



Where

do

we

go

from

here?

The news is inescapable—every day seems to bring new information about the slumping economy. Unemployment hits a new high. Another bank seeks bailout money. The number of houses in foreclosure increases.

To provide their perspectives on the ongoing recession, four USF professors from diverse disciplines recently sat down with *USF Magazine*. Rather than simply focusing on the reasons leading to the current situation (How did this happen? Who is to blame?), we wanted to know more—what's not being talked about, how other countries are being impacted, and whether the U.S. may emerge from the crisis as a stronger, more united nation.

Our panel included Bill Edwards, associate professor of sociology; Rich Puntillo, professor of finance; Peggy Takahashi, associate professor of management; and Bruce Wydick, professor of economics.

On a scale of 1 to 10, with 10 being well on the road to recovery, where are we now?

Wydick: I would say a 2 or 3 at the most. This recession ought to be much steeper than the one in the early 2000s and probably even steeper and maybe longer than the one in the early '80s. The problem was that we understood the one in the '80s—you had to raise interest rates to kill inflation. That one was a no-brainer and it just had to happen. This one is bigger and more mysterious. World trade is down 45 percent over several months ago, which is calamitous. Fortunately, (President Barack) Obama has realized that we can't get into a "better than thy neighbor" trade situation, which could literally throw the whole world into a depression as it did in the '30s. He's backing off the "buy America" kinds of things, but every country is trying to subsidize its domestic industries, which amounts to almost the same thing. Everyone is trying to save their own industries.

Puntillo: That's normal. You're taking government money, public money, and putting it into private enterprise, so you like to think you're going to build American jobs. If everyone does that, international trade falls. I wouldn't even guess where we are in the funnel.

Edwards: I think we're in step one of the scientific method—acknowledgement of a problem. But delineating the problem precisely is difficult. The problem manifests itself into so many permutations that we don't have problem clarity.

Takahashi: Plus, people are starting to tighten their belts and not buy things, so that's making recovery even more difficult.

How does the ongoing crisis affect our society overall as a whole?

Edwards: We're having a reality check. Even some people who may not be in financial difficulty are feeling the tension around them and thinking, "Is this a contagion and will I get it and do I need to insulate myself?" I think people realistically are reassessing themselves, their ambitions, their aspirations. There's a lot of anxiety because we just don't know what's down the road, we can't see around the corner. Folks are playing their cards close to the vest.

Wydick: I like the passage in the New Testament that talks about trials developing character. When you look at the generation that went through the Depression, there was a character formation that happened in that great generation that I think is largely absent in us today. I'm not saying that we should seek out difficult times, but at the same time, it's an opportunity for people to pull together, to care for the least fortunate in their community. There could be some opportunities for growth as a country.

My optimal decision in terms of investing or saving or consuming depends on what I see other people doing. If everybody thinks everybody else isn't going to invest or consume, then neither do they.

—Bruce Wydick



Edwards: There is this tremendous sense of extending help you see across the country where agencies that used to provide food and services to the poor or the marginally working class are now serving a population of a higher income and that population of a higher income is now meeting and interacting with people they may not have met before. For charitable organizations, there's a tremendous need. The other part of the equation is that charitable organizations are experiencing a downturn in terms of contributions. Will the nonprofits have enough resources to continue to do what they're doing? As individuals tighten their belts, they're going to make less of a contribution.

What is the most important economic reality that isn't being told to the American public?

Puntillo: This is an enormous problem. I don't think that the government, President Obama, our key players, know exactly how big it is. If they did tell us what the dimensions could be, it could really hurt the level of confidence that is already quite damaged. We're in uncharted waters.

Takahashi: This is something a long time in the making. It's not something that should have been a surprise to us, given that two years ago people could not get a car loan, but they could get a mortgage. There's something wrong with that. There were a bunch of indicators that suggested we were in a bubble. What's not being said is some of what Obama has been saying, that we got ourselves into this and that we need to really clean up.

