

# The Swing of the Pendulum



A History Lesson  
Looking for Keys to the Future

## Laissez-faire

- Allowing businesses to be free from state intervention
- Unbridled, unregulated capitalism

## Progressivism

- Favoring or advocating changes and reform
- Recognizes reality of large businesses
- Seeks to regulate business rather than own it

# Laissez Faire

## The Roaring Twenties



“The chief business of the American people is business.”

Calvin Coolidge inauguration speech on March 4, 1925

# Laissez Faire

## The Roaring Twenties



“We do not any longer need wartime revenues. The collection of any taxes which are not absolutely required, which do not beyond reasonable doubt contribute to the public welfare, is only a species of legalized larceny.”

“The property of the country belongs to the people of the country. Their title is absolute. They do not support any privileged class; they do not need to maintain great military forces; they ought not to be burdened with a great array of public employees.”

Calvin Coolidge inauguration speech on March 4, 1925

# Laissez Faire

## The Roaring Twenties



”The time is arriving when we can have further tax reduction, when, unless we wish to hamper the people in their right to earn a living, we must have tax reform.”

“The method of raising revenue ought not to impede the transaction of business; it ought to encourage it. I am opposed to extremely high rates, because they produce little or no revenue, because they are bad for the country, and, finally, because they are wrong.”

Calvin Coolidge inauguration speech on March 4, 1925

# Progressivism

## The Great Depression



“It’s time for the princes of property to share their resources.”

“The country ....demands bold experimentation. It is common sense to take a method and try it. If it fails, admit it frankly and try another. But above all, try something.

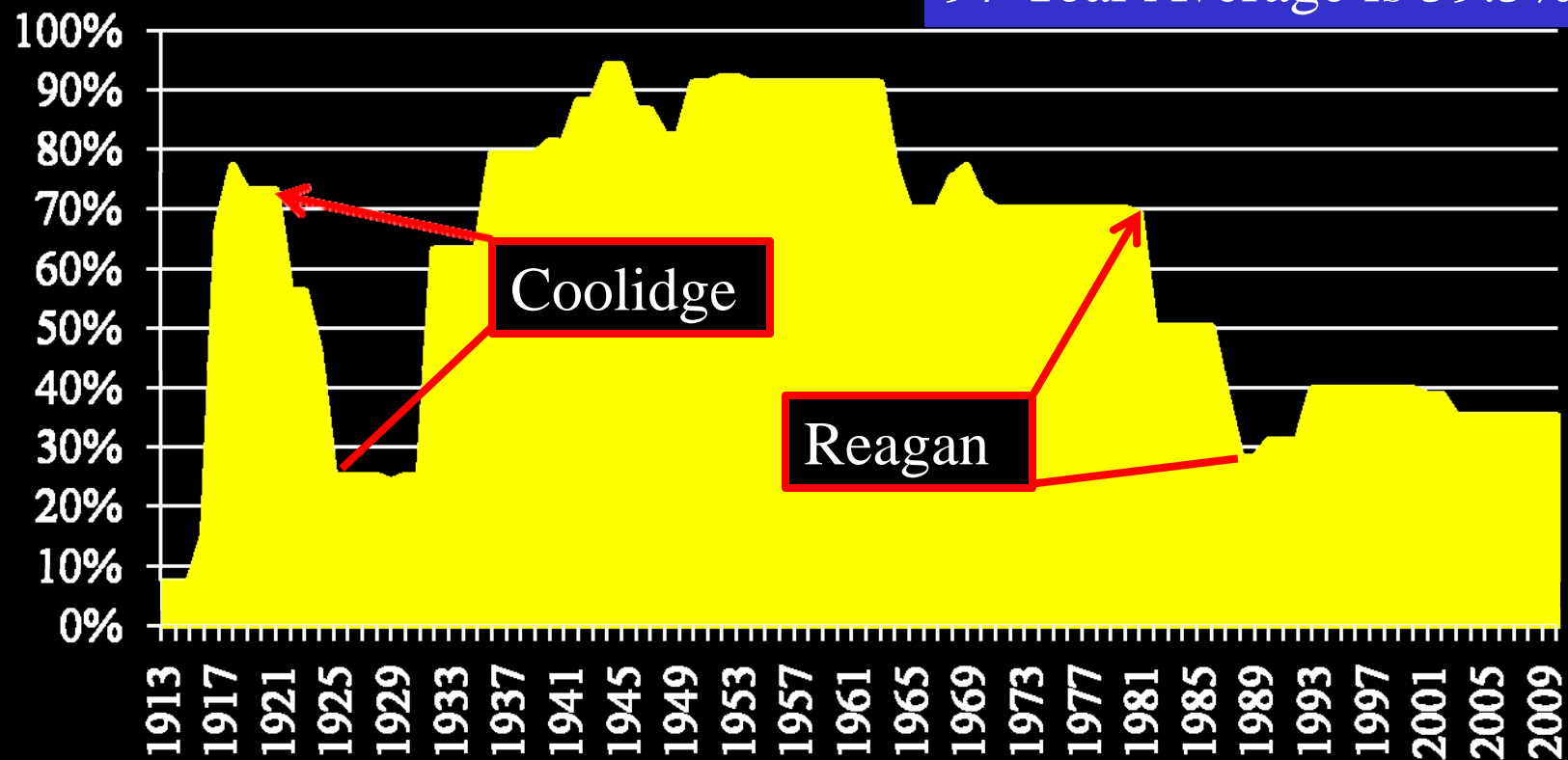
“We are beginning to wipe out the line that divides the practical from the ideal; and in doing so we are fashioning an instrument of unimagined power for the establishment of a morally better world.”

Quotes from Franklin Roosevelt before and after his election.

# Top Marginal Tax Rates

## Two Major Tax Cuts in 100 Years

97 Year Average is 59.5%.



Source: Tax Policy Center  
Urban Institute and Brookings Institution

# The Run Up

January, 1927 to September, 1929

- The S&P was 13.40 in January, 1927
- The S&P was 17.53 in January, 1928
- The S&P was 31.30 in September, 1929
- The market increased 134% in less than 3 years.

# The Crash (part one)

October, 1929 to December, 1929

- The S&P was 31.30 in September, 1929
- The S&P was 21.40 in December, 1929
- The market fell 37% in 3 months.

# Banking Crisis (part 1)

- The first banking crisis hit in November, 1930, one year after the stock market crash.
- 256 banks failed in November
- 352 banks failed in December
- The initial crisis didn't last long and bank failures declined sharply in early 1931

# The Four Month Rally (1930)

December, 1929 to April, 1930

- The S&P was 21.40 in December, 1929
- The S&P was 25.46 in April, 1930
- The market increased 19% in 4 months.

# The Crash (part two)

## April, 1930 to December, 1930

- The S&P was 25.46 in April, 1930
- The S&P was 15.51 in December, 1930
- The market fell 40% in 8 months.

# The Three Month Rally (1931)

December, 1930 to March, 1931

- The S&P was 15.51 in December, 1930
- The S&P was 17.53 in March, 1931
- The market increased 13% in 3 months.

# Banking Crisis (part 2)

- Credit-Anstalt, the largest bank in Austria fails in May, 1931.
- Makes the banking crisis truly global. Bank runs in Germany, Poland, Hungary, Egypt, Turkey and Mexico.
- In March, 1931 a second banking crisis begins in the US.
- Between August, 1931 and January, 1932 1,860 banks failed.
- “Money was cheap and easily available for a few safe borrowers, but difficult for everyone else.”

