



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

# **Newsletter**

**November 2011**

## **Our New Format**

Many of our subscribers have requested that we change from two side by side columns to having the text full page width. They believe that will make it easier to read on a computer. Please e-mail us and let us know what you think of our new format.

## **Will State Debt Do For The United States What Greece, Italy And Spain Are Doing For The Euro Zone?**

The national debt just passed \$15 trillion dollars as the U. S. entered an exclusive club of nations headed by Japan whose national debt exceeded their annual GDP. America has always prided itself on being number one, but having our debt surpass our annual GDP is an honor we should have passed up.

The failure of the Super Committee to come to grips with our growing debt problem only highlights the current failure of government to face economic reality. The federal government is creating debt at the fastest pace in our history, with more than 41 cents of every dollar spent being borrowed. Apparently, the government has not reached the understanding that the state and federal debt levels are a “real” crisis bordering on catastrophe.

**Annual subscriptions** to our **Newsletter** are \$250.

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Instead we only see political maneuvering, with no understanding of economic reality. To understand the current economic situation, we should put the combined state and federal debt in context. Every day we see articles discussing the impact of the Euro zone debt crisis. Our stock, bond, and commodities markets have had major swings as investors assess the potential impact of the European debt crisis on our economy and banking system.

Economists have focused in turn on Greece, Italy and Spain as the three biggest problems threatening the Euro and the economic health of all of Europe. By permitting entitlements to reach proportions beyond the ability of their respective national economies to support, Greece, Italy and Spain must move to severe austerity or bring down Europe and with it, possibly plunge most of the world into another recession.

The concern is that if Greece, Italy and Spain default on their debt, it will bring down the European banking system that owns that debt. The collapse of the banks could cause a recession or depression. At best, all of Europe's standard of living will be materially reduced. As we have seen in recent days, many U.S. financial firms, including banks, have exposure to the Euro zone problems.

What economists have not focused on is how our states present a more dangerous debt crisis for America and the dollar than Greece, Italy and Spain do for the Euro zone. (See e.g. the third article in our [March 2010 Newsletter](#), "[What can We Learn From Spain?](#)") comparing Spain's economic experience with the situation our 50 states and Federal government are now facing, as well as discussing how Wall Street fails to realize that lavish U. S. entitlement programs and deficit spending will reduce our standard of living and hurt our economy.)

Today, the 50 states comprising the "United States" owe well in excess of \$4.2 trillion dollars. When added to the federal debt that brings the combined debt to more than \$19 Trillion dollars.

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The states with the highest debt include California with more than \$612 billion, New York with \$305 billion, New Jersey with \$183 billion and Illinois with \$150 billion. The economies of California, New York and Illinois are each larger than Greece.

Take Illinois as an example. Illinois just enacted a 67% income tax hike. Its revenues for 2011 (fiscal 2012) have hit a new record high. At the same time, Illinois, as of September 2011, had a reported budget deficit in excess of \$5 Billion.

The reason the deficit was only \$5 Billion was because the state was systematically not approving social service agencies, pharmacies and others bills for payment to avoid officially adding them to the past due tally. The Illinois health care agency, for instance, is sitting on about \$1.9 billion in bills from Medicaid providers, because there's no money to pay them. The projected deficit for Fiscal 2012 is \$8.3 Billion. The State's bond rating is falling and there is little indication that the State can borrow enough to pay its bills, absent a dramatic shift in pension and entitlement programs.

The state is also moving to bankrupt county and municipal governments by taking away or withholding state taxes which are due these local governments. While local governments are compelled by law to have their employees participate in state pension programs, Illinois has set the benefits for those programs out of all proportion to the funding sources available. As accounting standards evolve, technically no governmental body in Illinois will be solvent.

When states like California, New York and Illinois stop paying their bills it destroys the state's economy. In Illinois pharmacies, health care providers, hospitals, and doctors are being crippled or put out of business by the state's failure to pay the more than \$1.9 Billion it currently owes them. In spite of a 67% tax increase, Illinois will head into its next fiscal year with the largest amount of unpaid bills it has ever carried over from the previous fiscal year.

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There clearly is no appetite in the Federal government to bail out state and local governments headed for bankruptcy. In fact, the Federal government cannot borrow enough money to bail them all out.

Even if California, New York, New Jersey and Illinois were the only states to go bankrupt, the impact on the United States would be far beyond anything Europe is expecting coming from Greece, Italy or Spain. The U. S. financial system holds far more state and local bonds than they do European debt. Most major pension funds hold state and local bonds and a substantial portion of all banking institutions' capital in the U.S. is held by regulation in bank grade investments of state and local bonds.

