

# Europe's Refugee Crisis Getting Worse

WASHINGTON – According to UNHCR, the UN refugee agency, so far in 2015 Europe received about 300,000 refugees who landed on EU countries after crossing the Mediterranean Sea from North Africa. For the entire 2014 the number was 219,000. So, we are trending up. And there is no end in sight. People escape from poverty, war, persecution and civil strife. Unless major changes occur in their countries, they will continue to flee.

## Many are coming

And these numbers are about those who were processed, and therefore counted. It is a safe bet to assume that the actual numbers are much higher. (And here we are not adding to the total count other refugees streaming into Europe from the Balkans, through Macedonia, Serbia, Hungary and other countries).

Well, beyond the humanitarian crisis, is this injection of millions and millions of new people (over many years) good or bad for Europe?

## Mostly bad for Europe

Unfortunately, it is mostly bad. In order to explain why, let's understand the broader context.

In most European countries the indigenous population is slowly declining, while on average it is getting older. All statistics about fertility rates point to a steep fall, especially in Southern and Eastern Europe.

This means that existing (and often generous) entitlement programs that provide cash transfers and free health care services to seniors citizens can no longer be funded via the

financial contribution of the active population.

### **Costly entitlements**

Add to this worrisome trend anemic economies that generate very little wealth, and you get an ugly picture of older populations progressively consuming more resources in countries that produce less and less.

As politicians are afraid of engaging in reforms that would amount to lower benefits, the only "solution" is to borrow part of the funds destined to transfer payments. This means that these shrinking and increasingly older societies, bit by bit, are also getting more indebted, and therefore poorer.

### **Is immigration a remedy?**

Given all this, allowing, in fact promoting more immigration could be a remedy. New, younger immigrants getting into the labor force would strengthen the productive base, while adding to the pool of active workers paying into the welfare systems.

***Yes, this is true. Except that much depends on what kind of immigrants you get. Unfortunately, most of the refugees getting into Europe seek help rather than work. They are mostly unskilled. Many of them are Muslims, something that makes it even harder to be integrated in historically Christian societies.***

### **Immigration into America**

On balance, America, with all its real problems caused by a broken legal immigration process, is still a magnet for people "who want to do something".

On balance, America is still viewed by would-be immigrants as the "Land of Opportunity". "Over there, we shall be able to do things that we cannot do here at home". The perception of a country that offers a good combination of personal freedom and economic freedom creates a real incentive for motivated

immigrants.

Needless to say, America also gets a lot of poor, illiterate people who have a really hard time adapting, once they get to the USA. They do not speak any English. They have no education. They have no skills.

### **High end**

But, on balance, most immigrants come to America seeking opportunity, not welfare. At the very high end, the highly educated Indians, Chinese or Korean immigrants who settle in Northern California quite often end up setting up and running successful high-tech ventures. While they make money, they create businesses. They create jobs. They enrich America.

### **The poor**

Sure, there are also hundreds of thousands, in fact millions, who end up at the bottom of the labor market. We find them as janitors, entry level construction or landscape workers. We see plenty more behind a counter at a 7/11, or working as parking attendants.

Still, on average, the new immigrants try to fit in, and eventually they rise within the existing economic and social fabric.

And then there are also truly remarkable stories. The Vietnamese "Boat People" who came to America, back in the 1980s, had nothing. Well, in many cases, because of their incredible ability to work hard and use any opportunity for economic advancement, their children ended up going to good universities. And this is also the case for other Asian immigrants who tend to value work and education.

### **In Europe, a different story**

Well, in Europe it is mostly a different story.

First of all, we are dealing with a different group of immigrants, with vastly different motivations. These immigrants are mostly poor or very poor people who come from Africa, North Africa, and the Middle East. Many of them are real refugees, escaping from conflict or civil strife in Syria, Iraq or Afghanistan. Just like the Central American immigrants crossing the US-Mexico border, most of them are illiterate.