# The Crash (part three)

March, 1931 to June, 1932

- The S&P was 17.53 in March, 1931
- The S&P was 4.77 in June, 1932
- The market fell 71% in 15 months.
- The market is now 85% below 1929 peak.



## Big tax increase in 1932

- Congress passed a massive tax increase in an attempt to balance the budget in 1932.
- The Revenue Act of 1932 increased the top marginal tax rate from 25% to 63%.

# Banking Crisis (part 3)

- Early in 1933, Congress required the names of all banks that have received RFC money to be made public.
- Led to runs on the banks identified.
- In the first two months of 1933, 4,004 banks failed.
- Bank holidays declared in Iowa, Michigan and Louisiana.
- By the end of 1933, 50% of the banks that existed in 1929 were still open.
- The Fed raised interest rates sharply to discourage speculation in gold and foreign currency.
- National bank holiday begins on March 6, 1933.
- Banks re-open on March 16, 1933.

# The Thirteen Month Rally (1933)

June, 1932 to July, 1933

- The S&P was 4.77 in June, 1932
- The S&P was 10.67 in July, 1933
- The market increased 123% in 13 months.

# The Nineteen Month Rally (1936)

July, 1935 to February, 1937

- The S&P was 10.65 in July, 1935
- The S&P was 18.11 in February, 1937
- The market increased 70% in 19 months.

# The Crash (part four)

## February, 1937 to April, 1938

- The S&P was 18.11 in February, 1937
- The S&P was 9.89 in April, 1938
- The market fell 45% in 14 months.
- The market is now 68% below 1929 peak.

# The Crash (part four extended)

June, 1940 to April, 1942

- The S&P was 9.67 in June, 1940
- The S&P was 7.84 in April, 1942
- The market fell 19% in 22 months.
- Thirteen years after the stock market crash, the market is now 75% below 1929 peak.

# The War Rally

April, 1942 to July, 1946

- The S&P was 9.52 in April, 1942
- The S&P was 18.05 in July, 1946
- The market increased 89% in 51 months.
- Seventeen years after the crash, the market is now 42% below 1929 peak.

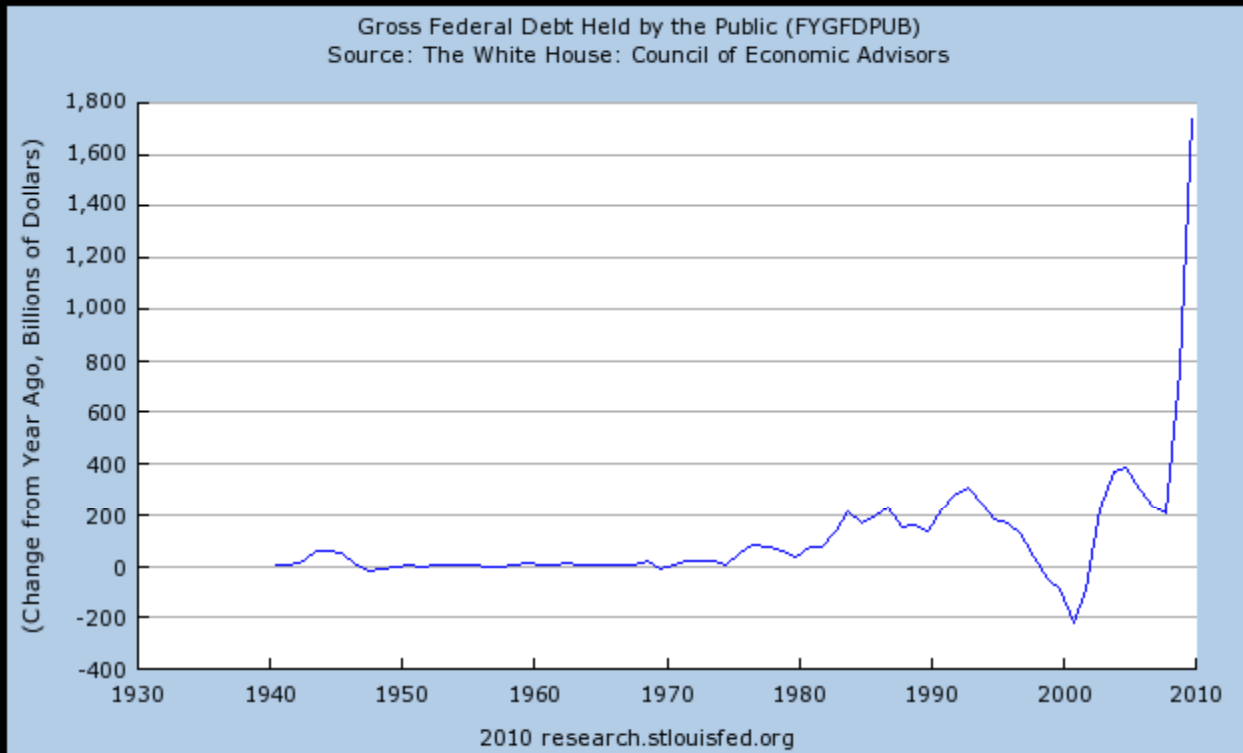
# “Getting Back to Even”

September 1929 to September, 1954

- The S&P was 31.30 in September, 1929
- The S&P was 31.45 in September, 1954
- Twenty-five years after the crash, the market returned to the 1929 peak.

# Gross Federal Debt Held By The Public

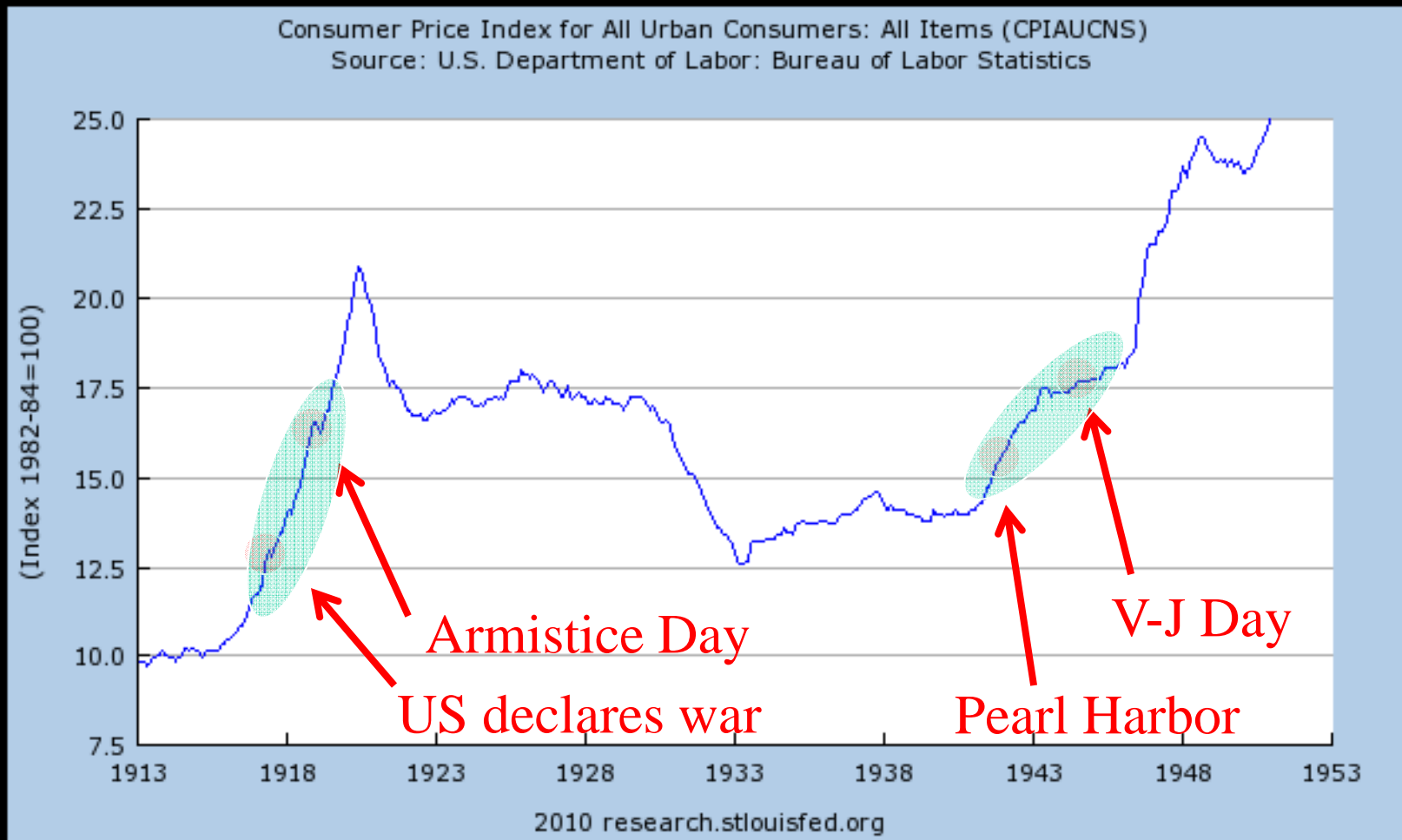
Title:  
Series ID:  
Source:  
Release:  
Seasonal Adjustment:  
Frequency:  
Units:  
Date Range:  
Last Updated:  
Notes:



