

# Recovering from the Great Recession in the U.S. and Nevada

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# The Great “Balance-Sheet” Recession

- Recessions - less common than they used to be.
- Depressions – much less common, much longer and deeper than normal recessions.
  - A recession caused by a financial crisis
  - A “balance sheet” recession: financial wealth collapses, banks collect reserves to offset bad debt, government becomes borrower of last resort, deflation and ZIR.

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# Response #1: Monetary Intervention

- Federal Reserve authorized:
  - Quantitative easing: purchase of government bonds, helped drive yield to zero.
  - Purchase of private mortgage-backed securities, central bank currency swaps, target federal funds rate near zero.
  - *Pushing vs. pulling on a rope.* Effectiveness varies.
- QE II is currently planned:
  - “Hail Mary pass” – to prevent deflationary expectations.

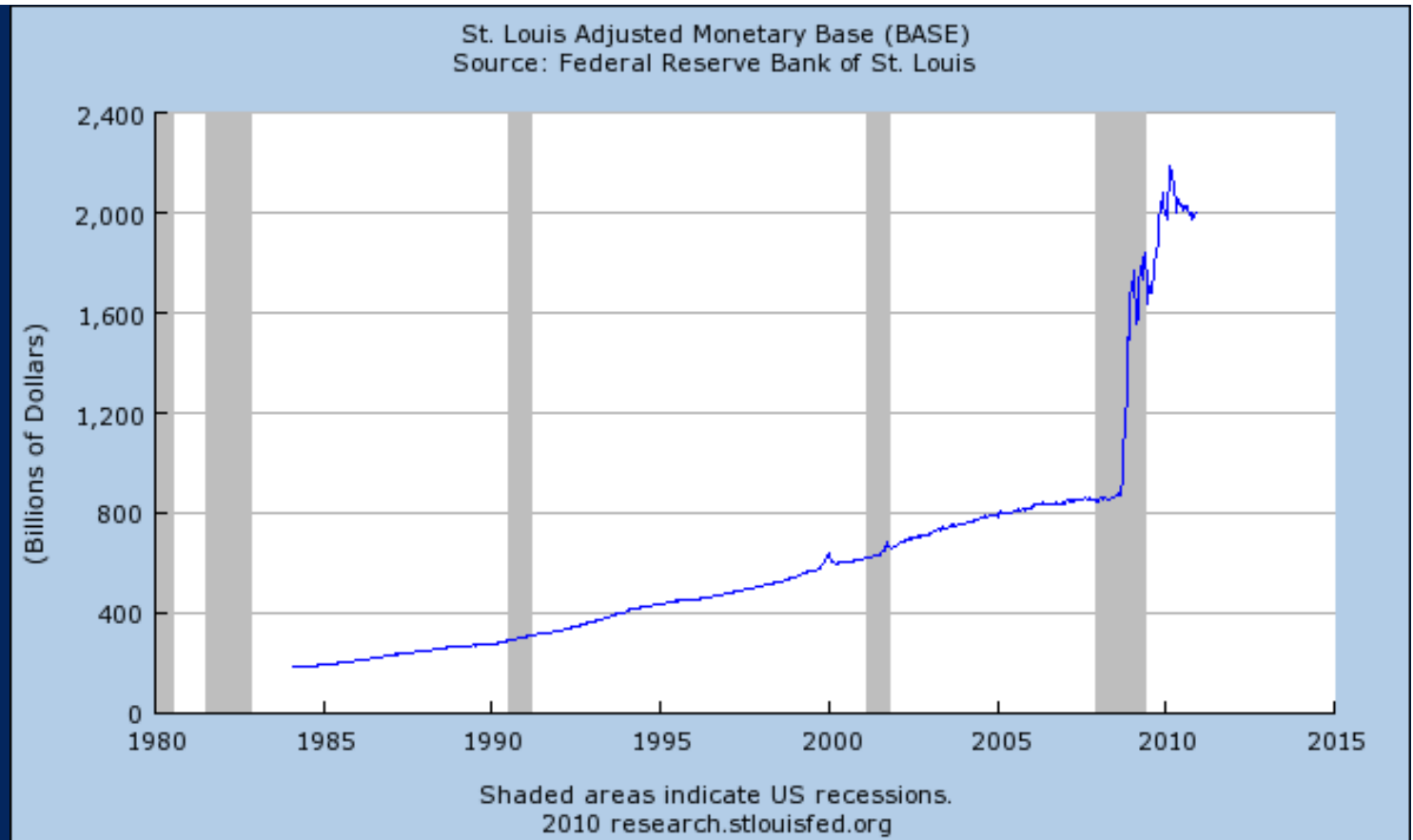
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# Monetary Base (Currency plus Bank Reserves)



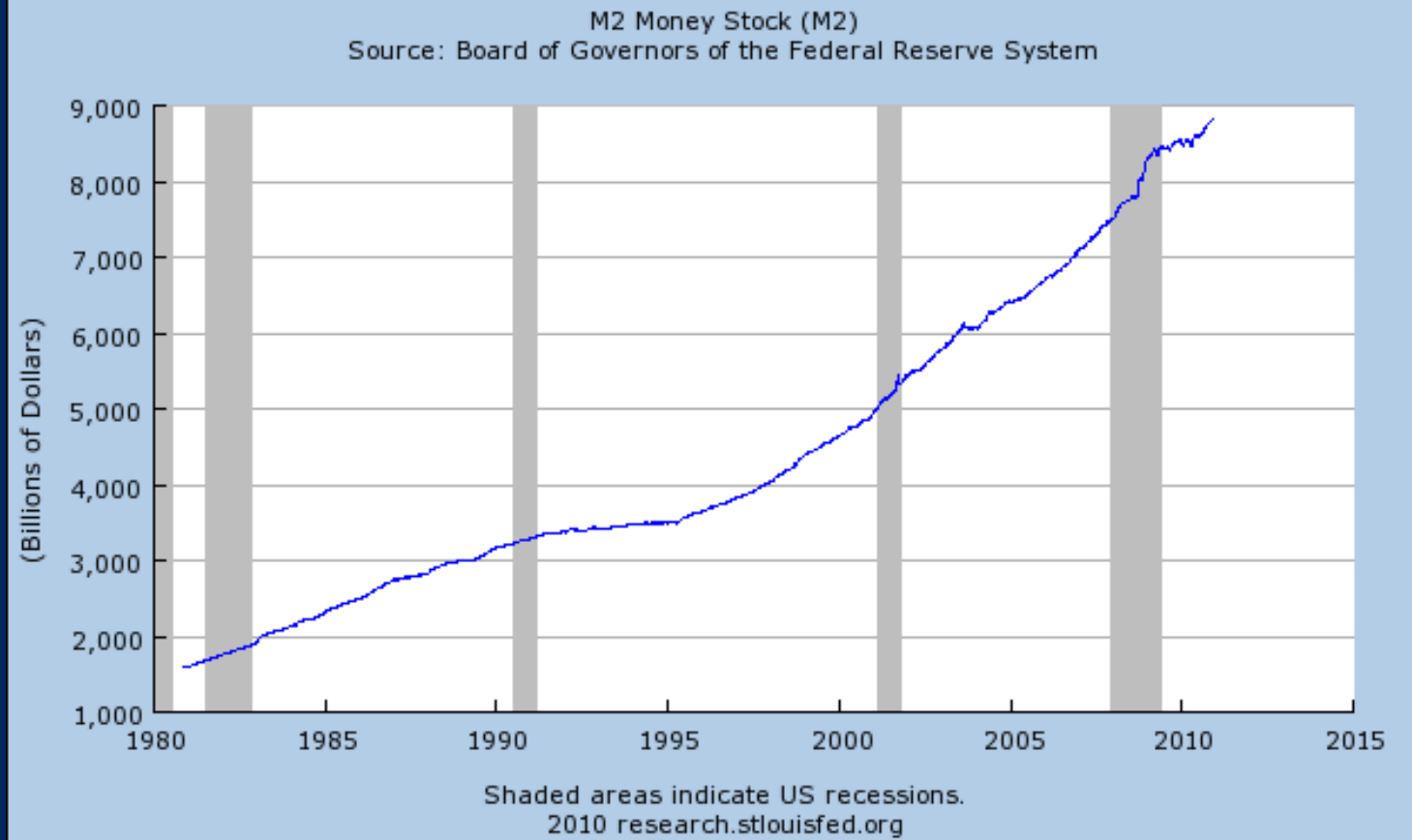
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# Money Stock (M2)



