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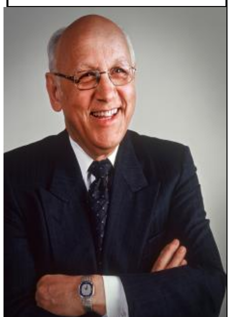
The World's Economic Mess



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Bill Caswell is an experienced coach of CEOs and senior executives around the globe. The author of 14 books, Bill has penned the 12-book series *The Respect Revolution* written, by a CEO for CEOs, as a guide to getting your company to *Excellence* and keeping it there.

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Apology: In last month's newsletter and in one a few months ago, I trespassed into yielding political judgements which were inappropriate to the purpose of this newsletter. I deeply apologize to those whom I have offended and can assure you that it will not happen in future newsletters. Bill Caswell

For the past few years, I have been the recipient of wise words from clever economists about Canada's and the world's economies. The trouble is, year after year, a robust return to economic good times that had been forecast (because all the traditional indicators said so) has not occurred. CCCC prides itself on digging deep into what is happening in our business world and pulling out answers, that while sometime counter-intuitive or against the grain of popular opinion, carry a logic that is irrefutable. It has been our pleasure to have our clients, twist their heads back and forth, expressing a sense of "Why didn't I see this obvious answer, before?" Let us now tackle the world economy so that we are better prepared to move into the future.

First, our thanks goes to two economists, Atif Mian a professor of Economics from Princeton University and Amir Sufi at the University of Chicago, Booth School of Business. Their approach was to follow the mantra of Sherlock Holmes who said that: "One must not theorize before one has the data; insensibly, one begins to twist facts to suit theories, instead of theories to suit facts." So, without an idea of where their investigation would lead, Mian and Sufi began to look at the economic facts. Whenever those facts seem to point in a certain direction, the two economists went back to the data to see if past results actually corresponded to what the facts seem to say. Only with that test confirmed would they move forward to the next step of their study.

To not keep you hanging in suspense, let us tell you why the economy has not recovered. The United States of America, is by far, the biggest kid on the economic block. What happens in the U.S. affects every country in the world. So, logically, Mian and Sufi focused on the U.S. Interestingly, when a path began to show itself, the authors (*House of Debt*, University of Chicago Press, 2015) found similar examples all around the world – not only in present times, but in years and centuries in the past. The reason that the U.S. economy has not recovered is because a huge portion of the U.S. economy, the lower class, has not recovered from its bankruptcy. Until the lower class begins its recovery, the entire economy will be dragging along. Unfortunately, when the lower class gets wiped out financially as it did in the 2008 Great Recession, they do not have the wherewithal to begin a quick recovery. They have nothing to start with and no special promise of, or assistance for, digging out of their holes. Recovery of them, and thus, the economy will take a long, long time, maybe even an entire generation.

When house prices and values collapsed in 2008, each of Bush and Obama in their presidential tenures, were viewed by experts as not only behaving like deer paralyzed by headlights, the actions they did take were in the wrong direction. They directed government support money to the banks and to corporations when they should have directed it to the suffering lower class. The banks had no problem; they did not need more money to lend out. Nobody was borrowing anyway. Corporations were already hoarding cash (as we explained in a previous CCCC paper). Solving our debt problem by encouraging banks to lend and thus create more debt would simply make a bad situation even worse. The ineffectiveness in helping those who were hurt most by the recession, the lower class, opened the door to those same people looking for a political savior with a simply-stated (and often dangerous because of shallowness) solution.

Directing money to the lower class in a careful, analytical way, would allow many of those underwater mortgage-wise, to recover sufficiently and sell their house at a bargain basement price. Thus they would walk away with some small value. Instead, unable to react to their financial dilemma, they faced foreclosure walking away completely ruined with personal bankruptcy as the only option. A bankrupt individual cannot borrow to begin rebuilding. Their earnings just cover day-to-day necessities, so a recovery to their before-the-recession wealth, as modest as it was, was virtually and practically impossible.

To reinforce the point, Mian and Sufi, did not speculate that the lower class equity is a paramount economic building block, the facts told them so, and then they saw those same results staring at them from other previous economic-turmoil histories. If a country in Africa collapses because of this factor, the rest of the world is not severely affected. But when the U.S. economy, representing at least half of the world wealth, is so affected, the entire world feels the pain.

Mian and Sufi went so far as to suggest a way to avoid such a situation in the future. Without going into a lot of detail, suffice it to say, they view our current mortgage situation as one-sided to the lender, the person who has money and who could suffer through a downturn. The borrower who usually has no money (why else would this person be borrowing?) stands to be the only one to lose. Imagine that such a person has purchased a house for $100k with a $10k down payment. That person's equity is $10k. The lender's equity is $90k. If for some reason, the market shifts and the house price declines by 10%, the house now has a value of $90k. The mortgage holder, who still retains the $90k mortgage, has lost nothing, and the borrower has lost his or her entire investment. This is not a shared risk. The borrower who cannot afford risk, shoulders the entire risk. The lender, who is much better able to shoulder risk, has no risk at all. Mian and Sufi propose that house purchase arrangement be designed to share the risk. If the house value drop by 10%, both the lender and the borrower see their investments drop by 10%. Likewise, if the house appreciates, both the lender and borrower benefit equally, corresponding to their mutual investments. These two economists recognize that politicians would never be likely to propose such a scheme so that the direction has to come from other levels in the society.

Mian and Sufi then take the numbers of the Great Recession of 2008 and demonstrate that, when using this shared-risk approach, billions of dollars would have been saved by the entire economy and point out the huge $ that both lenders and borrowers would have benefitted by. What an interesting thought!

Bill

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