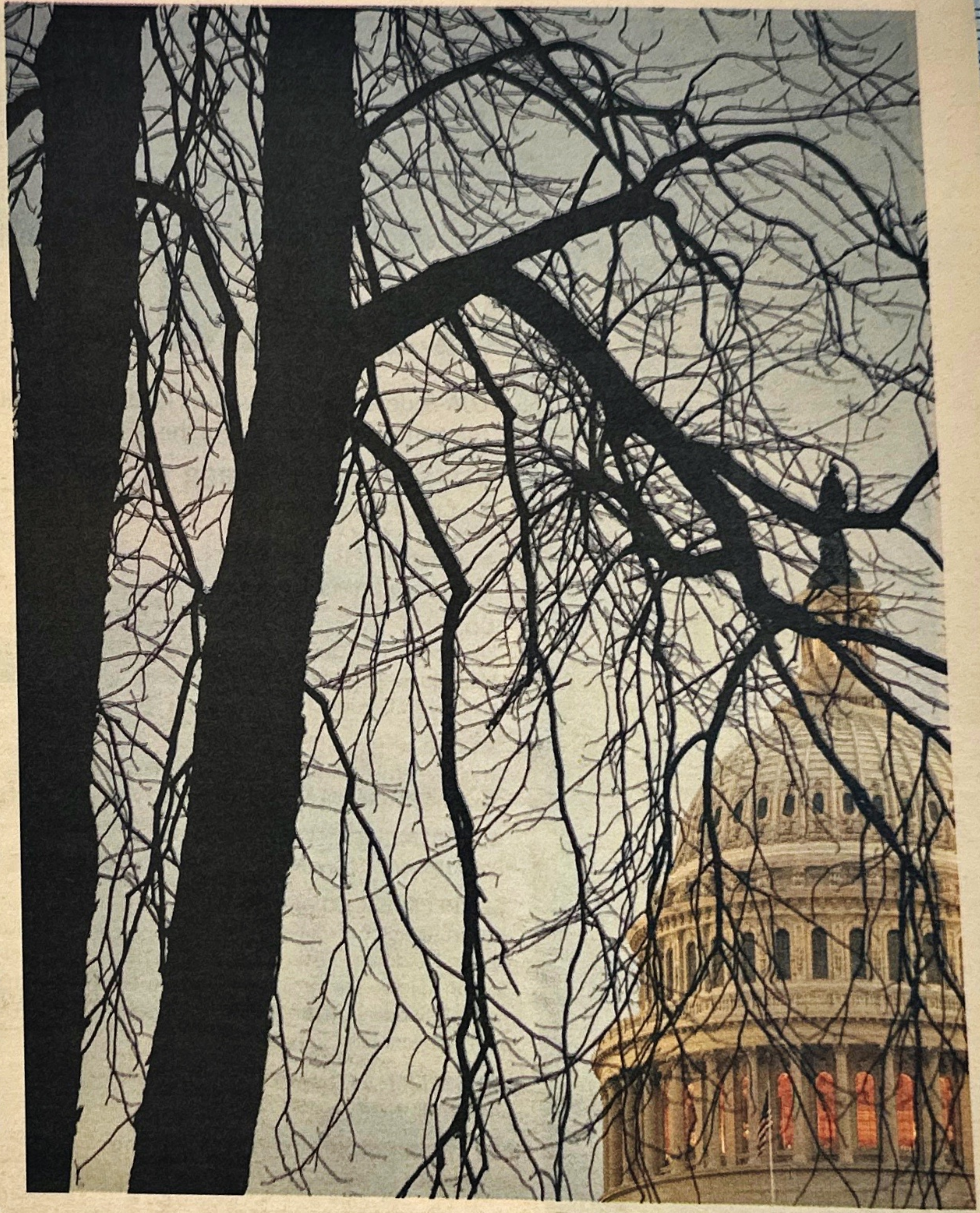

Market-Moving Myths

Despite conventional wisdom, misconceptions about the U.S. economy persist

We are living in a time in which the relationships between politics, economics and real estate have never been more interconnected. As I sit at my desk in Midtown Manhattan each day, I look at proposed legislation presented by local, state and federal legislators and try to figure out how these new policies will impact my ability to sell properties in New York City and what the potential ramifications will be on our commercial real estate market. Sometimes, connecting the dots is easy and, at other times, it is a bit more difficult. It's important to stay current with what elected officials are proposing because our markets can be significantly altered by new laws, either directly or indirectly.

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Therefore, watching the news and reading newspapers (or reading an electronic device) to look for indications of new policy have become even more important than in the past. One of the most interesting things to observe is the endless stream of soundbites that emanate from legislators on both sides of the aisle. Each side makes some arguments that are coherent and others that are absurd. What can be comical at times are the assumptions made by some politicians that bear no relationship to the facts. The folks who are responsible for shaping the direction of our future can at times be misinformed or, simply, uninformed.

This week, I would like to review three assumptions that are regularly presented to U.S. citizens as givens despite having no basis in fact. There are no direct relationships to commercial real estate presented here. These issues are more impactful on our general economy (which, of course, trickle down to our marketplace), but I thought they would be interesting to discuss nonetheless, particularly as we enter an election year. I'm sure we will continue to hear these day after day as we get closer to November 2012.

The three assumptions I want to present today are: 1) The U.S. is dependent on foreign oil from the Middle East, 2) China holds most of our national debt, and 3) our national budget is fixable by agreeing to a balanced budget.

U.S. Oil Consumption

