WTF Just Happened?

I started writing macroeconomic essays in January 2009. Back then, the smartest people in the room had totally missed the circumstances that led to the global financial crisis. That crisis threatened the fiat currency system we have operated under for many decades. Why did this happen? Why did our greatest economic minds miss something that almost destroyed our economy? I wanted to know.

Since January 2009, I've written about 80 essays on various socioeconomic topics. Most of my essays have focused on what seem like obvious dysfunctionalities in today's economic system, or at least the economic systems of developed economies.

In the beginning of my journey as an armchair economist, what defined a developed economy was an environment where needs were so ubiquitously met that wants had become a large (the?) economic driver. Developed-economy populations generally lived a comfortable to a very comfortable life.

You don't often see an emaciated person in the developed world. Instead, there's an obesity problem. And virtually every developed world citizen has a toilet in which to do their business. There are those without a roof overhead but there are also plenty of roofs they could sleep under. Developed economies have challenges, but they are not third world or emerging market economic challenges.

This was at least the assumption 11 years ago. Today though, as most of us know, developed economies have a shrinking and struggling middle class.

In the U.S., Average Joe wages have not grown enough in the last couple of decades to keep up with their cost of living. Readers have likely seen the stories suggesting that nearly 40% of Americans could not afford a $400 surprise expense in any given month. How have the economic lives of so many people become so fragile? Why does the American Dream seem to be disappearing?

It is commonly understood by most economists, investors and policymakers that inflation has not grown measurably for many years. That is true when considering official government reported data. But for a great many Average Joes, that official data is meaningless. Their wages barely budge, and every year they seem worse off.

It has been convenient for the official calculators of inflation to suggest the cost of many products have not been inflating because the value of those products was increasing. Today's automobiles may cost more, but they come with more, like embedded intelligent communications and transportation systems. And telephones today come with access to all manner of instantaneously available information and entertainment.

There may be a formula that suggests inflation today is benign, but consider that we are expected to pay up to $1,000 for a new smart phone. A couple of decades ago, that phone cost about $30, information was available for free at the library, and entertainment was free on TV. Yet, this $1,000 smart device is no longer a luxury item. The Average Joes and their families require them in order to fit as well as possible into "modern" society.

In addition to the cost of more expensive but "better value" consumer products, other important and impactful personal expenditures highly necessary for a competitive and successful working career, like health care and education, have risen much faster than official inflation.

All the current wonderful technologies that are minting billionaires and millionaires have not allowed Average Joe wages to increase enough to meet their growing "benign inflation" living costs. And, given that achieving 2% GDP growth has been challenging for several years it appears these wonderful new technologies have not contributed greatly to overall prosperity.

These circumstances have created obvious social tension and economic fragility, so much so that governments in developed economies have become dependent on injecting larger and larger amounts of capital (money) into their economies in order to maintain social and economic order.

To rise out of the 2001/2002 recession, the U.S. government injected a great amount of capital into the economy via fiscal spending, which increased government debt. In addition, our central bank, the Federal Reserve, increased monetary stimulus by decreasing interest rates.

In order to escape the 2008/2009 recession, the U.S. government injected an even greater amount of capital into the economy via fiscal spending, which increased government debt. And then again, the Federal Reserve increased monetary stimulus by decreasing interest rates, as well as adding over $3T into our monetary system via quantitative easing.

Federal debt to GDP in 2000 was about 55%. By 2008 it had reached 64%. By 2010 it was 80%. By 2013 it had reached 100%. Very soon it will be over 120%, if it isn't there already.

The average 30-year mortgage rate in 2000 was 8.05%. The average mortgage rate in 2003 was 5.83%. Today it is 3.31%.

The lower the cost to borrow, the more people can afford to spend. Lower interest rates create lower monthly payments, so it's easy to borrow more and buy more.

Who can't see this pattern? Over the last two decades in order to keep our economy functioning, we've had to inject larger and larger amounts of capital into our economic system. All that money created numerous jobs, so many that just prior to our current crisis we were at generational lows for unemployment. But now, 40 or so million people have been laid off.

Up to 25% of all the workers in the U.S. have been laid off over the last few weeks. How great is an economy, if, in an economic instant, 25% of its work force gets laid off? It's certainly not a great sign of economic resilience.

Growing fiscal and monetary stimulus over the last 20 years did not strengthen our economy. It actually made it more fragile. The jobs we created were in low pay, non-essential industries. Now a great number of those people are unemployed.

As is common knowledge to mainstream economists, the U.S. economy has changed dramatically over the last 50 or so years. After WWII, goods production dominated our economic activity. But over the last few decades we've seen a transition from goods production to service and consumption. Today, around 70% of our GDP is generated by our service sector (which includes consumption).

Service? Consumption? These are highly sustainable industries? The current crisis suggests they are not.

Today, our overall economic "prosperity" is highly dependent on the retail store, restaurant, hotel, resort, spa, massage parlor, nail salon, casino and various forms of entertainment. Powerful industries, powerful jobs?

Except for the celebrities and their "handlers," the majority of these service and consumption jobs are low pay. Only so many people can be movie stars, professional athletes, or highly paid lawyers, investment bankers and investors.

Some of these low-pay, non-essential service jobs will return, but not all of them. In just the restaurant industry, experts are predicting a loss of as many as 30% of those businesses. Follow that trend into all the other non-essential industries. It suggests we could be stuck with high unemployment for some time to come.

That's why the federal government has and will continue to inject trillions of dollars into the economy and why the Federal Reserve is backstopping all manner of public securities. We can't let these "wants industries" fail. They support way too many jobs.

During the Obama administration, we almost doubled the national debt, from $9T to almost $18T, while the Federal Reserve added about $3T to its balance sheet. That's a tsunami of capital injected into our economy compared to any prior presidential administration, but it's likely a paltry sum compared to what will be injected to pull us out of the current recession.

In just the last couple months, Washington has injected or pledged $2T+ into our economy while the Federal Reserve balance sheet has expanded from a bit over $4T to over $7T. And the year still has many months to go. Federal debt and Fed balance sheet growth during the eight-year Obama administration approached an asthonishing $12T. In just one year—this year, 2020—it looks like we could exceed half that amount.

So, WTF just happened?

To put it in terms both mainstream economists and Average Joes can understand, we fucked up.

Many will suggest the fuck-up was closing down economies in order to flatten the curve, in order to save our hospital systems from being overloaded with crisis patients. Maybe closing down many parts of the economy helped reduce the pressure on hospitals and prevent even more COVID deaths, but in the process 40 million workers lost their job.

One such worker was George Floyd. His death was senseless, to be sure. Had we not just seen the most rapid and dramatic drop in the history of U.S. employment, do you think George Floyd would have resorted to using counterfeit money? And how has this period of massive layoffs influenced the scope and scale of social unrest we have recently experienced?

Closing the economy like we did was a mistake, but the real fuck-up came about as we embraced a consumption- and service-based economy over the last several decades. It should now be obvious we've been growing "non-essential" industries much more than we've been growing essential industries.

The foundation to all economy is goods production. That's been the case since indigenous people turned rocks into spear points in order to trade for corn that another tribe had grown from seed. Service serving service that serves service is not a sustainable economy. Nor is an economy where the consumption of wants has far eclipsed the consumption of needs.

We can only hope that government policy moves our focus towards creating more essential jobs—those that produce goods. If we don't start to transition back towards more domestic goods production, the likely result will follow the pattern of the last three recessions. The next crisis will be bigger than this one. It will require even more bucket loads of money for us to keep the wheels on. And today's social unrest will pale by comparison.

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