BusinessAdvisor

a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

VOLUME 28
NUMBER 6
AUGUST
2012

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AN UPDATED LOOK AT THE ECONOMY

by Mary Hanson

In 2009 I wrote two articles about the economy and the mostly negative indicators for the future. In September of 2009 I wrote an article entitled "Why America Won't Be Back," predicting continuing challenges for economic growth. I predicted that "we will bump along the rough road of 'economic recovery' for a number of years without meaningful economic improvement." I commented that "Government policies, spending, debt servicing, and taxes will impede economic growth."

An eye on local and global economic conditions is important to business owners and investors. The economy will either directly or indirectly affect the market for any firm's goods or services as well as the cost of doing business.

In reviewing key indicators and government policies to update my picture of the economy, I found few economic factors that offer hope of a brighter future. Since 2009 additional negative circumstances have become evident.

There are at least four notable new developments that further darken an already gloomy picture. One development is the slowdown of the economy in China, which now purchases around 10% of global output. The reduction of China's demand for equipment and commodities threatens to affect the economies of a number of countries dependent upon export. In 2009, China was the bright spot of the global economy.

Another development is the European debt crisis, which has grown to the point that it threatens the survival of the Euro. The debt of European banks and governments are intertwined to a significant degree, making resolution of the European debt problem a long-term and politically dangerous endeavor.

The U.S. national debt has grown by over $1 trillion each year since 2007, reaching a total ($15.8 trillion) that is greater than 100% of the U.S. gross domestic product (GDP) of approximately $15.5 trillion. The level of debt is only manageable based on the artificially low interest rates orchestrated by the Federal Reserve. By the time you read this, the national debt will be increased by another $3.6 billion for each day that has passed since these words were written. Of every $1.00 spent by the federal government, $.35 is borrowed.

The U.S. federal government continues to spend without addressing the ballooning debt and precarious financial situation that is building. Much of the spending, including purported stimulus spending, is non-productive (the U.S. receives no current benefit from the expenditure) and there are no anticipated changes in policy which would reverse or reduce this trend.

The Economic Indicators

In early 2009 only the yield curve seemed to predict improvement, while other indicators, such as the Conference Board Leading Economic Index, the ISM index of new orders, the ISM manufacturing activity index, the ISM index for the non-manufacturing sector, the Korea

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Composite Stock Price Index (an indicator of global manufacturing), the U.S. stock market, and the Conference Board Consumer Confidence Index, all looked weak. By September of 2009 these indicators reflected some improvement, but I observed then that they "do not seem to reflect a deep, wide, or steep upward trend."

The yield curve in 2012 has flattened, due greatly to manipulation by the Federal Reserve's "Operation Twist." A flatter curve does not predict economic improvement.

Stock markets have rebounded. The Dow Jones Industrial Average, now pushing 13,000, was dropping through the 7,000s in February of 2009. The KOSPI index, a Korean stock market index that serves as a global manufacturing index, was under 1,100 in February of 2009 but back in the 1,800s in July of 2012.

Various economic indices are mixed, but still evidence minimal improvement since 2009. The Conference Board Consumer Confidence Index, at an all-time low of 25.0 in February of 2009, reached 62.0 in June 2012. The Conference Board Leading Economic Indicator Index dropped from 99.5 in February 2009 to 95.8 in June 2012.

The ISM indices of new orders and manufacturing activity were in the 30s in February 2009. A reading above 50 percent indicates expansion; below 50 percent indicates contraction. Those indices for June 2012 were at 47.8 and 51.7. The ISM index for non-manufacturing was at 52.8 in June 2012 vs. 42.0 in February 2009.

Real Estate

Many economists claim that our economy cannot recover without a recovery in real estate. In 2009 excess inventory was estimated at around a 10 month supply. The national inventory now is estimated at around 4 to 6 months. Houses stuck in the foreclosure pipeline effectively prolong the foreclosure process and prevent the recovery of the real estate market through the clearance of inventory.

The current estimated underwater status of 30% (up from 22%) of home mortgage loans dampens consumer spending and blocks many home-owners from relocating for better economic opportunity.

A noted "bright spot" in early 2012 was the increase in "housing starts" for residential housing units, at 760,000 units for June. While an improvement over prior periods, the number is only 34% of the high of 2.2 million units in February of 2005 and less than half the typical levels since 1997.

It should be clear by now that low interest rates and low prices alone will not revive the housing market.

The commercial real estate loan market that in February 2009 was predicted to be problematic has proven to be so. So far only 28% of the commercial loans maturing in 2012 have been paid in full. But since "investors' dismal expectations have been met" the news media gives little coverage to this factor of the economy.