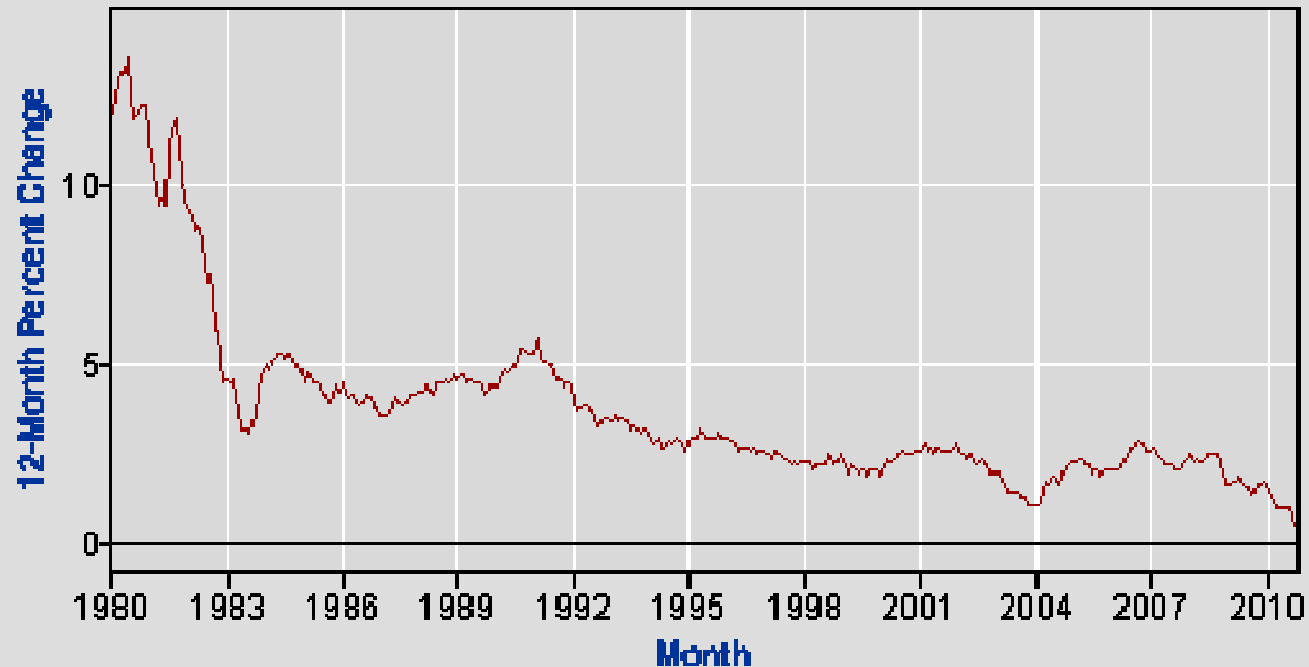
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But inflation hasn't been a problem yet...



12-month  
CPI Core is  
very close to  
zero.

# Response #2: Bank Bailouts

- Emergency Economic Stabilization Act:
  - \$700 billion authorized in October 2008. Only \$550B used.
  - TARP funds began with plan for purchase of troubled MBS, but changed to an equity purchases approach, with restrictions over executive pay.
  - \$270B went to AIG, GM, Wells Fargo, Citigroup, BoA, JPMorgan Chase, Morgan Stanley, and Goldman Sachs.
  - \$27B went to over 600 banks (\$300K-\$968M)
  - Majority has already been paid back, with interest.

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# Response #3: Fiscal Intervention

## A) Economic Stimulus Act of Feb. 2008:

- Tax rebates for 2008, estimated \$150B cost (about 1% of GDP) in 2008.

## B) American Recovery and Reinvestment Act of 2009:

- Estimated \$800B cost over several years: <\$200B spent in FY 2009, and \$400B in FY 2010 (about 3% of GDP).
- About 40% in tax credits, 30% in state fiscal support, and 30% in infrastructure investment (education, energy, health care) and some extended benefit support.
- *How effective was this stimulus?*

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# Was it Worth it?

- The total economic loss from the Great Depression was about 120-140% of 1929 GDP (about \$20 trillion now).
- The total loss from the 1980-1983 recessions was 15-17% of 1979 GDP (\$2.4 trillion now).
- The IMF estimates a typical depression costs more than 50% of GDP cumulatively over 7 years (\$7 trillion now).

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## The Stimuli added about \$1 Trillion to the Federal Debt (about the same as the recent tax cut extension)

- If the recovery would have begun in 2010:1 instead of 2009:3...
- OR if this spending could prevent only a fifth of the combined effect of a typical depression...
- OR if GDP would have declined 8% in 2009 instead of 4%...  
... then it would be a very good investment.

But we don't KNOW the counterfactual: What would have happened without it? It probably wasn't done optimally.

