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Double-Dip Recession

By Richard W. Rahn
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Dire prospects rise along with borrowing

We are likely to have a double-dip recession, and this is why. Your Uncle Sam has been having a hard time because he spends more than he makes. He engages in much unproductive behavior and wastes a lot of money on things that he doesn't really need. He is easily influenced by his irresponsible children, Nancy and Harry, whose mantra is: "Spend, Sam, spend." Sam is also sloppy with his finances. His record keeping is poor, and he is frequently ripped off by people who claim to be his friends.

Recently, Sam experienced a big drop in his income, because his employer (the American taxpayer) had been taking financial hits. But Sam likes to live well, so he went to Mr. Goldman and Mr. Sachs' bank and borrowed some money. He also hit up some of his friends in China and Japan for additional loans. Sam had promised to cut back his excessive spending, but then he found he was so good at borrowing he decided not only not to cut back, but to spend more.

Sam was living in a good way. He bought many new cars for his friends and a new health-insurance policy that promised to cover 100 percent of anything his friends might need forever, and Nancy and Harry told Sam he should make his employer pay for it. It was a great life.

But then things began to turn a bit sour. Sam's employer said he would have to take another pay cut to pay for the health insurance and all of the new, legally required environmental equipment, which would wipe out most of the profit he had been making.

Sam then did what he was good at -- he borrowed money. He found out that Mr. Goldman and Mr. Sachs' bank and his Chinese and Japanese friends would still lend him money. But since he had borrowed so much and was a credit risk, they said they were going to have to greatly increase his interest rates. Sam agreed to pay the higher interest in exchange for the additional loans, but then Sam found he did not have enough money for all of the spending he wanted and all the presents he had promised to give to others.

So, as you would expect, Sam ran out of money even sooner this time. He had to run back to the bank and his friends, and borrow even more at ever increasing interest rates, until he found that he was just borrowing more money to pay the interest on all the money he had previously borrowed.

SAM'S Financial Statement				
	1987	**1997**	**2007**	**2009***
Deficit as % of GDP	-3.2	-0.3	-1.2	-11.9
Spending as a % of GDP	21.6	19.6	20.0	27.4
Debt as a % of GDP	40.6	46.1	36.9	54.8

Source: CBO; * -- Data for 2009 are projections

Desperate, he went to see his friend Ben at the really big bank, and said: "What can I do?" Ben looked at Sam's income statements and balance sheet, and said: "You are in deep trouble, but this is what I will do for you. Because there is no way you can now earn enough to pay off all of these debts, I am going to give your employer 'new money' to pay you twice as much as you have been earning." Sam said: "Hey, that's great. But what's the catch?" Ben said: "The money will look the same, but it will only buy half as much as before. It will still be called a dollar so you can pay off your debts to your Chinese and Japanese friends, and to Mr. Goldman and Mr. Sachs' bank. They will all be hopping mad, of course, about getting dollars that can't buy much, but that's their problem."

Sam said: "Wait a minute .... I will only be able to buy half the things I used to with these cheap dollars." Ben said: "That's right, Sam, it is called inflation, but it is better than debtors' prison or being knee-capped."

It turns out Mr. Goldman and Mr. Sachs were not at all upset about Sam paying off the loans in "the new dollars" since they had long ago sold off Sam's loans to others who had heard Sam had always been good for the money in the past.

Sam's employer is every American, and we have all been suckered by Nancy, Harry and their irresponsible colleagues. Tax revenues (Sam's income) have been falling at a record rate, and now only cover half of government spending. Spending is up more than 50 percent in one year. Consumer spending rose slightly last month, but incomes fell.

As interest rates rise, as they must, and international commodity and other prices rise as the global economy recovers, real, after-tax, inflation and tax-adjusted disposable incomes will continue to fall. This means real consumption can rise temporarily but will likely fall again, giving the United States a double-dip recession.

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