But here is the fundamental distinction. America is viewed as a “*Land of Opportunity*”. America is a “*Can do country*” that is natural magnet for “*Can do people*”.

### **Go to Europe to get help**

***Europe instead is viewed by the would-be immigrants as a peaceful, tolerant place where the state has many generous social programs. In other words, you go to America to get work, while you go to Europe to get help.***

***Granted, this is a broad generalization that will not do justice to many highly motivated people. Still, by and large poor people are attracted to Europe as the place to go to not in order “to do something”, but in order to “get something”.***

### **No benefit for Europe**

For all these reasons, demographically challenged Europe will get very little benefit from this relentless migratory wave from Africa and the Middle East. Instead of the immigrants learning European customs, while focusing on improving their education, skills and work opportunities, we see that larger and larger parts of Europe start resembling the countries where the immigrants came from.

### **A giant welfare agency**

Look, I am not against multiculturalism –as long as the new cultures enrich the existing one. But this is not the case.

The immigrants bring into Europe mostly their problems, including out of step customs regarding the value of education, and the place of women in society.

In the meantime, Europe has become an extra-large social welfare agency that has just received and will continue to receive millions of new applicants, while its funding sources are dwindling.

This does not look good.

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## **Will Tesla Be The Electric Car Maker of The Future?**

**WASHINGTON** – Thank God, US IT tech companies are still in the lead. It is hard to match the combined strength of Apple, Google, Intel, Facebook, Cisco, Microsoft, Oracle, and so many others.

### **A high-tech car company**

But now we also have Tesla, the high-tech electric vehicle (EV) manufacturer, aspiring to be part of the super high-tech, high valuation technology companies club.

And here is a problem. Undoubtedly, Tesla is a tech company. But it makes cars, not software. Can Elon Musk, its founder, keep saying that because he is creating a technology revolution about to transform the automotive sector the metrics about unit costs and profitability that would apply to

traditional car makers do not apply to Tesla?

### **You buy into the revolution**

Who knows really. As Philip Delves Broughton notes in a well crafted FT op-ed piece, (*To be rational about Tesla is to miss the point*, August 27, 2015), if you are buying Tesla's stock you are buying into a huge bet. And the bet is that this particular EV technology will indeed disrupt the entire car industry, soon enough displacing the old, established players.

If this is indeed so, then forget about the traditional metrics. Forget about the fact that Tesla's stock is absurdly over valued. Indeed, as Broughton notes, the entire company is worth about half as much as BMW, a competitor that makes 35 times as many cars.

You buy Tesla stock simply because you believe what Musk says about massive future sales based on the guaranteed success of new, affordable EV models that have yet to be produced.

Well, if Musk is right, then he is the man who will transform the world automotive industry. Again, if this is so, then Tesla stock at \$ 200 or even \$ 300 a share is a bargain.

### **If Musk is wrong**

But if Musk is just a clever marketer, your investment most likely will be worth nothing in just a few years. Indeed, what if Tesla EVs cannot deliver any real profits? What if there are other companies out there that will come up with a more efficient electric engine and/or a new generation of truly revolutionary low-cost, high charge, low weight batteries?

Well, then it is good-bye Tesla, the trail-blazer that got it only half right.

### **Subsidies**

And just one more thing. Tesla current lousy numbers would be

a lot worse without the subsidies that Tesla and other EV manufactures receive from the federal and state governments.

Policy-makers love anything that replaces the internal combustion engine. Therefore Tesla buyers benefit from a tax rebate, while the company gets carbon credits that it can sell to others, this way making extra profits.

Look, nobody denies that Tesla already makes a great car. The Model S gets fantastic reviews. But it is not a cost-effective product.

### **The Concorde was great, but it kept losing money**

By the same token, when a French-British consortium launched the Concorde, back in the late 70s, many thought that we had entered a brand new era of cost-effective supersonic air travel.