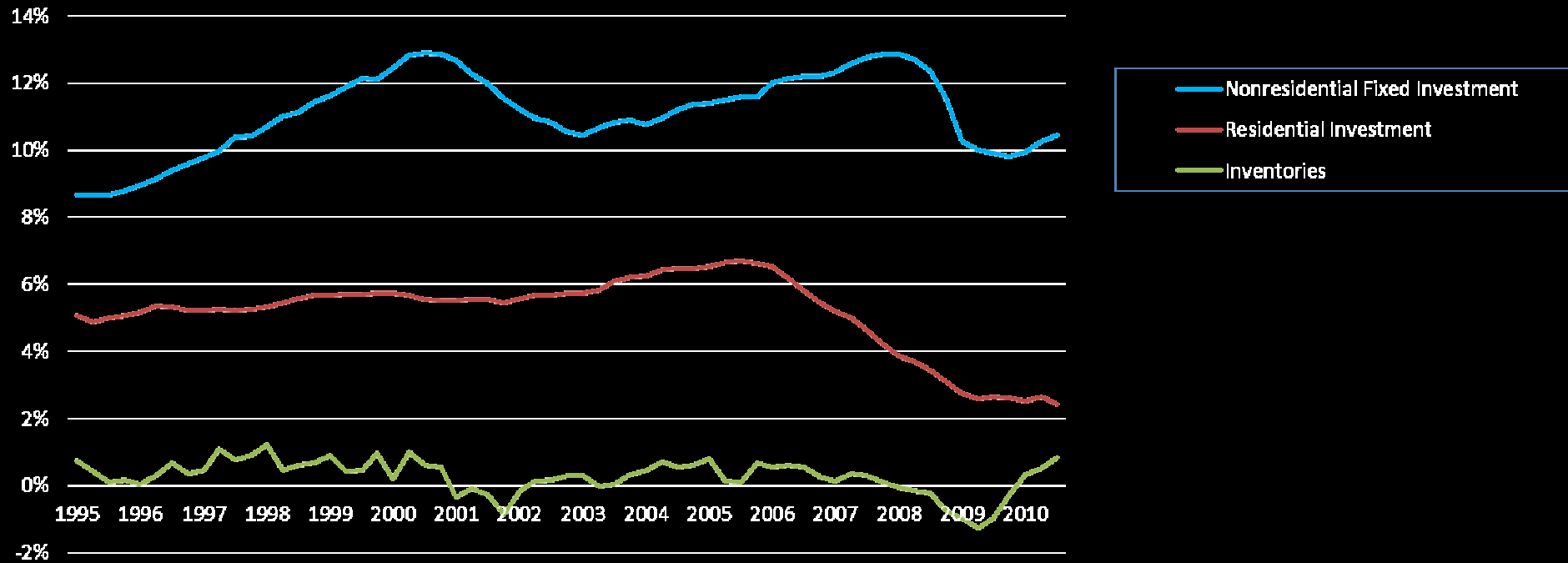
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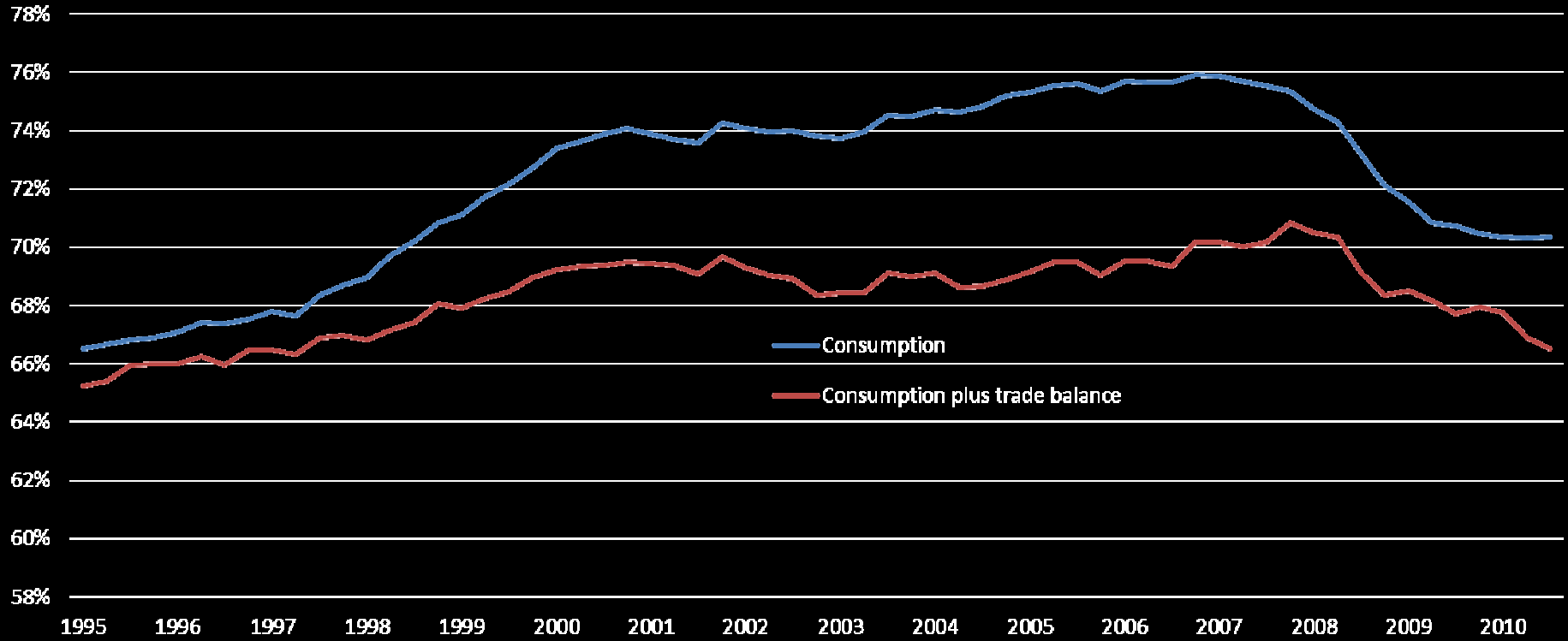
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## Real U.S. Investment (Share of GDP)



## U.S. Consumption Share



# The Federal Deficit and the Debt

The Federal Debt is almost \$14T, about our annual GDP (\$10T in 2008, less than \$6T in 2000).

- About \$8T is held by private, half by foreigners.

The current deficit is temporary due to the recession, but there are serious structural problems: tax cuts, the growth of health care costs (i.e., Medicare).

Borrowing for investment, or in bad times, makes sense.

Borrowing in good times for consumption does not – IBGYBG.

