

A trillion here, a trillion there

By Colin Read, Everybody's Business

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— People are scared. Fear has gripped the economy. Some with steel nerves are still buying stocks and bonds, but many have either pulled out of the market, or are afraid to open their 401K statements. Is there anything we can do to take back our economic future?

Some of the current panic is simply fear of the incomprehensible. It is hard to relate to the astronomical numbers now bandied around like baseball scores. How do we relate to a trillion dollars, or a one with twelve zeros after it?

For instance, we implemented an economic-stimulus package worth about \$150 billion earlier this year, had an emergency economic repair bill of \$700 billion earlier this month, and are now discussing a second stimulus package more carefully targeted to infrastructure investment that should push the fiscal stimulus to more than a trillion dollars in a single year.

The numbers are numbing. Everett Dirksen, Senate Minority Leader from 1959 to 1969, once famously uttered, "A billion here, a billion there, pretty soon it adds up to real money." Adjusted to today's dollars, that would be six billion here, six billion there, ... How about a thousand billion?

How do these new trillions stack up? Let us put some of the numbers in perspective.

The U.S. Gross Domestic Product of almost \$15 trillion represents the current market value of all the final goods and services produced in this country. With a population of about 305 million, this represents production valued at almost \$50,000 per person each year.

The national debt is now over \$10 trillion, and is expected to rise to the equivalent of about \$40,000 per person in the next few years. We recently had to add another digit to the federal-debt clock in Times Square just to keep up with the tally.

The value of the world's publicly traded companies have fallen from almost \$60 trillion a year ago to a little above \$30 trillion today. A little more than a quarter of the valuation is from the U.S., a similar amount is from Europe and the remainder represents the value of markets for the rest of the world.

While the value of U.S. publicly traded companies, partnerships and investment trusts has been as high as \$16 trillion, it has fallen to under \$10 trillion lately. This is a loss of about \$6 trillion over the past year, or about \$20,000 per person in the U.S. We recently lost more than a trillion dollars of wealth in the U.S. in a single day.

Now the federal debt approximates the value of all the traded companies in the U.S.

The U.S. housing stock has been valued at more than \$20 trillion a couple of years ago. Some estimates of the value of the housing stock, adjusted for inflation, is down by more than 30 percent, or about \$6 trillion. This represents another drop in our average wealth of about \$20,000 per person.

These drops in investment values and housing values translate directly into consumer spending. Consumption represents about 70 percent of our nation's spending. And every fall of \$1,000 in housing wealth reduces consumption by \$60, while a \$1,000 decline in investment wealth reduces consumption by another \$40. Once households adjust to the \$6 trillion fall in investment portfolios and an equal fall in housing values, consumption could drop by \$600 billion, or almost 5 percent of our annual economy. This will mostly be felt by those who lose their jobs through the economic contraction, must sell their homes to relocate, or must begin to tap their savings to retire or to put a child through college.

The fiscal-stimulus checks many households received earlier this year, and the proposed stimulus package

that may be necessary in the next few months, appear large. However, a new stimulus package will fill less than half of the gap arising from decreased consumption.

It is less the value of our asset portfolios, and more its effect on consumption, that will take time to remedy. But with a large federal debt, our capacity to temporarily supplement this fall in consumption is very much constrained. Unfortunately, with long-term bond interest rates around 4 percent, we find ourselves paying an equivalent amount in interest to service our federal debt as we struggle to supplement flagging consumption. The value of the world's publicly traded companies, trusts and housing stock pales, though, in comparison to the value of those notorious credit default swaps that are so often mentioned in the news these days. The Wall Street Journal recently reported that the world's credit default swaps total more than \$62 trillion. But while the housing stock and the value of shares of companies have intrinsic value because they represent ownership of physical assets, credit default swaps are derivatives. They have no value in themselves, but instead derive value from an underlying security.

In this case, the credit default swaps are insurance bets. They are policies to protect underlying mortgage packages and other assets. The market creates and trades such swaps much like we could buy multiple life insurance policies. Of course, no one expects payouts of \$62 trillion, but the huge liability on financial ledgers has shaken financial markets.

These are more than numbers on a page. They represent jobs and our economic future. When the finances get unnecessarily complicated, or the numbers get so mind-bogglingly large that they no longer seem real, how do we make rational decisions to protect what we have spent a lifetime to create? And if we all struggle to understand the institutions and innovations that so profoundly affect our collective future, do our political leaders understand it all any better?

The Great Depression provided us with an enduring lesson. We realized we must take responsibility for our own economic future and secure our own economic education. I hope our current global financial meltdown endows us with a recognition that we leave the economy to others at our own peril. If we demand financial transparency and economic literacy, we can help ensure financial "innovations" are done with us rather than done to us.

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