Hearing politicians say that we are dependent upon oil from the Middle East is enough to make your head explode. The U.S. consumes 19.1 million barrels of oil per day. Guess where more than half of that comes from? Yes, the United States. More than 9.7 million barrels (50.8 percent) comes from domestic sources. From outside of the U.S., we receive 2.3 million barrels per day from our neighbors to the north. Twelve percent of our total daily oil consumption comes from Canada. This is more than double the amount we get from anywhere else. From the Middle East, we get about 200,000 barrels from Kuwait (1 percent), 415,000 barrels from Iraq (2.2 percent) and about 1.1 million barrels from Saudi Arabia (5.7 percent), which is our largest supplier in the region. It is noteworthy that we get almost as much from Nigeria, which supplies us with over 1 million barrels per day (5.2 percent).

Of the 19.1 million barrels we use per day, the U.S. Energy Information Administration says that 80 percent of that, more than 15 million barrels, goes into cars, trucks and planes. Clearly, we need to transport ourselves and our goods more efficiently. Presently, the average fuel efficiency of all vehicles sold in America is 22.5 miles per gallon. CAFE standards are slated to improve this number to 35.5 by 2016 and, this past July, the president announced a groundbreaking agreement with 13 major automakers to improve the standard to 54.5 by 2025. If this actually occurs, it could cut our consumption down to 10 million barrels per day, which could easily be accommodated by the U.S. and Canada.

Notwithstanding the potential consumption savings from efficiencies, our long-term solution in this area could be closer to home than we may think. The American Petroleum Institute claims that an additional 10 million barrels per day could be produced in North America. This initiative would produce 1.4 million new jobs and generate an estimated $800 billion in government revenue by 2030. The only thing standing in the way of this is proper government cooperation. For our economy, it is critical to remember that the price of fuel is reflected in the cost of almost everything we purchase.

China and Our National Debt

How many times per day do we hear that we are selling ourselves out to China, which is "buying all of our Treasuries"? I have heard several politicians say that we "owe our future to China." There is no doubt that our national debt is massive and growing rapidly. Today, it is over $15 trillion dollars and is rising by about $50,000 each second of every day. Seventy percent of this debt is owed to U.S. citizens. The largest holder of our debt is the Social Security Trust Fund, which is used by administration after administration as an ATM. Presently, there is about $2.67 trillion owed to the und, which represents about 19 ercent of our debt. The Federal Reserve Bank is the second largest holder of our debt, clocking in t $1.63 trillion, or 11.3 percent.