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## Government Spending and Revenues (Share of 1950-1990 Trend Quarterly GDP)

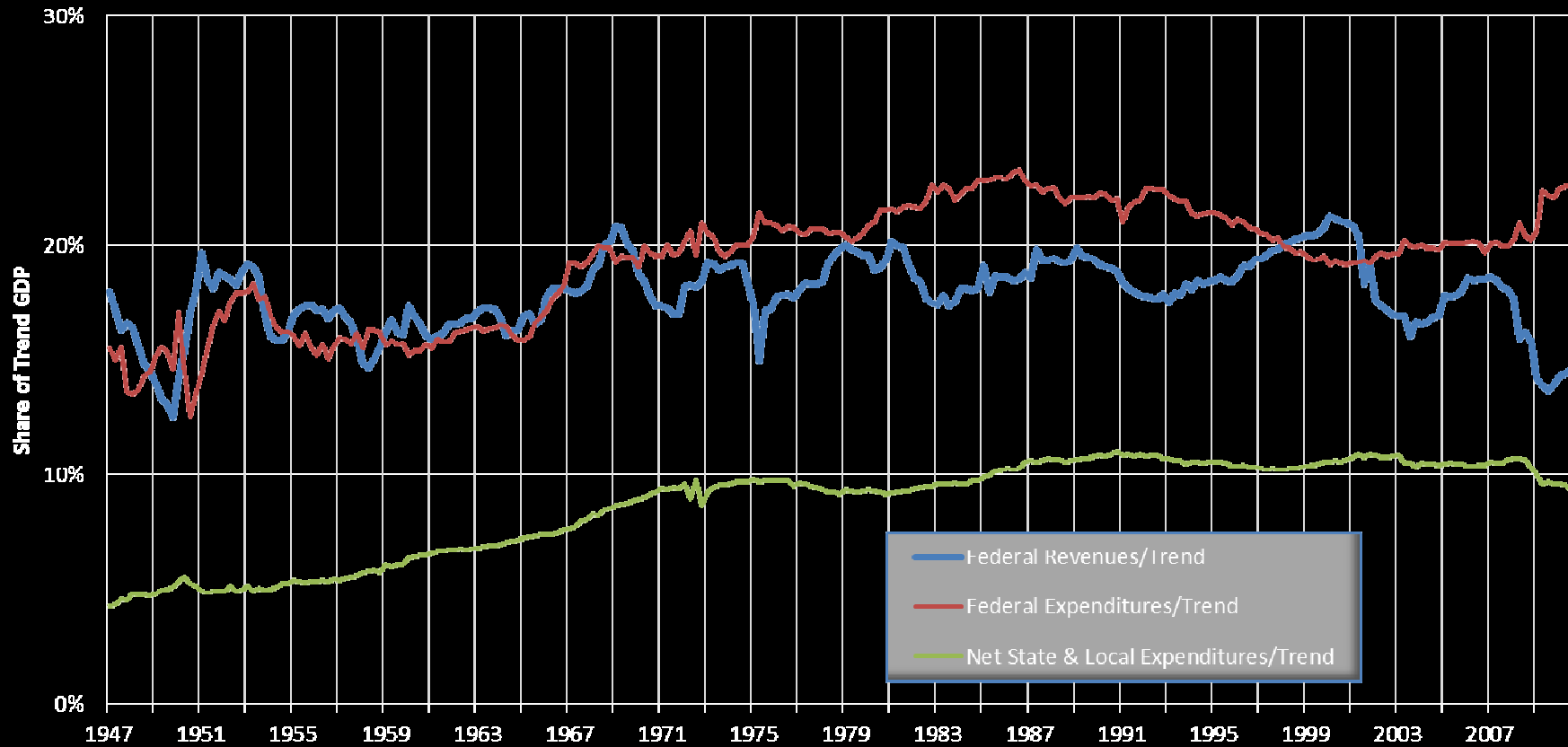
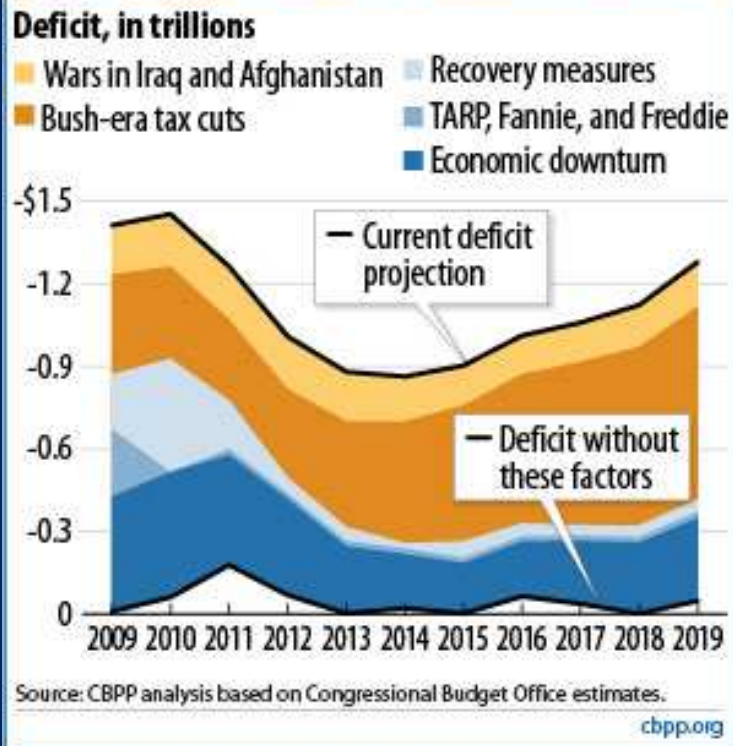


Figure 1:  
Economic Downturn, Financial Rescues,  
And Legacy of Bush Policies Drive Record Deficits



The recession and the stimulus made big budget deficit projections even bigger.

It is disingenuous at best to extend current tax cuts and complain about the deficit.

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# Fifty Herbert Hoovers

- State and local governments are often ignored.
- SLGs purchase more goods and services, and employ more people, than the federal government.
- Most SLGs have balanced budget requirements, which means they must either cut spending or raise taxes during recessions.
- SLG financial crises lag the rest of the economy.