DATE	VALUE
1939-06-30	48.2
1940-06-30	50.7
1941-06-30	57.5
1942-06-30	79.2
1943-06-30	142.6
1944-06-30	204.1
1945-06-30	260.1
1946-06-30	271.0
1947-06-30	257.1
1948-06-30	252.0
1949-06-30	252.6
1950-06-30	256.9
1951-06-30	255.3
1952-06-30	259.1
1953-06-30	266.0
1954-06-30	270.8
1955-06-30	274.4
1956-06-30	272.7
1957-06-30	272.3
1958-06-30	279.7
1959-06-30	287.5
1960-06-30	290.5
1961-06-30	292.6
1962-06-30	302.9

# Inflation and Deflation

## Two World Wars and Inflation



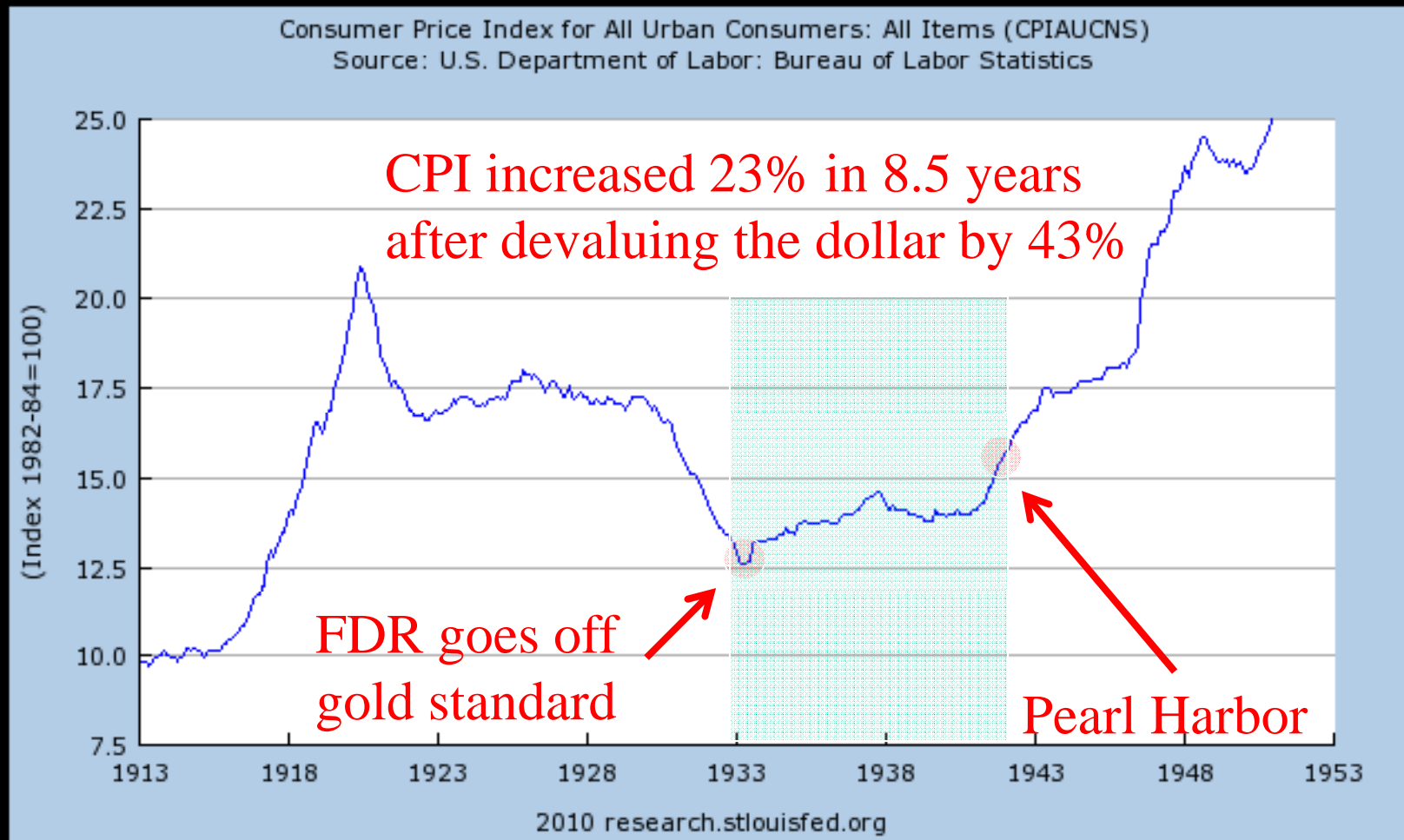
# Inflation and Deflation

## Two big deflationary events 1913-1953



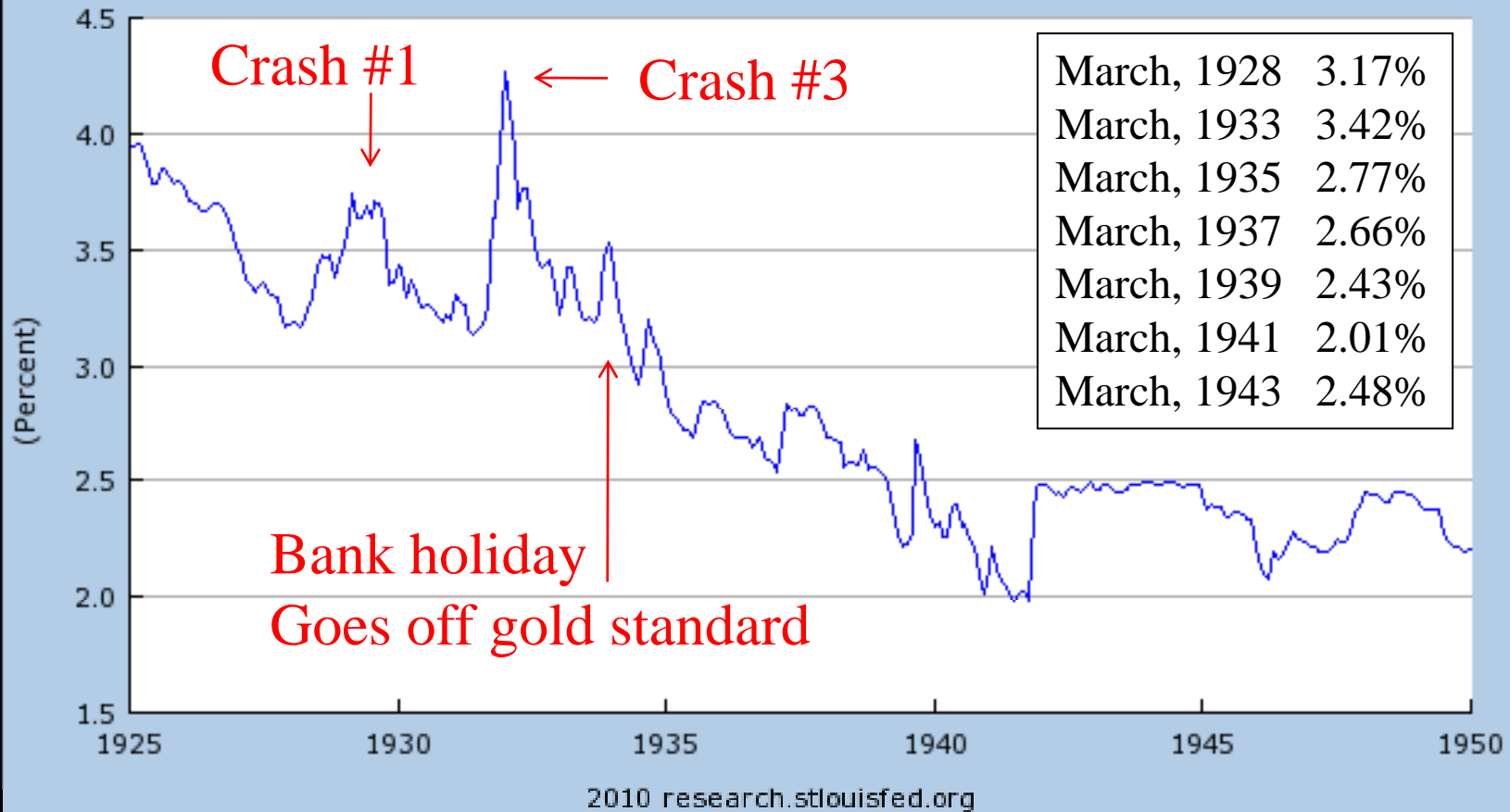
# Inflation and Deflation

## Devaluing the Currency and Inflation



# Long-term Interest Rates

Long-Term U.S. Government Securities (DISCONTINUED SERIES) (LTGOVTBD)  
Source: Board of Governors of the Federal Reserve System



# What Can We Surmise ?

- If banks don't lend, then the government will lend directly.
- Deflation is THE serious concern, to be avoided at all cost.