Real estate and associated loan markets still provide ample justification for economic pessimism.

Unemployment

The key unemployment rate of 8.1% in February 2009 is now at 8.2%. The total of workers categorized as "unemployed" in U.S. statistics was 12.5 million in February 2009 and 12.7 million in June 2012.

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A key challenge for U.S. employment is that the economy must absorb both the newly unemployed and new workers entering the workforce upon graduation or departure from college, high school, and training programs, and those who seek employment after a change in family or financial situation. The number of such new workers is estimated at 125,000 per month. In other words, the U.S. economy has to create 125,000 jobs each month just to absorb the young people and others just entering the job market. Even more jobs must be created to put the unemployed back to work and bring the unemployment rate down.

More important than the unemployment percentage is the big picture of employment and productivity. Fewer people are looking for work, making the "unemployment" number appear better than it is. The unemployment rate of 8.2% is determined by dividing the number of "unemployed" as defined by the Bureau of Labor Statistics – currently 12.7 million – by the total of the U.S. "labor force" – currently 155 million. The Bureau of Labor Statistics defines "unemployed" to only include workers who have looked for a job in the last four weeks. The BLS also reports statistics on "discouraged workers" – those who gave up looking for work – and on the "involuntary part-time" – those who have been unable to find full-time employment. Currently those two additional un- or under-employed categories add 9 million to the rolls of those who would or should be working. The real unemployment or underemployment rate is disturbingly high and presents a serious challenge for the U.S. to put these millions of people back to productive (and taxpaying) work.

Obstacles to Economic Recovery

- **National debt.** Paying just the interest on the national debt will require about $220 billion in 2012. Even at low current rates this consumes 6% of the budget (and 9% of actual revenue). If (or when) interest rates rise, the interest alone could consume an alarming portion of the U.S. budget. Even if the U.S. stopped deficit spending today, the U.S. is in a precarious position with the current debt alone. Debt service and repayment of debt are unproductive expenditures, paying for benefits (or imagined benefits) from prior periods. The use of federal funds on unproductive obligations crowds out productive expenditures that would enhance the economy.
- **Local governments.** Decreased revenues from business sales tax and real estate taxes have collided with overspending by municipalities to create a potential crisis at the local level.
- **Pension plan liabilities.** An estimated 88% of all state and local government workers are covered by defined benefit pensions (which pays a retiree until death), while only 10 or 20% of private companies still offer such retirement plans. The low returns on pension plan investments along with the long retirements (e.g., from age 60 to age 90) of former public employees threaten the budgets of states and municipalities. A growing portion of local budgets will need to go to funding the retirements of former employees.
- **Student loans.** The Consumer Financial Protection Bureau reported that total student debt now

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Publisher's Note

Many economists and politicians promote government stimulus plans to boost the economy. The level of debt has become so high and the level of economic output so low that only economic growth can begin to solve the problems. In my view government is by nature too inefficient and too subject to influence and distortion to be a good source of solutions. Attempts to stimulate the economy through government spending have, in my view, predictably failed because of the lack of wisdom in government programs.

In my opinion the best economic stimulus possible would be a broad reduction in taxes, leaving money in the hands of consumers, investors and businesses who are motivated by results. I doubt any government could build value or create jobs as effectively as the average American taxpayer.

Mary Hanson
Attorney/Publisher

exceeds $1 trillion (up from just $430 billion in 2005). The delinquency rate for all student loans approaches 9%. 37 million Americans have student loan debt (up from 23 million in 2005). Compared to other consumer debt (which totals $2.5 trillion, most of which is dischargeable in bankruptcy), these non-dischargeable student loan obligations are significant.

The alarming levels of debt owed by consumers and governments mean that funds that otherwise could have been used to purchase goods and services are redirected to "debt servicing." The prospect of ever-increasing debt payments is daunting.

- **Unfunded liabilities.** In addition to repayment of the national debt, the U.S. government is obligated by law to make payouts under programs such as Medicare, Medicaid and Social Security. The Government Accountability Office projects that payouts for these programs will significantly exceed tax revenues over the next 75 years, and the cost of these deficits will add tens of trillions of dollars to the U.S. budget. Estimates range from $45 trillion to $85 trillion.

Businesses and investors need to treat current conditions as the "new normal." Planning and decision-making need to be done with this background in mind. The ever-increasing debt burdens in American society are like epidemics. Unfortunately, the remedies, if ever implemented, will take years to effect a "cure."

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