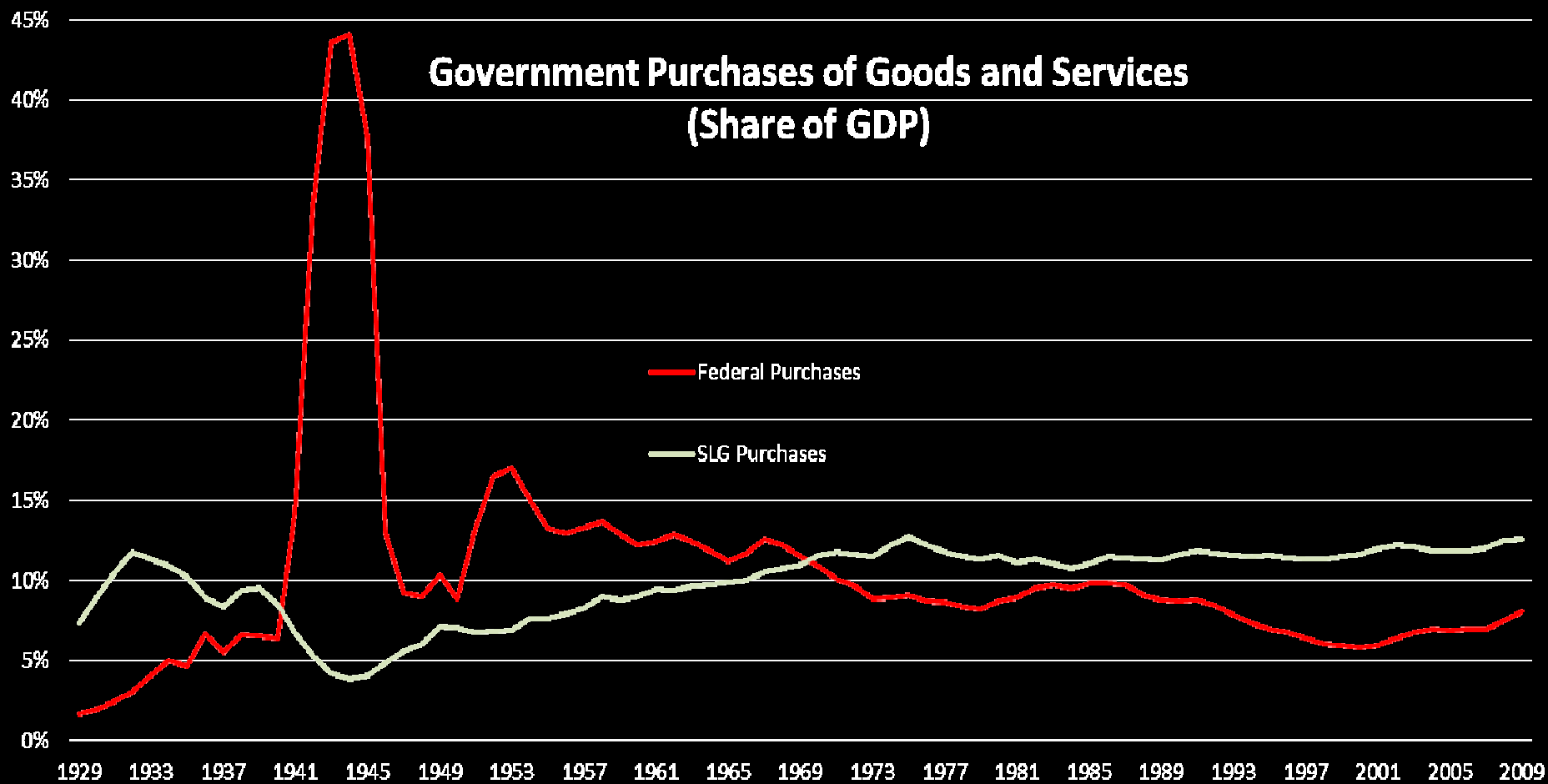
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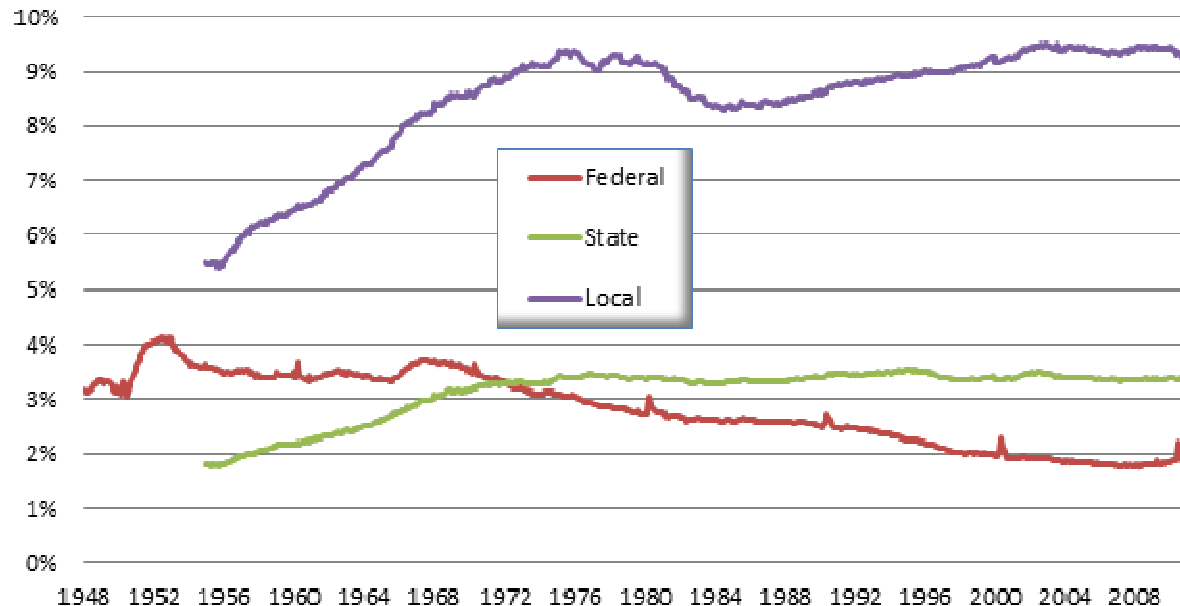
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## Government Purchases of Goods and Services (Share of GDP)



## Federal, State, and Local Government Employment (Share of Labor Force)



## Runaway growth in government?

Spending cuts have bigger effects than tax increases.

It should therefore be no surprise that when SLGs are cutting spending as the Feds are cutting taxes, the economy does not recover very fast.

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# What happened to Nevada?