- The amount of stimulus needed to get the economy out of depression is massive.
- Movements toward austerity led almost immediately back into recession.

# What Can We Surmise ?

- The US government sextupled its debt in six years and interest rates fell and inflation was very subdued.
- Going off the gold standard and devaluing the currency did not result in “runaway” inflation and high interest rates.
- The temporary hiring programs such as WPA, PWA, and CCC didn't resolve the unemployment problems.

# What Can We Surmise ?

- The US economy really didn't pick up until 1940, when the government started issuing cost-plus contracts for defense spending.
- The government debt expanded from \$48 billion to \$271 billion in six years to pay for the defense spending.

# What Can We Surmise ?

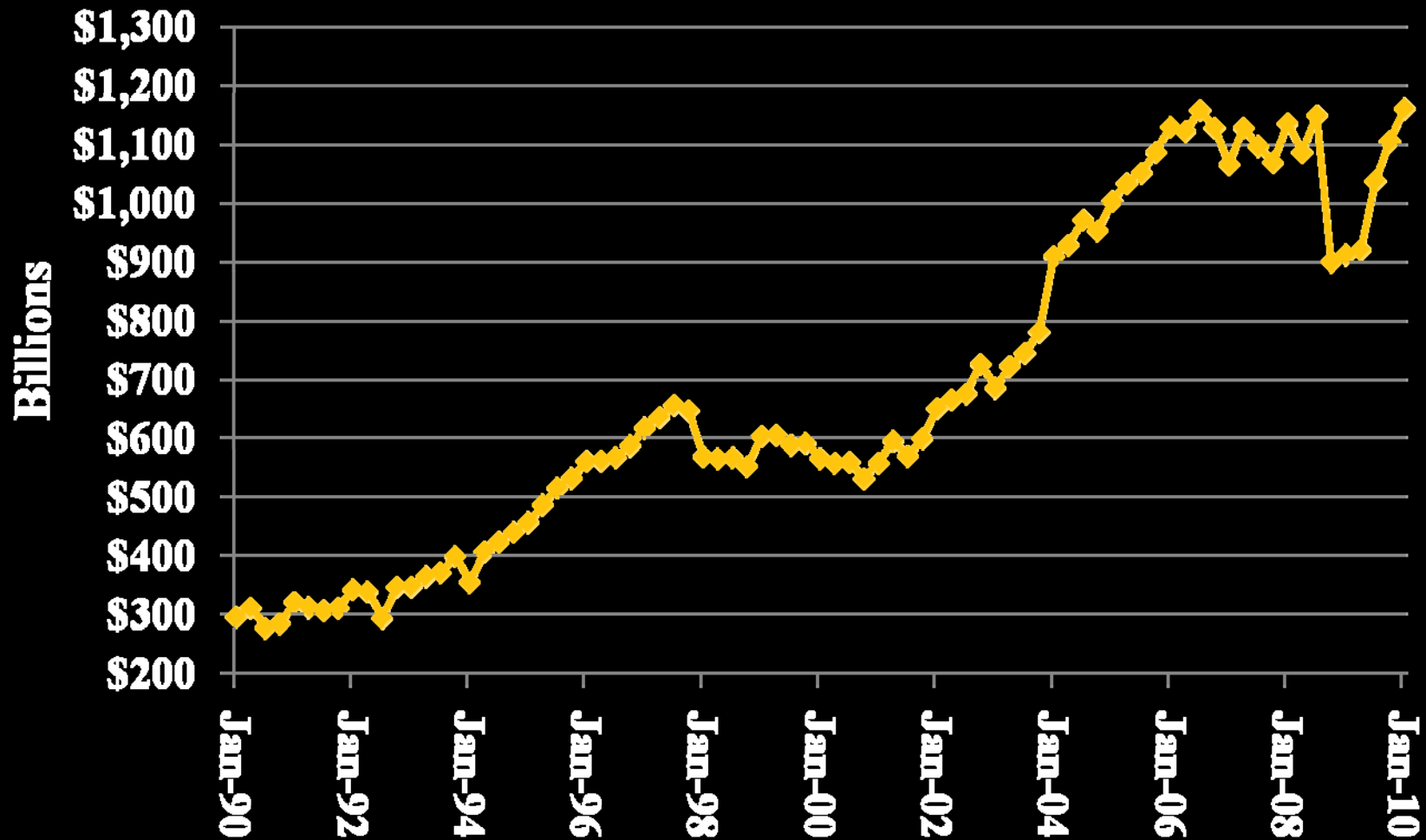
- There can be fits and starts that look like the economy is turning the corner.
- The uncertainty of government regulation is a killer to business activity.
- The negative comments during political campaigns can damage public confidence.