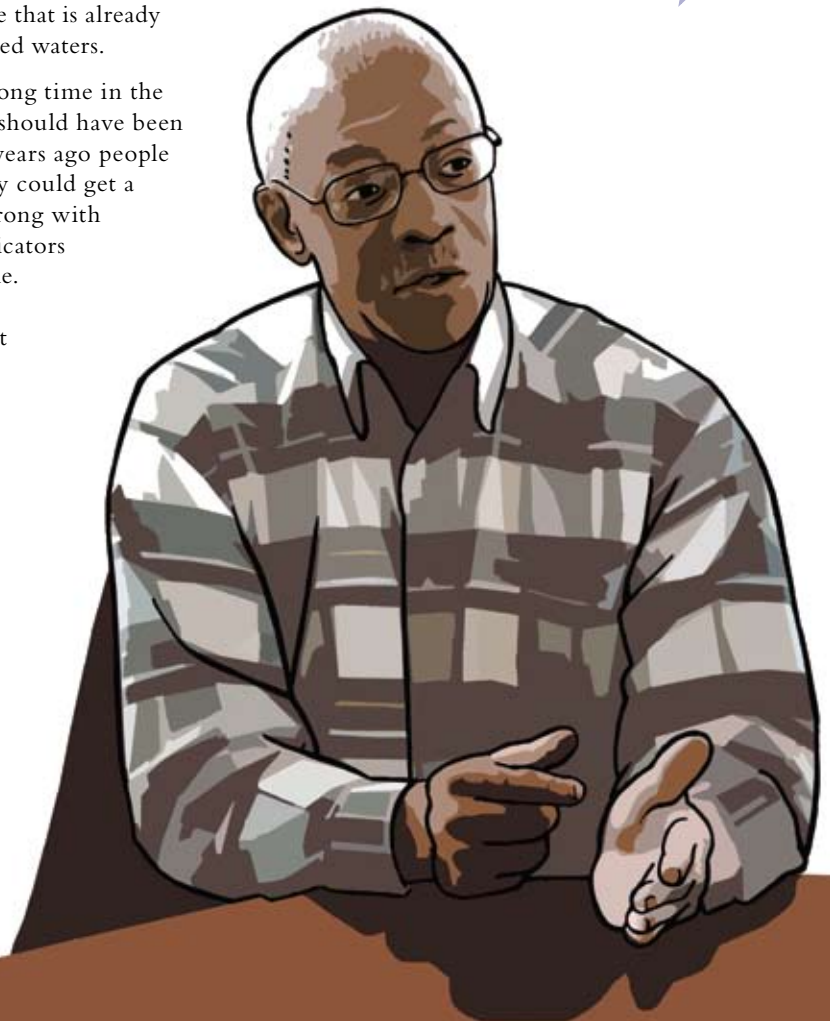
Wydick: I agree that it's been a buildup over a number of years. The lynchpin seems to be when we allowed the financial sector to finance essentially what was a speculative bubble. We introduced systemic risk into the entire financial system. It was an oversight in the regulatory laws that allowed a company like AIG, who's essentially insuring the mortgage market, to be so exposed to this risk and for Wall

Street to be so exposed to this risk, that it could bring down in a matter of weeks these institutions that have survived 100-150 years.

Puntillo: It's a regulatory failure, but it's an investor failure also. Investors are supposed to understand that if AIG failed, they'd be affected. Then there were the retail borrowers, people buying homes

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that they had no capacity to pay unless the price went up. I'm old enough to remember that when you bought a home in California, you had to hold it for two years before you could ever get back the 6 percent sales commission, and we experienced 3 percent a month. It was massive failure all around.

Wydick: Investors who take risks are supposed to fail part of the time, otherwise they shouldn't receive a risk premium. The problem is when that risk becomes systemized. That downside of individual investment decisions shouldn't bring down the whole system. I think that's where we got ourselves into a lot of this.

Thinking beyond our borders, how is this crisis affecting other countries?

Wydick: The media has given very little attention to the crises that are brewing overseas right now. In China you have lines a mile long of people that have become unemployed from factories. You have political economies in Eastern Europe that are on the brink. You have a lot of the gains of the post-Soviet breakup that we thought were cemented in place, but who's to know if you have rioting in the streets because of the international economy.

Puntillo: The experiment of the European Union is subject to possibly having some real difficulty. Maybe if you push it to the extreme, those countries could come apart in their agreements. If they no longer feel it's in their interests to remain together, they won't. It's an artificial, relatively recent phenomenon. If the crisis gets worse and they start protecting themselves, we could have kind of a breakdown in Europe.

Wydick: The United States may be in better shape than Europe, because we have a strong central government that's able to relatively quickly deal with these problems. Europe right now is just in paralysis with the European Union because it's so difficult to get anything done with 27 different countries and decisions move much more slowly. There's also much more fragmentation there.

What about in Japan? There have been comparisons made between our current economic situation and Japan's "lost decade" of the 1990s. Are there lessons we can learn from that experience?

Takahashi: The first lesson is that of cutting interest rates. You can end up in this liquidity trap, where

Meet the Experts

Bill Edwards is an associate professor of sociology and teaches a course on credit, debt, and society, as well as one on globalization, with a particular interest in global cities. His research centers on the growth and development of mega cities throughout the world. He has taught at USF since 1988.

Rich Puntillo is a professor of finance and teaches a course on venture capital and investment banking. His research interests include investment banking and due diligence, and corporate governance. Puntillo has been interviewed on Bay Area television stations and quoted in the financial press about the financial crisis. He has taught at USF since 1986.

Peggy Takahashi is an associate professor of management and teaches courses on global management. Her research has focused on Japan. She has taught at USF since 1997.