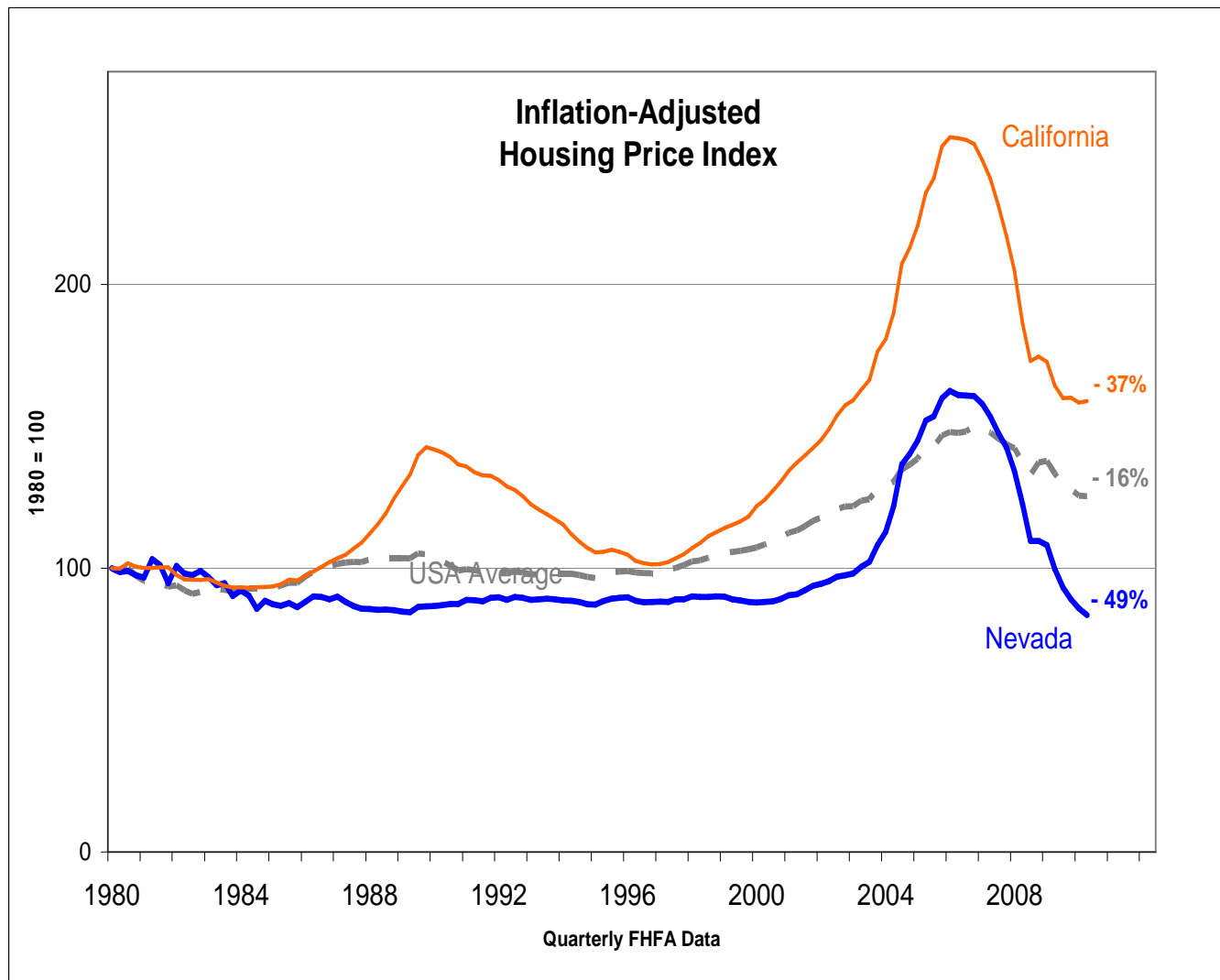
- Gaming was a sustainable model, until our monopoly ended.
- Las Vegas maintained growth by building new properties, but gaming/hotels/tourism still a falling share of state economy.
- Rapid construction was not sustainable: building homes for other construction workers, dependent on California bubble.
- Low educational attainment: supply and demand.
- Relatively undiversified economy: little public investment.
- State government revenues reliant on gaming tax, narrow-based sales tax; local government reliant on property tax, state.

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**Nevada lagged California, and our initial housing stock was smaller.**

