Two Scoops or Double Dip?
–The Rocky Road to Recovery

TAMING YOUR TAXES

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August ended in California and finally we had some "normal" summer heat. My family and I usually make five or six trips to the coast by now, but why leave the Central Valley when it's 75 degrees outside? The cool weather has had some side effects, including some adverse effects on crops (tomatoes), but others (almonds and grapes) appear to be delayed but faring well. I imagine certain businesses (ice cream shops, air conditioning repairmen, pool companies) in particular, are suffering from the combination of cool weather and poor economy. When the heat finally came I took my kids to Stone Cold Creamery and my youngest son ordered two scoops (of Rocky Road). As I listened to him order I thought "two scoops or maybe a double dip?" My mind turned to our economy.

The potential for a "double dip" recession is a major worry for economists and the public. Most people feel we never came out of the recession (although technically there is mild "growth" in 2010 when compared to 2009). We may have stabilized, but true recovery appears far off. There just isn't a driving force to spur the economy. Growth is imperceptible, despite "stimulus." Mike Dalton, CPA, and Cathy Dodson, Director of Planned Giving at UOP, expressed the concerns of many of us during a recent Stockton Estate Planning Council meeting. We were selecting speakers and "it would be good," they said, "to have an economist give us their view of what's really happening."

Like changes in the weather, changes in the financial climate can have serious, long term ramifications. You can't go directly from a huge credit bubble, created with enormous financing (a wet year), and reverse to a near credit freeze (a multi-year drought), without wrenching and long lasting economic consequences. Economist Paul Krugman says we are in a "liquidity trap." If we make poor political and policy decisions, the rocky road which we are already on could be washed out by nastier events.

So are we likely to have a double dip recession? Economist, Nouriel Roubini, of New York University (dubbed "Doctor Doom" for his early prediction of the financial collapse) says we now have a 40% chance of falling back into recession near term (by 2011). The Economic Cycle Research Institute Growth Index is at – 10.5%, a level which indicates risk of a substantial downturn. Some believe that we are like Britain at the end of World War II, with our status as a world power waning (remember the Suez Canal crisis?). See the financial crisis postings at http://fabiusmaximus.wordpress.com/financial-crisis/. Others believe we are more like Japan whose credit bubble burst in 1989, leading to serious deflation in the equity and real estate markets. This was dubbed the "lost decade" although the situation has lasted 20 years.

Unemployment remains high as stimulus spending slows down and cities, counties and states continue to contract to cover budget shortfalls. Businesses are slow to hire domestically. As for trade (exports vs. imports), we are still way out of balance. Our trade deficit in the first half of 2010 is reported in excess of $250 billion. Yet the value of the dollar is still relatively high in comparison to other currencies which means imports are cheap for us, but our exports are still costly to the rest of the world. Our debt levels are still enormous.

Ben Bernanke recently indicated the Fed stands ready to respond further. But with short term interest rates near zero, about all the Fed can do is purchase T-Bills (i.e., print money) to keep interest rates low. Repeated stimulus and low interest rates were Japan's solution, but as with Japan in the 90s, these solutions are not yet working. Also like Japan in the 90s, we have an aging population which means our medical, pension, and social security costs will be rising. And as people retire, they tend to sell off assets.

In short, we haven't done enough to fix the structural imbalances which are the root of our problems. What part of the stimulus has focused on bringing jobs and factories back from overseas? Economic competition with Europe, China, and the "Asian Tigers" continues as the world rebalances from the post world war American dominance. Meanwhile, we aren't putting our stimulus money into producing a more scientifically and technologically literate work force and have applied only modest amounts to improve infrastructure. We have not (yet) weakened the dollar to improve import-export imbalances (perhaps because a weak dollar is a double edged sword while we are still so dependent on foreign oil).

The failure of stimulus measures to address these structural problems is why some economists believe it may be decades before we return to our old "normal" (i.e., post World War II) economic patterns. According to the Austrian School economists, like Peter Boettke of George Mason University, we will simply not be able to use financial stimulus alone to resurrect our slowing economy as doing so sows the seeds of the next crisis. We ignore such warnings at our peril.

It's helpful to understand that recessions come in various shapes and sizes. Some are "V" shaped like the 2000-2001 dot.com recession which turned around rather quickly after the bubble burst because low interest rates and easy credit led to the real estate boom. Other recessions are "U" shaped which means things turn around, but more slowly. The 1989-90 recession is a good example of that, it took three or four years to feel like we were back on track. Even when we knew the recovery was strengthening (because the tech boom was happening) it took some time for the population in the Central Valley to feel benefits from over the hill.

Sometimes recessions appear to be "V" shaped but then double-dip and become "W" shaped. That means that the recession started with a downturn, was followed by a fairly strong recovery, and then hit another shock-wave down before a sustained recovery. We haven't had sufficient recovery from our 2008 recession to tell whether a "double dip" (if it happens) will eventually turn into a "W" shaped recession. It will likely take five to ten years from the inception in 2008 to fully know the direction we are heading and whether we are likely to return to pre-recession economic levels.

Other types of recessions have been described as "L" shaped (the recession hits, GDP drops to a lower level, and then just levels out without a significant recovery). This is where the "new normal" terminology comes from. A true "L" shaped recession would imply a long term down and sideways trend like Japan has suffered for 20 years. While Japan is still a major economic power, with world class companies like Toyota, Honda, Sony, and Mitsubishi, its Nikkei stock market stands at about 25% of its 1989 level and its real estate market has had a similar long term fate.

Not to seem totally dour, most economists believe the risk of a double dip recession is still relatively low, and only a few put the odds at over 50%. The "risk" is partly something we can control by our actions. To overcome the situation, we will need structural reforms and we will have to learn to live within our means. Whether by choice or economic necessity, we will have to get off the consumer treadmill, buy more American products, and start on a more productive path. The silver lining is that hardships teach us about enjoying the simple pleasures in life like sharing time with our family and friends, perhaps over a couple scoops of ice cream. Reining in our bad habits (and insisting that our government do the same) is the right thing to do if we want to put this country back on track.