# The Economic Outlook For Investors and Decision Makers

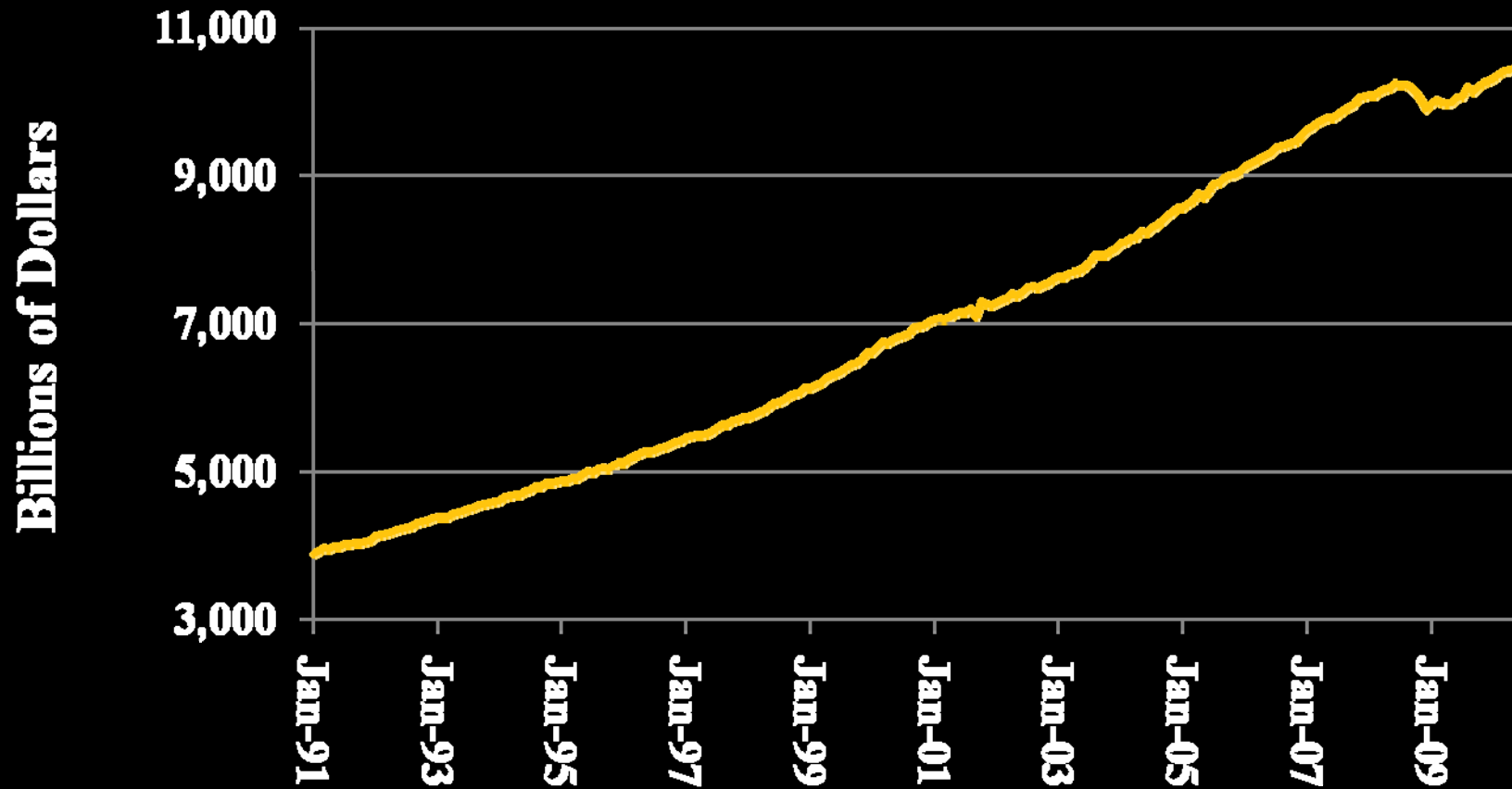
Dr. Mark G. Dotzour  
Chief Economist and Director of Research  
Real Estate Center at Texas A&M  
College Station, Texas  
[dotzour@tamu.edu](mailto:dotzour@tamu.edu)

# More Good News Corporate Profits Are Up!



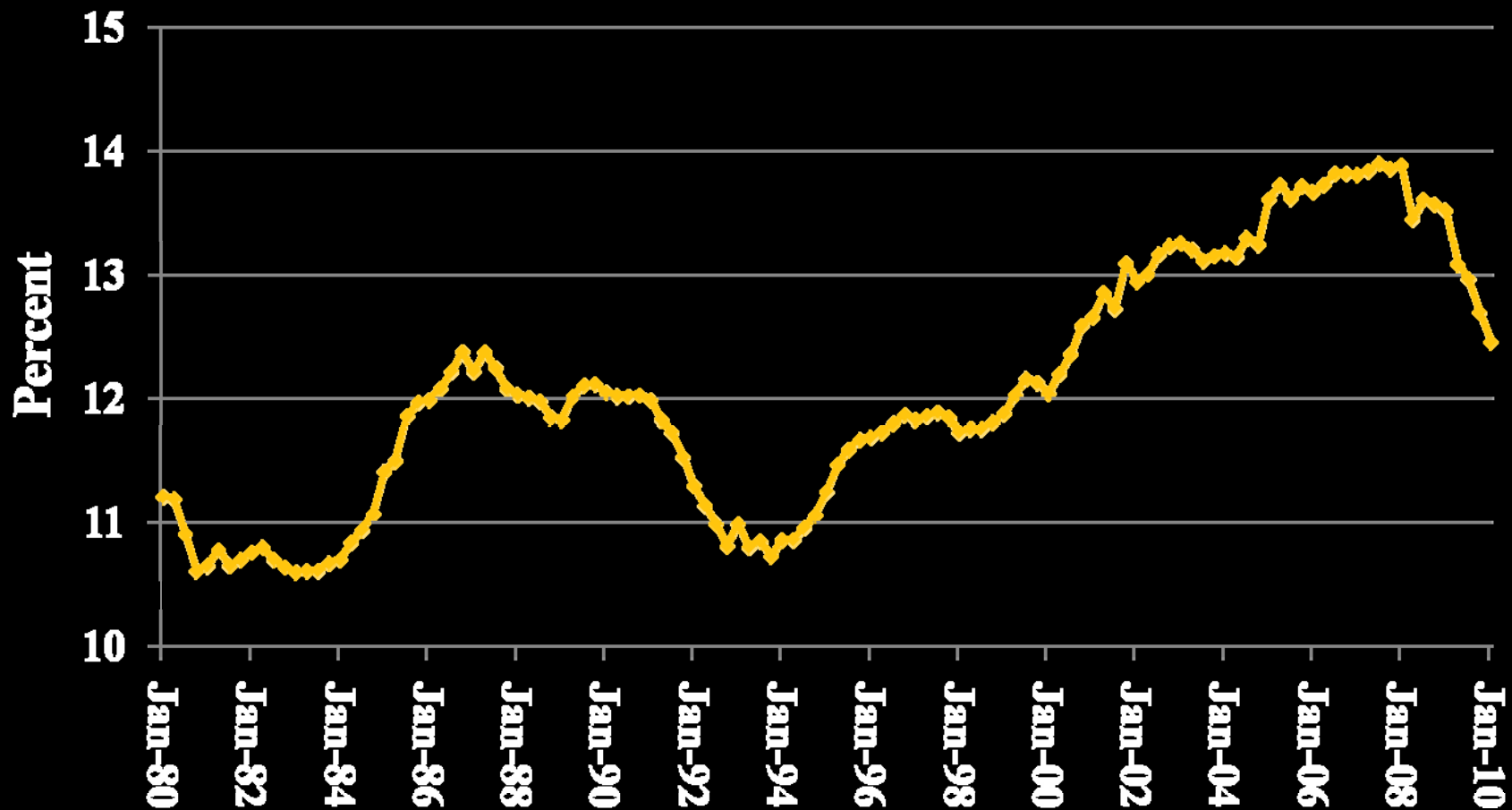
# More Good News !