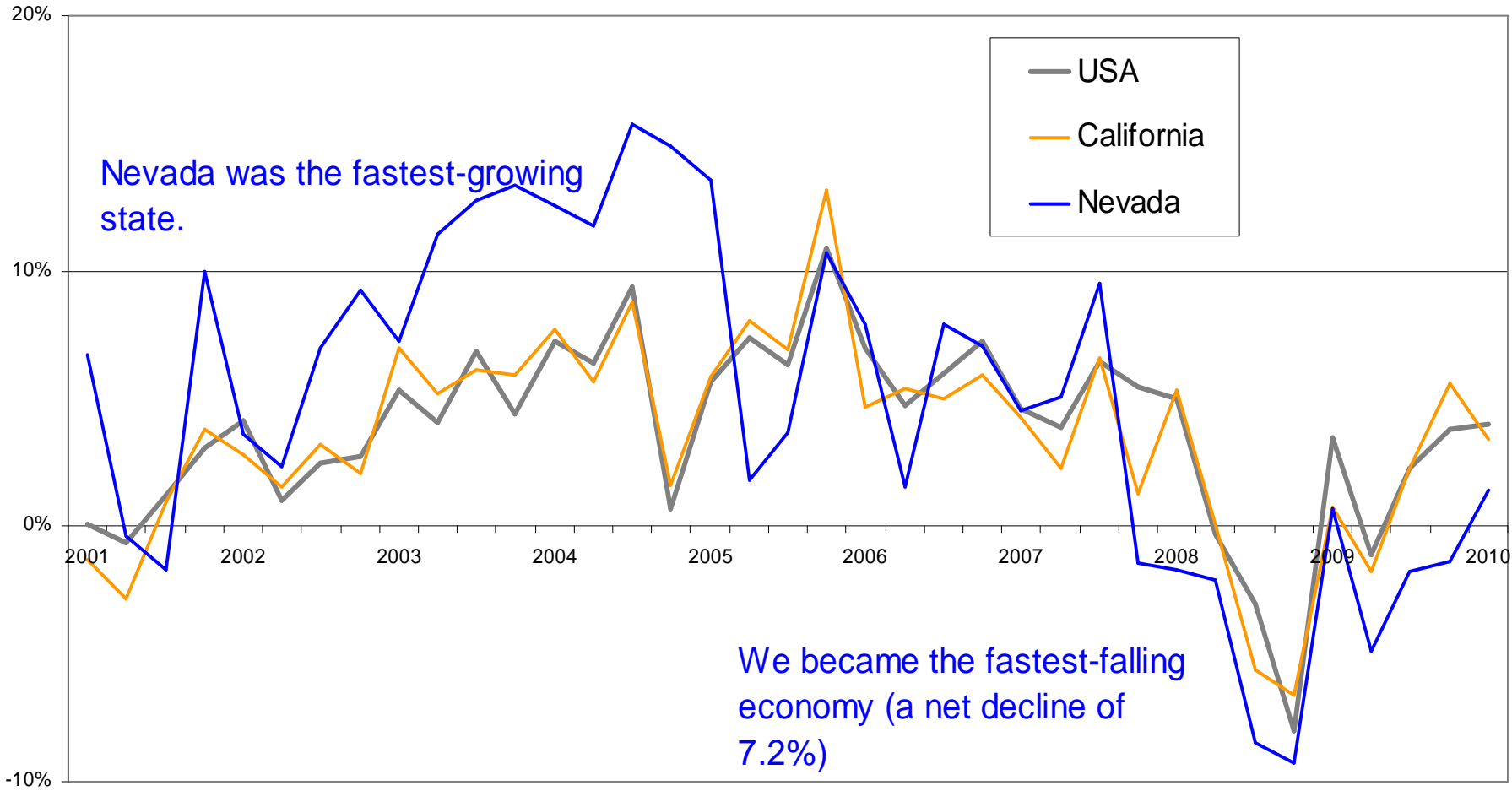
**They came here looking for deals.**

**Our construction sector was the country's largest.**

**Underwater mortgages:**

- **USA 23%**
- **CAL 33%**
- **NEV 66%**

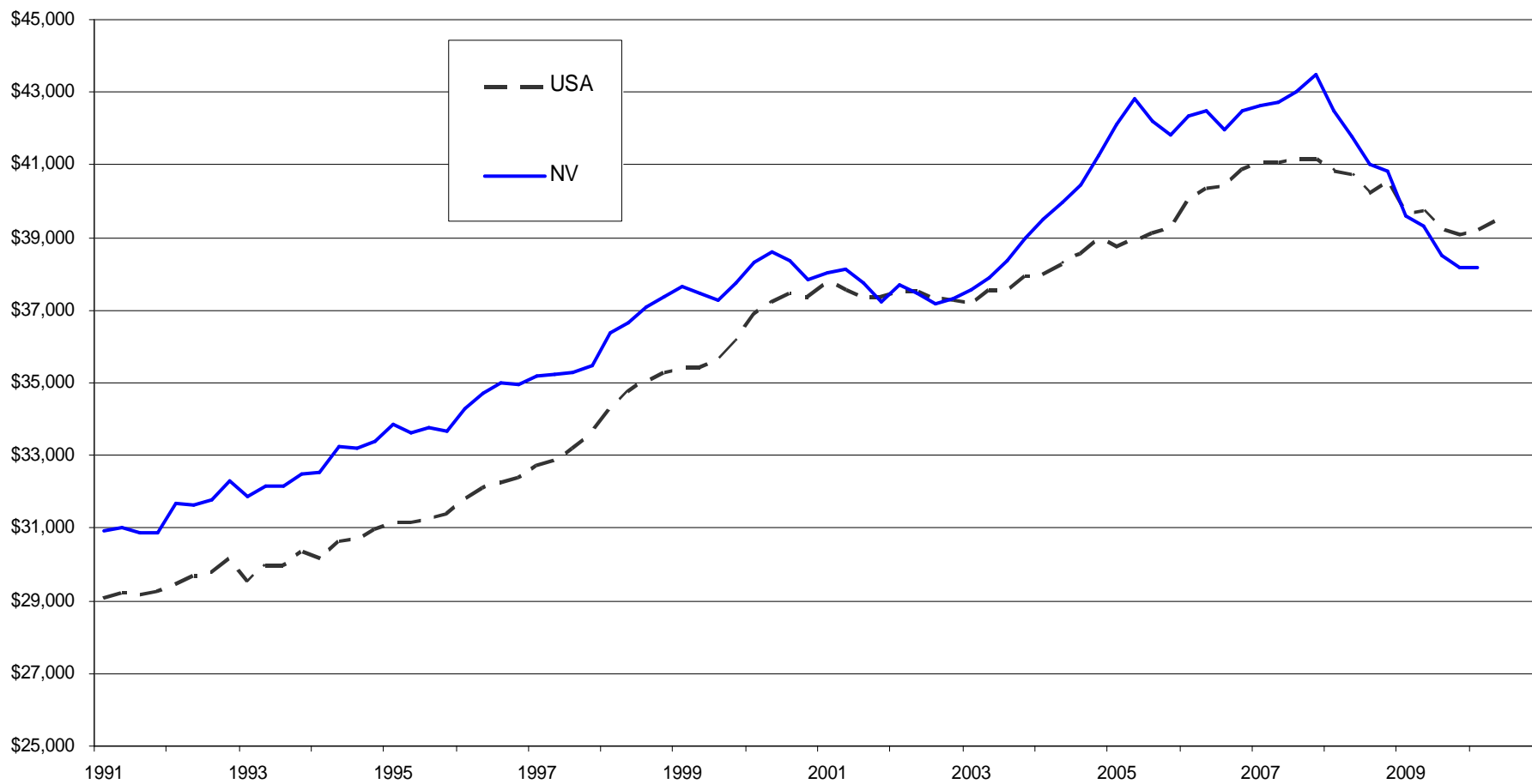
# Personal Income Growth Rate



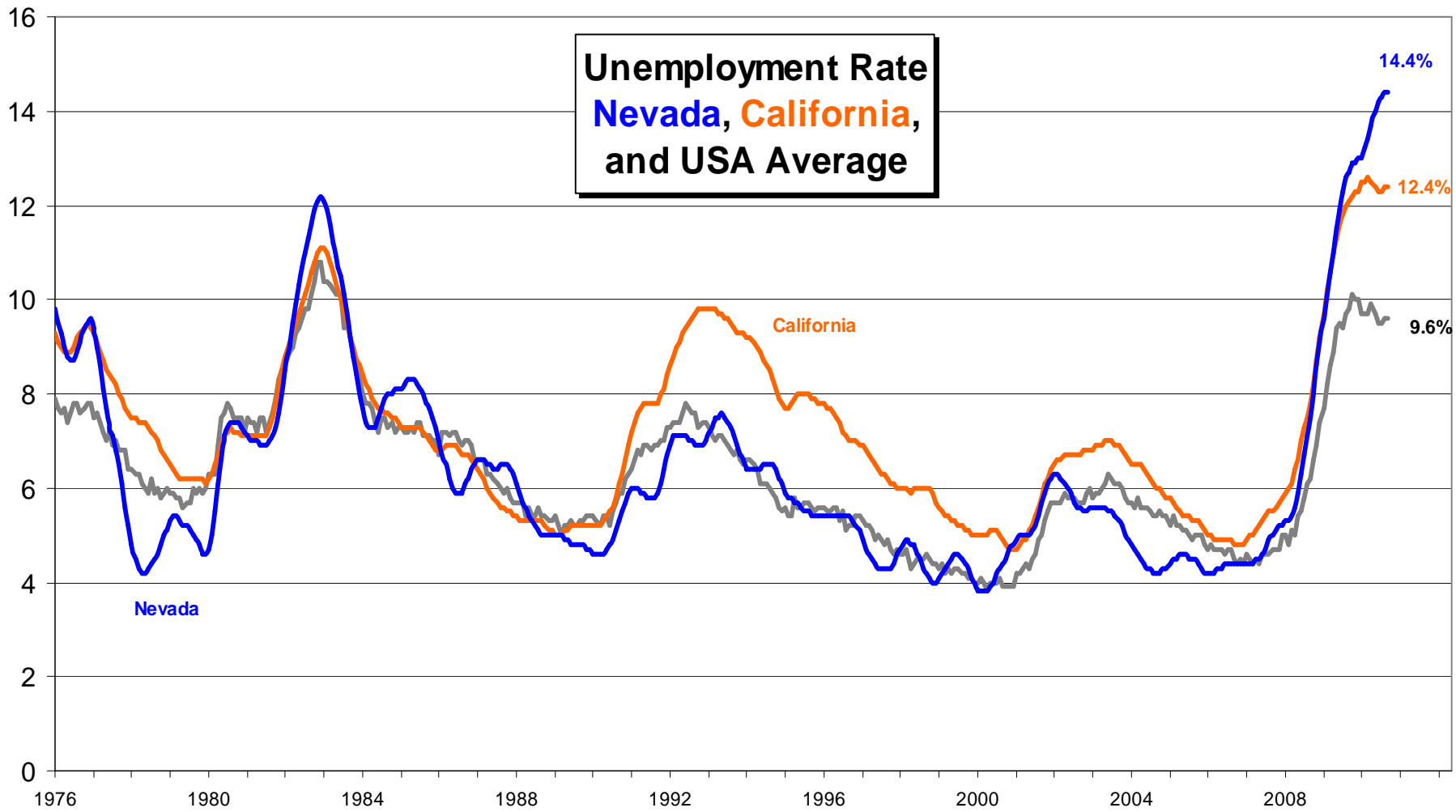
Nevada was the fastest-growing state.