Like the Euro, if our state and local governments began to fail, the dollar would suffer a major problem. With a failing economy in states like California, New York, New Jersey and Illinois the U.S. economy would be pushed over the brink into recession or worse.

Today, the Europeans are discussing having to issue Euro denominated bonds backed by the credit of all the members of the Euro zone, not just a single country in order to bring down borrowing costs and fund on going government operations. In Europe, to get the stable economies to issues Euro Zone Bonds, they are talking about giving those countries the power to force the failing Euro zone countries to make major cuts in entitlement.

If that is the cure, think of giving every one of our states the right to borrow using federal bonds rather than state bonds. The counter part is the federal government bailing out the states.

To avoid this, our states and federal government need to get their fiscal houses in order and entitlements under control. If, for example, the new health care law goes into effect, the added cost of Medicaid to Illinois alone, when added to the \$1.2 billion in Medicaid bills and the \$1.6 billion owed to the medical providers that care for Illinois state employees and retirees enrolled in Illinois self-

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funded group health plans will quickly drive Illinois bankrupt. How many other states are in the same position?

Perhaps before the federal government borrows that next \$2 trillion dollars currently authorized, economist should start alerting the public to where this is all going.

## Is Delaying The Keystone Oil Pipeline A National And Economic Security Risk?

The Keystone XL project is a proposed \$7 billion pipeline that would run nearly 2,000 miles to connect Canada's oil sands to refineries around Houston and the Gulf of Mexico. The pipeline could carry more than half a million barrels of oil a day.

After more than a year's review by the state department, the government announced the project would need further review, effectively delaying any decision about its construction until after the 2012 election. Canada as expected countered by discussing building a pipeline to its West coast and selling its oil to China.

The U.S. currently is dependent on the Middle East and Venezuela for a substantial portion of its energy supply. With all the talk of clean energy, absent some dramatic changes on where the U.S. obtains its fossil fuel, we will be dependent on these energy sources for the next 20 years. Any major problems in the Middle East could drive the price of oil up well above \$200 per barrel with serious effects on the U.S. economy.

U.S. Newspapers have given little coverage to the increasing terrorist pressure on Israel. Hamas has been firing constant rocket barrages from the Gaza Strip. They recently received more weapons from Libya. Hezbollah in Lebanon

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has moved 20,000 rockets into position to attack Israel. Last week Iran reportedly attempted to put a nuclear warhead on a long range rocket and is working not on tactical nuclear weapons but on weapons of mass destruction threatening Israel's very existence. With Iran, Syria, Hamas, and Hezbollah leading a drive threatening to wipe out Israel, coupled with the "Arab Fall," the Middle East is becoming increasingly unstable.

Both in the short run and in the long run, increasing our access to Canadian oil would have a positive effect. Canada is already our No. 1 source of imported oil, producing 1.5 million barrels a day. This is more than Mexico and Saudi Arabia combined. With the Keystone pipeline, Canada was planning on increasing its export of oil to 2.2 million barrels a day over the next 4 years.

The expectation is that the Keystone pipeline would hold down the per barrel cost of oil to the U.S. over the next several years. It would dramatically help to insulate us against developments in the Middle East, permitting more effective policy choices with respect to Iran and its terrorist threat as well as with respect to Russia and China. By reducing our dependence on Middle East oil and OPEC's pricing power, the Keystone pipeline would contribute to stabilizing the value of the dollar as a reserve currency.

Certainly the thousands of jobs created by building and operating the Keystone pipeline would be an immediate boost to the economy. Oil price stability would also contribute to our economic growth. The idea that the government would encourage the diversion of needed Canadian oil to China, reducing China's costs and increasing its ability to undersell the U.S. in world markets, is shocking.

Delaying or worse, possibly killing the Keystone pipeline, clearly hurts both the economic and national security of the U.S.. It is one more government step toward economic stagnation.

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## Recent Cartoon



### Black Friday Sales

## THE WISE OLD OWL

The data points toward a slowly growing economy throughout the first half of 2012. The failure to address the spending crisis by itself will not change our direct. Had spending been cut materially, unnecessary regulation been addressed, and meaningful tax reform been enacted, optimism would cause an increase in the growth rate.

Without these, the economy will continue to have various sectors affected quite differently. The longer run picture is more uncertain now that it is clear that the economy's structural issues will not be dealt with before the election.

Even more worrisome is the possibility that the political fighting may cause the government to take inappropriate actions over the next few months which could cause damage to the economy. The fact that 2013, absent any action by the government will see between \$1.5 and \$3 trillion dollars of new taxes affecting a broad cross section of the economy will be an increasing negative for growth. We can help you plan around this future to grow revenue during this tricky period.



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