## Personal Consumption Expenditures



Source: Department of Commerce

# More Good News ! Household Debt Service is Declining



Source: Federal Reserve Board

# Corporate Hiring Plans: Next 6 Months

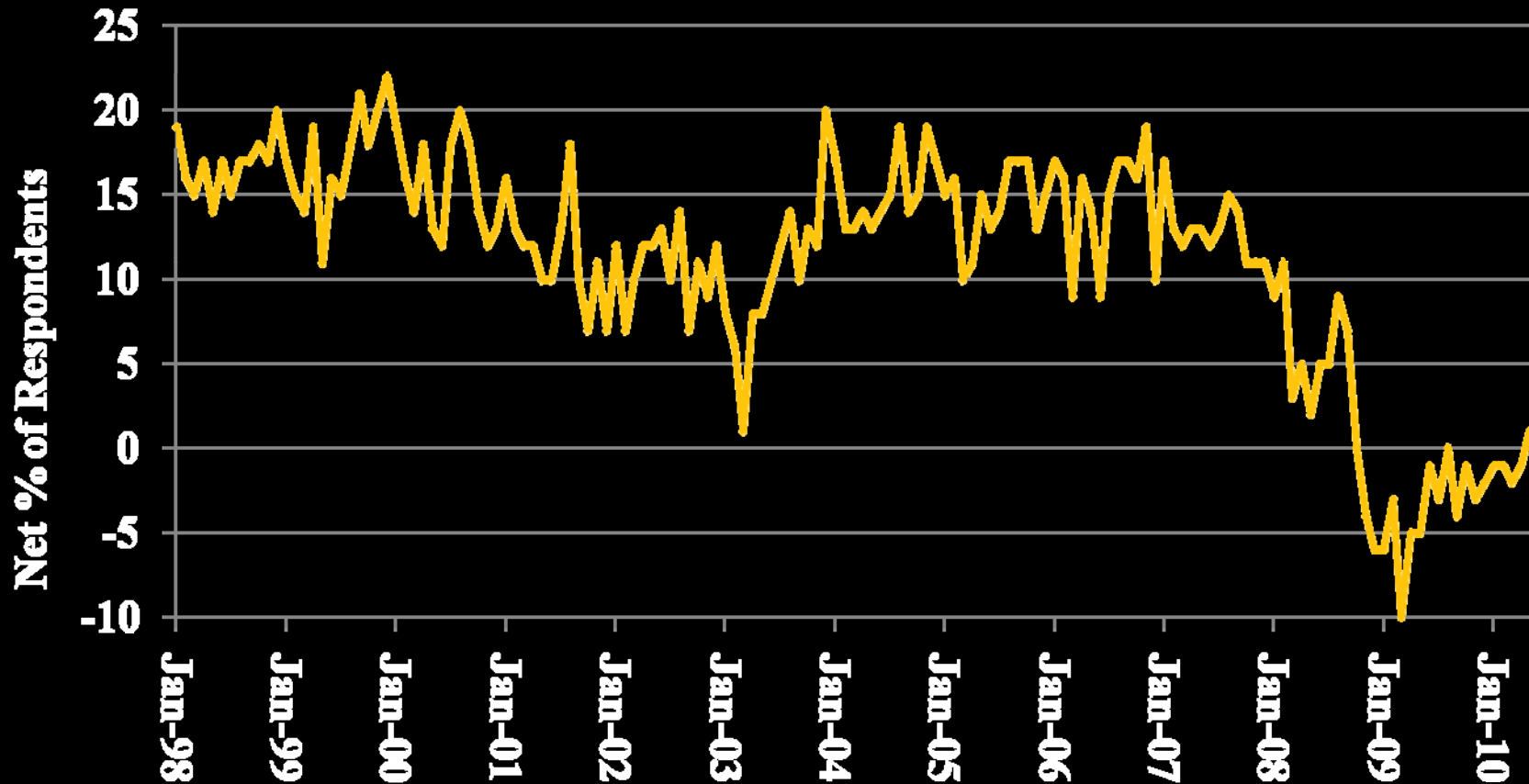
	Q2-10	Q1-10	Q4-09	Q3-09
More Jobs	39%	29%	19%	13%
Less Jobs	17%	21%	31%	40%