Bruce Wydick is a professor of economics and teaches courses on economic development, international economics, and game theory. Much of his research is concerned with the operation of credit markets and the evaluation of projects in developing countries in the areas of microfinance, education, and health. He has taught at USF since 1996.

there's lots of capital, but people aren't spending. Japan's last good economic year was 1989, then they really muddled, which is what we're doing right now. Japan tried cutting interest rates and if you factored in inflation, there was a negative interest rate. But there was no borrowing, there was no economic expansion. One of the mistakes Japan made was they went into tremendous debt by funneling money into the same types of programs that we want it to go into—social spending, building things. The difference between the U.S. and Japan is that Japan's infrastructure was already pretty good. A lot of our infrastructure actually does need to be rebuilt. I've heard a lot of complaints about our deficit going up because of all this spending, and that we're having big government, that's going to be woe on us, and look at Japan, they did the same thing and look what happened, but I see the differences.

Puntillo: Japan has a debt outstanding to its GDP of well over 100 percent. Ours is probably moving towards 50 percent and we worry about these deficits, thinking ultimately interest rates will rise and the dollar will fall. In Japan, interest rates have been low for all the time that the deficit has gone up, and except for the last couple of months, the yen has been doing just fine. Everyone is crying wolf for our deficit, and yet we have the example of Japan and its currency has not collapsed and interest rates have not gone sky high.

So is it fair to make a comparison to Japan's experience?

Takahashi: We just don't want to look to Japan and make the same mistakes they made by continuing to lower interest rates because lowering interest rates didn't help them in the long run. Putting money into social programs isn't such a bad idea in the case of the United States. In Japan, some

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projects were very foolish. But here we need the infrastructure in order to grow economically. We can't let our infrastructure continue to go down the tubes and by infrastructure I mean everything, not just roads and bridges, but schools.

How big of an impact is a lack of confidence having in extending this crisis?

Wydick: Economics, macroeconomics in particular, is about at the stage physics was at before Isaac Newton came along. One of the things we do understand is that psychology plays a much more important role than had been previously built into models. My optimal decision in terms of investing or saving or consuming depends on what I see other people doing. If everybody thinks everybody else isn't going to invest or consume, then neither do they. That brings about the role for government, which is to try and stop that downward cycle and give some people confidence that somebody is spending something. This makes the arguments about socialism or the arguments about the deficit getting bigger rather hard to hear for some economists. But we've already shot all our bullets with interest rates, so the only thing that's left is fiscal stimulus.

Puntillo: They're doing more than just fiscal stimulus. The Fed and the Treasury have been able to put money into the system in such a way that they're trying to rehabilitate the financial system and trying to be a source of stability. They have pushed as far as they can on interest rates, but they're building up a balance sheet, making sure they're going to be able to buy loans and securities from various financial institutions and hold those so that the financial institution gets money to be able to lend again. They're in effect providing liquidity, it's a liquidity backstop. We have a wounded financial system and it has to be rebuilt. Stimulus won't work if the financial system isn't rebuilt.

Will these actions help restore some confidence?

Puntillo: There's one case that was a total success. Most big corporations don't go to a bank for their working capital, they basically borrow money in the capital markets in something called commercial paper. In that commercial paper market, when Lehman Brothers failed, everyone said, "Who will be next?" There was no ability to find somebody who would buy GE's paper, Cisco's paper, Apple's paper, so the Fed stepped in. The biggest buyers

were money funds, so the Fed kind of guaranteed the deposits in money funds, and they guaranteed deposits in banks, because banks are reasonably big buyers. That stepping in all of a sudden gave credence and now the so-called secured collateralized commercial paper market is almost back to normal when it was literally stopped dead. The question is if they solve this one, does the problem pop up over there? If they keep picking it off one at a time, rebuilding, maybe things will get better in the capital markets sooner, but that's going to take awhile, and that shows up under the radar. That doesn't make into the newspapers.

Wydick: I think it's important for people to realize that literally the best people are working on this problem. It's a question of whether even the right people can solve this.

Edwards: You've got an incredible team, but it's like having a puzzle that you don't have the box for, to see what the puzzle is. You've got these geniuses at the table trying to figure out what exactly the puzzle is. You might know what the corners are because they're square pieces. People who understand the nature of the team may have a greater appreciation for what may be going on. But other people, the general public, will not have that confidence. The public wants to know if this is getting better. When are jobs going to be starting? When are shovels actually going into the shovel-ready projects?

Is there an opportunity to emerge as a stronger country as a result of this crisis?

Wydick: It could turn us into a very different kind of economy; moving away from employer-based health care coverage is one way. To tackle the deficit problem, you have to get at health care, Medicare, and Social Security. This will hopefully give us a chance to restructure our economy away from foreign oil dependence with these green infrastructure projects. We may also have a more stable financial system, one that has the right amount and the right type of regulation to check greed and keep bubbles from happening and that can just allow for steady growth and not get-rich-quick schemes.

Takahashi: This is definitely an opportunity, especially given the condition the United States is in across different areas—education, health care, infrastructure. We're not in very good shape and we can use this opportunity.

Edwards: We may come out of this in a kind of revolutionary sense because the kinds of things that the president is talking about are really futuristic, very specific things like thinking differently about the environment, about transportation, about schools, about how we even equip schools. It may be a revolution in our society. What will emerge may be unprecedented, far-reaching, and I think society could become very much transformed. [USF](#)

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