We became the fastest-falling economy (a net decline of 7.2%)

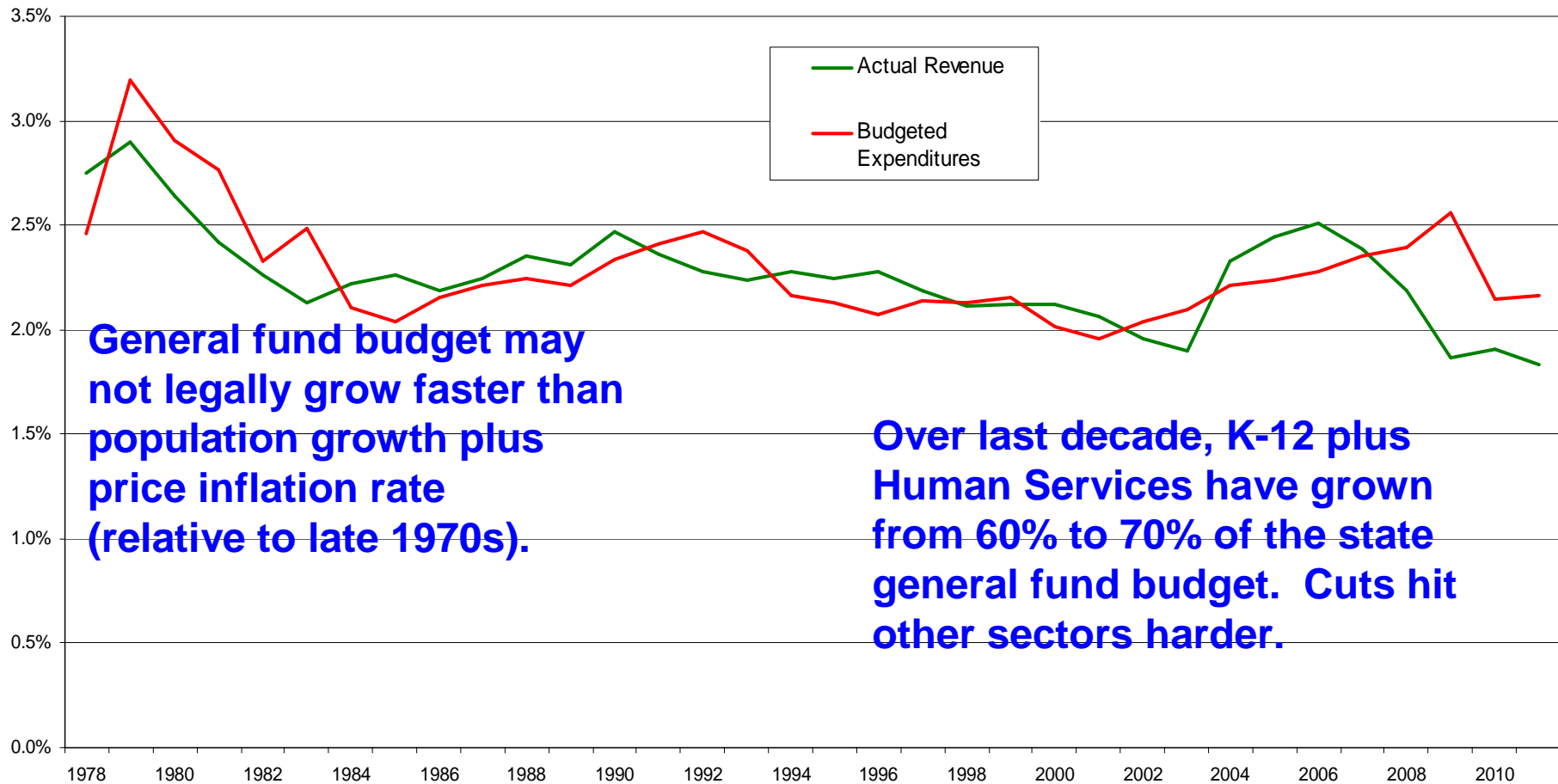
Real Per-Capita Personal Income



**Unemployment Rate**  
**Nevada, California,**  
**and USA Average**



Nevada State General Fund  
(Share of 1980-2005 Trend GSP)



**General fund budget may not legally grow faster than population growth plus price inflation rate (relative to late 1970s).**

**Over last decade, K-12 plus Human Services have grown from 60% to 70% of the state general fund budget. Cuts hit other sectors harder.**

# What is the Prognosis Now?

- Housing prices are stabilizing nationwide, but there is still a significant inventory of foreclosures and forced sales which are off the market.
  - Nevada's housing glut is much worse.
- National "recession" over in 2009, but still in trough.
  - Nevada's recession may have ended in 2010.
- Unemployment lags growth, and acts as a brake.
  - Nevada's rate is being checked by emigration.

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# What about Nevada?

- State revenues appear to have bottomed out and are starting to recover, but all funds are drained.
- California is adding jobs, which will help in Nevada, but Nevada has lost half as many as California has gained.
- Nevada underinvests in education and public investments, and is poised for large additional cuts.
- States with more educated workforce are quicker to recover.
- People continue to hope for one more magic bullet.

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# So What Shall We Do?

- Nevada is a low tax state, no matter what NPRI says. The projected budget gap is only 1% of GSP.
- Few state employees, but once paid well on average.
- Local employees paid even better, on average.
- We can trade reforms which reduce the growth of future spending in return for tax restructuring now.
- Basic state services necessary for a decent present, but education is necessary for our economic future.

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