# Problem 1

Small Businesses Are  
Reluctant to Hire

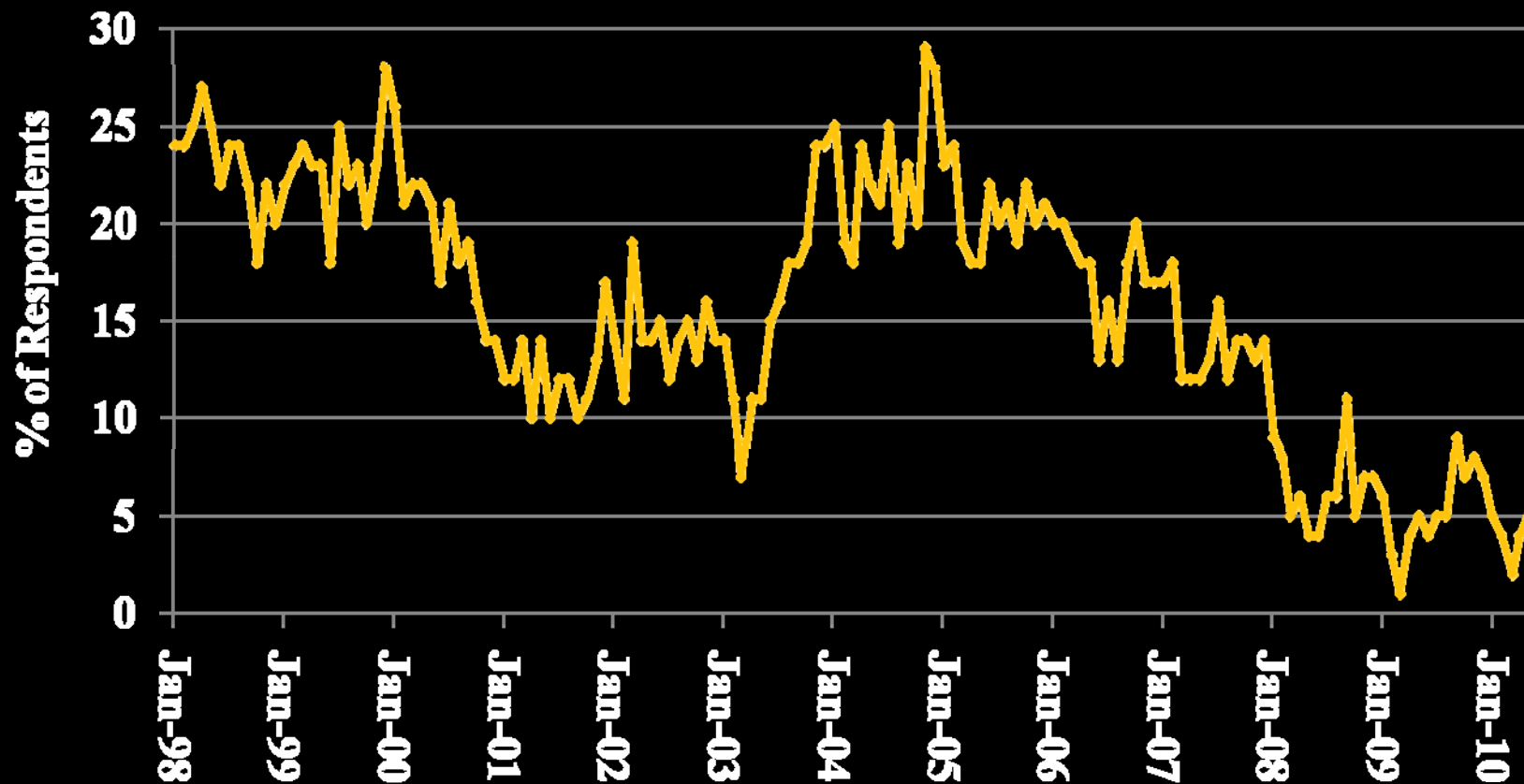
# Small Business Outlook

“Planning To Hire People In The Next Six Months”



# Small Business Outlook

“Now Is A Good Time To Expand”



# Lockhart on the Economy

Another gauge of the labor market is the percentage of people who, along with the unemployed, have stopped looking for work—so-called discouraged workers—as well as those who are working fewer hours than they want. The combined unemployed and underemployed figure is about 17 percent of the workforce.

With job growth negative to flat, real incomes have stagnated. Total personal income, including transfers from the government, has grown modestly, but income from wages and salaries has declined from a year ago.

According to the Congressional Budget Office, under current law federal budget deficits rose from an average of about 2.4 percent of GDP in the period from 1970 to 2008 to 10 percent in 2009. No budget path currently under consideration would keep the public debt from growing relative to gross domestic product. Clearly, an ever-rising debt-to-GDP ratio is unsustainable and a matter of great concern.

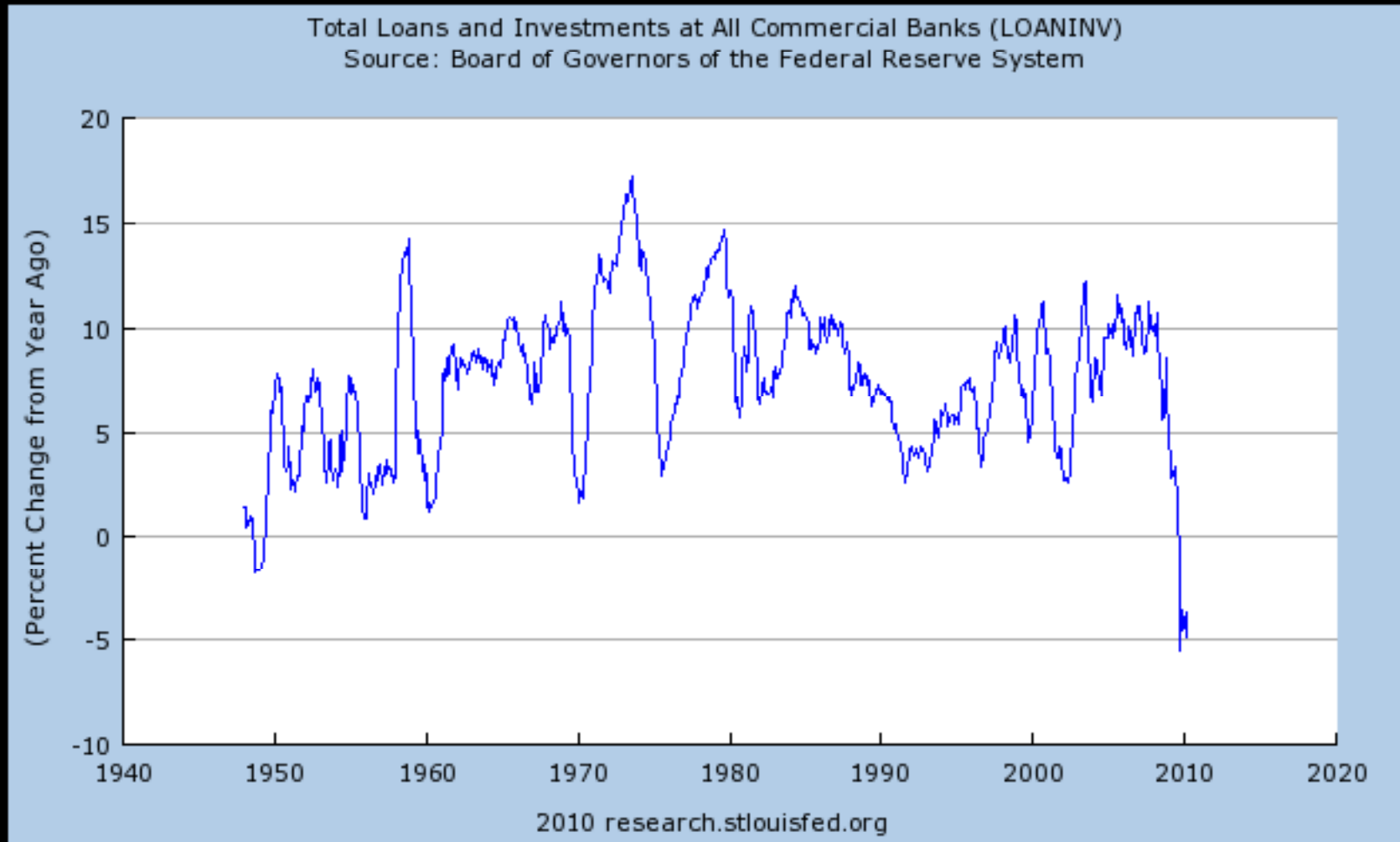
Dennis P. Lockhart, President and Chief Executive Officer  
Federal Reserve Bank of Atlanta - March 22, 2010

## Problem 2

The Banking Crisis Has Not  
Been Solved....