While foreigners hold about 30 percent of our debt, China, the largest of all foreign holders, holds $1.16 trillion, or about 8 percent of the total. This figure represents about only one-quarter of the debt held by foreign entities. Japan holds nearly as much with $912 billion, or about 6.4 percent. For some perspective, U.S. households (which include hedge funds) hold about $960 billion, or 6.6 percent of the total.

The bottom line with respect to our debt is that we owe most of it to ourselves. What is more important is the magnitude of the total debt and the implications it has on our future. This leads to the third of the assumptions we will take a look at, which is that a balanced budget will miraculously solve all of our economic problems.

The National Debt and Deficits

Most Keynesian economists believe that the government stepping in to create demand, at times when recession kicks in, is appropriate economic policy. Many politicians also follow this school of thought. The downside to this policy is that it increases government debt and deficits. What most proponents of this approach fail to remember is that the time during which Keynes developed his theories was a time of cyclically balanced budgets. During good times there were surpluses that were saved so the government was able to step in and spend during down periods without substantially increasing debt.

Unfortunately, the U.S. government has been running constant deficits since 1969, making Keynesian policies less effective and, in most cases, harmful. Moreover, the term "reducing the deficit" is now thrown around like such a wonderful thing. Certainly it would be positive to reduce the deficit, as a deficit of any amount adds to the total debt. The fact is that if the deficit is any amount more than zero, we have to borrow and our national debt grows. This dynamic reduces the term "reduce the deficit" to a meaningless sound bite.

As mentioned earlier, our national debt is now in excess of $15 trillion. The impact this has on our budget (and I use the term loosely as we don't actually have a budget and haven't for a couple of years) is profound. To lend some perspective, the entire budget for NASA is $6 billion annually. The budget for the Department of Transportation is $26 billion and the budget for the Department of Education is $31 billion. Because of our debt, we spend $454 billion each year on interest payments alone. As our debt balloons, Congress appears unconcerned, treating debt as an abstraction, Monopoly money, someone else's problem.

Our spending addiction and massive debt, and both sides of the aisle are guilty, have caused annual budgets to grow dramatically. When George W. Bush became president, the entire federal budget was $1.2 trillion. By the end of his second term, it was $2.9 trillion. Today, there is no budget but spending for FY2012 is scheduled to be $3.6 trillion. Revenue is scheduled to be $2.3 trillion, hence the $1.3 trillion deficit. Think about that. We will spend 57 percent more than we take in.

The scary thing is that in addition to the debt, there are massive unfunded liabilities in Social Security, Medicare and Medicaid that are not included in the published national debt data. These programs are vexing societal enigmas and are accurately referred to as the "third rail of U.S. politics." Depending upon which report you read and the accounting method used, these unfunded liabilities total anywhere from $50 trillion to $116 trillion, mainly due to the patently unsustainable nature of the programs. And they are unsustainable regardless of how high taxes are raised. The ugly realities are starting to be felt as, in August 2010, Social Security began paying out more than it took in for the first time and is on track to have a zero balance by 2032. Similar fates await the other programs and tangible action is needed, but is not likely to occur.

The only way to fix our long-term budget problems is to address these programs with fundamental changes. This, or a subsequent, Congress needs to show courage, wisdom, honesty and vision. It won't be easy but this is necessary. Many European countries hid their heads in the sand for decades and now they are finally taking action. Retirement ages are rising, contributions are increasing and the rules of the game are changing. Why? Because without them bankruptcy is all that is left. The U.S. has an opportunity to address these issues voluntarily. Many European countries have no choice. Let's hope we make changes before we are in the same predicament.

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