*Well, it was not so. Nobody said that flying the Concorde was a bad experience. On the contrary, it was wonderful. But it was a commercial disaster. Therefore, after a long agony, the Concorde was finally pulled out of service in 2003. This does not mean that supersonic commercial jets will never be made. It simply means that it will have to be something other than Concorde.*

Now, are Tesla vehicles the real thing, or just the automotive versions of the old Concorde?

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## **US Hit By Global Slow Down**

**WASHINGTON** – Will US stocks recover? Or are they headed even lower? The optimists tell us that Wall Street panicked in the last few days. Forget about China. The fundamentals of the US

economy are solid. There is no reason to liquidate stocks. Therefore: *"Be smart. Buy the dip!"*

### **Over valued stocks**

This is almost unbelievable. We all know that US stocks are over valued because of an unprecedented stretch of zero interest rates decreed years ago, at the time of the financial crisis, by the US Federal Reserve. As traditional savings accounts became non viable, most people went into stocks, therefore inflating valuations. We know that. Besides, we also know that many major companies, instead of investing in additional capacity, have been busy buying their own stocks. Obviously this provided extra support. However, it is clear that IBM and others cannot inflate their share price for ever by propping up their stocks in this way.

### **Modest GDP growth**

More broadly, there is an obvious disconnect between modest US GDP growth (about 2% a year) and stellar stocks valuations. And this modest growth is not going to improve. The Congressional Budget Office (CBO) just revised down its own optimistic projections for 2015. According to the CBO, the US economy will not grow at 2.9%. Most likely the rate is going to be only 2%. Well, that is 30% less than estimated only a few months ago. So, no improvements.

All this should be enough to tell us that a major stock market correction was indeed in order. In fact, whatever the daily gyrations, probably we are not quite done with that.

### **China: worse than you think**

That said, if we look at the global economy, there is reason to be even more pessimistic. First of all, the China story. Well, it looks that it is much worse than it appears. For starters, for the first time major business media are openly saying what many have been suspecting all along. The Chinese



authorities falsify their growth statistics. China says that it is growing at 7% a year. Well, make that 5%, or even less, according to many analysts. This is no mere detail. This tells us that China's problems are most likely bigger and deeper.

And since most of China's growth comes from fixed investments, especially in construction, a major slow down of this gigantic engine has and will have an enormous negative ripple effect across the global economy.

### **Excess capacity**

Consider this. In the 1990s China steel production was about 100 million tons a year. Today it is 1.1 billion tons! However, because of the slow down, this capacity represents double its current demand. That's more than 500 million tons over capacity!

And what is the effect of this rise and fall of production on world iron ore prices? Iron ore used to be \$ 30 a ton in 2008. Thanks to China's demand, it went up to \$ 200 a ton. Now it is down to \$ 100.

This means that major producers made huge investments to increase their capacity, counting on continuing Chinese demand. Well, now they are in big trouble. BHP Billiton, a world mining giant, just announced its worst results in 12 years. Profits are down 86% .

### **End of the BRICS**

So, thanks to China, commodity prices are down, way down, hurting many producers across the globe. To make matters worse, commodities happen to be abundant in poorly managed emerging countries. So, falling economic fortunes have to be added to garden variety mismanagement, incompetence, corruption, and political crises.

Mix this nasty brew and you see that all the famed BRICS are

out of luck, (India is probably the only partial exception). China aside, Brazil is in very poor shape, while there are mass protest against President Dilma Rousseff. Under performing South Africa just announced a GDP contraction. Russia has been hit by the double blow of low oil prices, and economic sanctions due to the Ukraine crisis.

### **Dismal prospects almost everywhere**

You want more? Abenomics failed in Japan. The economy is anemic at best, and there is no plan to diminish the burden of a monumental public debt. Saudi Arabia will run huge deficits because of lost revenue due to low oil prices. Turkey is in political turmoil, while its economy is sputtering.

Almost the entire Arab World is in chaos, with civil war in Libya, ISIL in Iraq, and self-destruction in Syria. Europe is barely treading water. Its southern periphery is and will continue to be in bad shape. France is doing poorly. Coming into the Western Hemisphere, Canada is also suffering because of low oil prices.