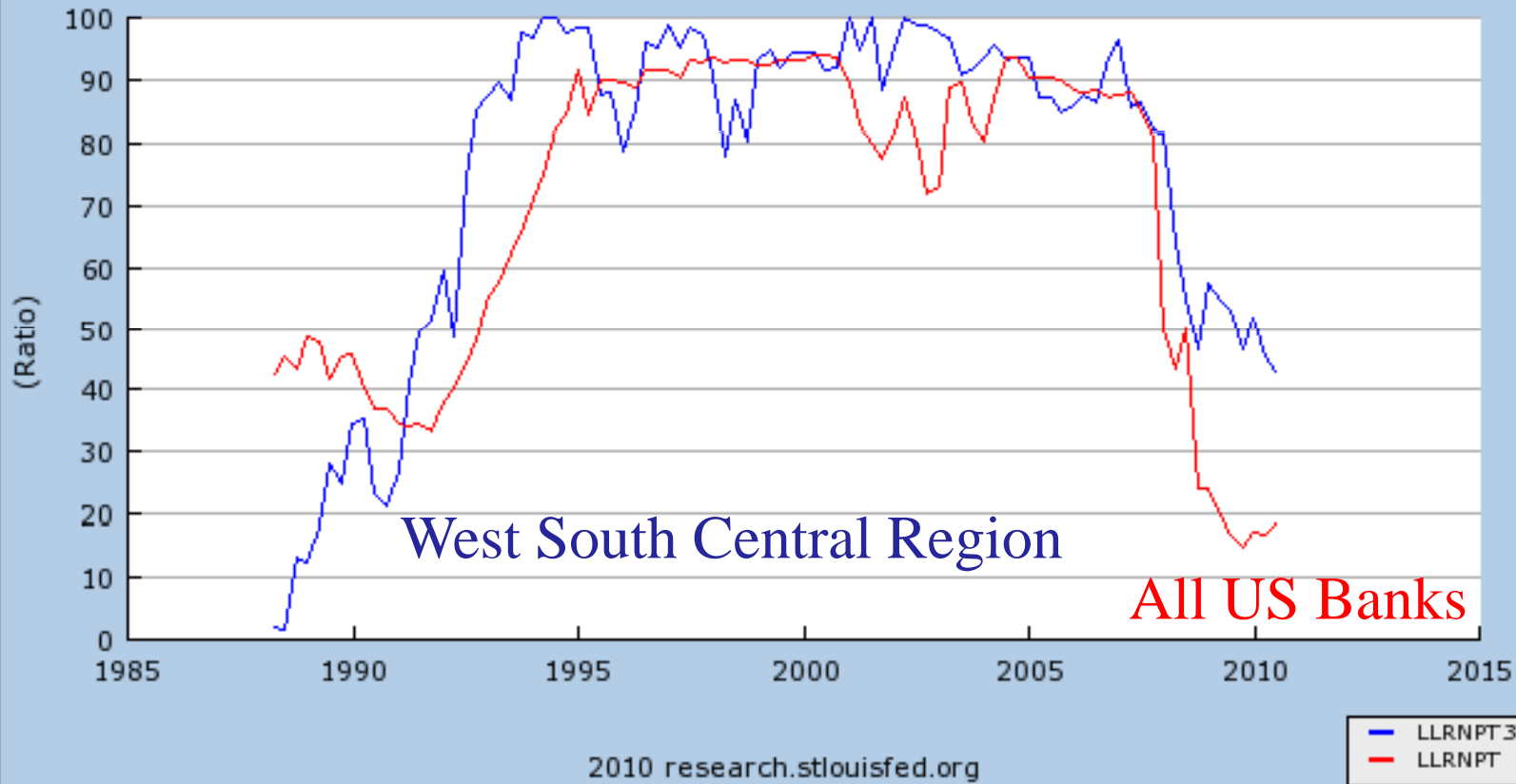
It's Just Been Anesthetized

# The Biggest Credit Contraction Since the Depression



# Assets at Banks Whose ALLL Exceeds Their Non-Performing Loans

Assets at Banks whose ALLL exceeds their Nonperforming Loans, Banks with Total Assets from \$1B to \$10B, West South Central Census Division (LLRNPT37)  
Assets at Banks whose ALLL exceeds their Nonperforming Loans (LLRNPT)



# The “Hoover Maneuver”



- What are we doing in 2010 and 2011?
  - Raising taxes
  - Tightening credit

It didn't work well in the 1930's and it won't work well this time either.

# Heizo Takenaka: Japan's Version of Paul Volcker



# The “Japanese Experience”

- Stock market bubble burst in 1989
- Real estate market bubble burst also
- Now (21 years later) the Japanese stock market is still 75% below its 1989 peak.
- Now (21 years later) commercial real estate land prices are 66% below its 1980's peak.

# The “Japanese Experience”

- Japanese banks incurred huge losses from bad real estate loans made in the 1980’s.
- The banks failed to recognize the loans on their books for more than a decade.
- “Zombie loans” at “zombie banks”.
- Finally Takenaka required the banks to write off their bad loans and take losses.
- Restored confidence in the banking system.

# The Japanese Experience Now: 22 years later

Japanese commercial land prices fell to the lowest in at least 36 years as developers faced tighter credit markets and the recession discouraged buyers. Prices declined 6.1 percent in 2009, more than the 4.7 percent drop a year earlier, the Ministry of Land, Infrastructure, Transport and Tourism said in a report released today.

Values are at their lowest since the ministry began collecting comparable data in 1974.

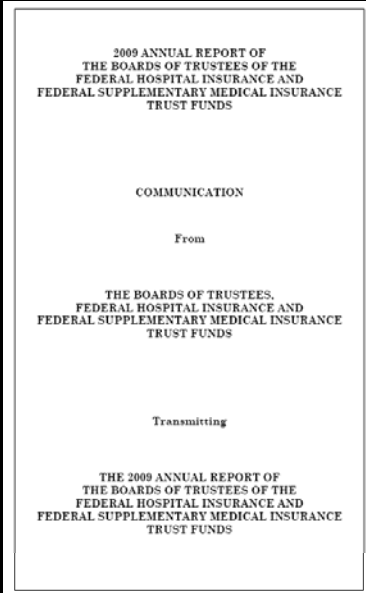
The decline in commercial prices, which are about a third of what they were in 1991 after Japan's bubble economy peaked, may slow as the nation recovers from recession.

*Bloomberg*

*Last Updated: March 18, 2010 03:50 EDT*

## Problem 3

States and counties,  
cities and school districts  
have to “rightsize”  
their budgets



# Medicare Trustees Report

From the 75-year budget perspective, the present value of the additional resources that would be needed to meet projected expenditures, at current-law levels for the three programs combined, is \$45.8 trillion.

Unfunded HI and OASDI obligations .....	\$18.8 trillion
HI and OASDI asset redemptions.....	\$ 2.7 trillion
SMI Parts B and D general revenue financing .....	\$24.2 trillion

# Conclusions

- American Consumers are fixing their balance sheet and returning to the stores.
- American businesses have right-sized and returned to profitability.
- American small business owners are still frozen with uncertainty and sitting on cash.
- States, cities, counties and school districts will have to right-size their spending.
- Federal policies are serving up another perfect storm with tighter credit and higher taxes.
- The “extend and pretend” gambit in the banking system will retard growth until it’s resolved.

# Conclusions

- The “real” economy is trying to turn the corner
- Small business hiring is essential to offset weakness in the public sector
- There is a lot of pent up demand from businesses that have postponed decisions and are sitting on cash.
- There is a lot of pent up demand from consumers that have postponed decisions too.

# Risks

- Public employees balk at cost cutting measures
- Political will to “stimulate” fades away
- Higher income tax rates reduce consumption
- Higher income tax rates reduce investment
- Congress continues adversarial role with large and small business
- Failure to resolve the banking system causes the commercial real estate markets to stay frozen for another year.
- China continues to manipulate their currency.