sectors access to capital. All of this will reduce economic activity.

The reduction in economic activity will cause long term increasing unemployment and future reduction in economic activity. At the same time the added cost of borrowing will cause *inflation*. Current government policy suggests only two ways to reduce deficits, increased taxes and printing money.

Increasing taxes in a down economy, historically reduces long term revenues. The increased taxes reduce economic activity and reduce private sector liquidity. They also drive up costs and inflation. The Fed, then generally seeks to prime the economy and fund federal debt by printing money to buy government

debt. Without growth, there is no increase in real GDP to support the increase in the money supply. This further fuels inflation. Under these circumstances, the result is increasing reduction of private sector liquidity and a further slowing of the economy.

Our *demographics* suggest that we have an aging population. If the conditions described above are in place, the aging population's savings will be eroded at the very time everything the aging population needs is increasing in cost. This will further reduce economic activity and liquidity in the private sector. Given the dramatic increase in entitlements there will be a substantial increase in the requirement for government expenditures with a reducing base of workers to carry and spread the cost.

Time tested (*proven*) *economic theory* suggests that current policy, over time will result in the above scenario coming to pass. The proven result would be a complete breakdown of the free market system. The type of dislocations described above would be structural and not be self correcting. In such a perfect storm, our government and economy would effectively be bankrupt, and we would ex-

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perience the type of result, economists refer to as a “Great Depression.”

At the current rate, the ITR’s prediction that all of this could come to pass by 2030 is optimistic! The recent disagreement between the U.S. and the other members of the G-20 reflect the practical judgment of the overwhelming majority of those countries that this could happen far more rapidly than the U.S. government thinks.

Europe is beginning to experience the early stages of such a meltdown. To fix these conditions is not easy. Current U.S. policy is to redistribute the wealth on the theory that the pain will be experienced by a minority for the benefit of the less fortunate majority. But, as Churchill put it, this is merely the equal sharing of misery.

Until now the U.S. concept of a free market system has not been a class concept of “haves and have nots,” but one of opportunity and mobility that creates jobs and prosperity. When John F. Kennedy proposed broad based tax cuts to stimulate the economy and bring the U.S. out of the 1960 recession, he explained, a rising tide raises all boats. This approach is not based on taking away what others

have earned, but creating the conditions for people to improve their economic situation through creating new wealth.

This approach, based on more than 200 years of the “American Experience” reflects proven economic theory. Which path the U.S. will choose going forward remains to be seen.

Are Consensus Economists Beginning To Predict Government Policy Will Lead To Lack Of Job Growth & Stagnation?

Increasingly, consensus economists are expressing concern over government policy. In his July report, Jeff Thredgold, a noted consensus economist, sights five “major disincentives emanating from Washington DC” he believes are likely to inhibit job growth and stagnate the economy. These were 1) higher healthcare costs being imposed on the “business sector” by the new healthcare legislation,

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2) “potential ‘cap & trade’” legislation boosting business costs, 3) “sharply higher” income tax rates on business and individuals, including dividend taxes, capital gains taxes, and a variety of new taxes on investment income, 4) many states and local communities imposing greater costs on local businesses as a means of generating greater “fee” income and higher taxes to help offset declines in sales taxes, property taxes, and existing income taxes, and 5) “government out of control when it comes to budget deficits.” None of these concerns will come as a surprise to our readers.

As Thredgold states, “My simple definition of economics is ‘people respond to incentives’. The disincentives to add jobs in this country remain formidable.” What the consensus economists need to do now is focus on what this means for the long term future of our country.

The U.S. trade gap in May hit its greatest level in the last year and a half as our imports from China grew dramatically! Our trade gap grew by 4.8% to \$42.3 billion dollars. The gap with China grew to \$22.3 billion, 15% higher than the month before. This reflected the fact that China restricts, through a variety of means,

our exports to her while we do not restrict Chinese imports.

More than anything else this reflects the fact that our “stimulus” spending and policies, rather than stimulating our economy, stimulate China’s. Our **Newsletters** on numerous occasions have pointed out how programs like underwriting green energy wind turbines are so constructed that the components are bought from Chinese, not U.S. manufactures.

As a practical matter, what this demonstrates is that our deficits are financing China’s recovery rather than our own.

Last month’s unemployment report showed more than 25.8 million Americans unemployed. Of the new jobs reported, and they were few, only 28,000 were private sector jobs. Of that 28,000, 21,000 (75%) were with temporary help services. Those are the people that provide temporary help because the private sector does want to take the risk of hiring permanent employees!

If we want to put our people back to work and return to real growth, we need to return to a tried and true approach to economic recovery.

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