### **US to be affected by the global economy**

Given this rather uninspiring world scenario, the idea that the US will continue to do well because of our "good fundamentals" is just crazy. First of all, our fundamentals are rather weak. Secondly, we live and operate in a global economy.

Because of its insane investments binge, China used to drive growth. Now it is dragging a good portion of the world economy down. And there are no other locomotives of comparable size.

The idea that America can keep chugging along all by itself, even if at a modest rate, while the rest of the world is losing speed or worse is a complete fantasy.

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# America Needs Good Pro-Growth Structural Reforms

**WASHINGTON** – After the August 24 sell off, there was no real bounce back. The US stock market regained some ground, but only some. Still too many uncertainties for investors, I guess, from the Fed and its decisions on interest rates to the real global ramifications of the Chinese sudden and somewhat mysterious convulsions.

## **Put our house in order**

Alright, enough of that. Forget about markets. The smart thing for America would be to begin –right now– to put our own house in order. In order to do so, we need to focus on at least three major areas:

### ***1) Fiscal and Tax Reform***

### ***2) Deregulation***

### ***3) Public Education Reform***

## **Fiscal reform**

On fiscal and tax reform, Washington had a great opportunity to start the process back in December 2010, after the release of the final Report by the **National Commission on Fiscal Responsibility and Reform** headed by Erskine Bowles and Alan Simpson, (it was also known as the “Debt Commission”). The bipartisan Report, (endorsed by the majority of the Commission members), was aptly titled “*The Moment of Truth*”. It provides a good start on a process eventually leading to entitlement and fiscal reform. It is a genuine bipartisan effort led by two credible, experienced national leaders, a Democrat and a

Republican. Granted, it is not comprehensive. It does not seriously address health care policies. But, there again, it was a good faith attempt to get things moving. It was a very good start.

Well, President Obama looked at the Report, thanked the co-chairmen and essentially discarded it. Notwithstanding subsequent political upheavals, Tea Party activism, Republican congressional victories and more, we have made zero progress to reach the needed political agreement on reform. And yet real fiscal reform that would have to include a major overhaul of the large and soon unsustainable entitlement programs (Social Security, Medicare and Medicaid) is essential.

### **Necessary**

Let's be clear. This reform is no guarantee of long term economic growth. But it is hard to believe that we are going to go very far while America will carry the weight of an enormous debt burden. Look at anemic Japan. Is this where we want to go?

Same for tax reform. America has an absurdly long and complicated federal tax code. We have the highest corporate tax rate in the developed world. This is not good for business.

(It would be nice to see some serious discussion about these issues in the unfolding campaign. This would be more substantive than stupid polemics about "anchor babies").

### **Deregulation**

Ditto for deregulation. When concerns about regulatory compliance become the overriding daily preoccupation of business owners, we have a real problem.

Regulations should be about establishing and enforcing reasonable environmental, work safety and public health

standards. But now we have gone way beyond that. The attempt by the US Environmental Protection Agency, EPA, to essentially outlaw coal-fired power plants (and more) by regulatory fiat, on questionable legal grounds, is just the latest illustration of this.

### **Education reform**

And finally public education. This is after all and will be the *"Knowledge Economy"*. In this new world, If you do not have a good education, you are done. If you do not know much, if you do not master sophisticated skills, you simply do not have the entry ticket. Period. No way to have access to good jobs. You will be relegated to the lower echelons of society. No prayer to become "upwardly mobile", as we used to say.

Slice it the way you want, but if we do not get serious about drastically improving American public education standards, at least half the country, the half that cannot afford private education and live in poor neighborhoods, will be left behind.

### **We need an action plan**

This is what needs to be done –today. Forget about Wall Street gyrations. Let's get busy and rebuild the solid fundamentals of a world-class, truly competitive US economy.

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# **Trouble Ahead For America**

**WASHINGTON** – May be we should not try to read too much into the Dow Jones 1,000 points plunge at the opening on August 24. May be it is all about super fast electronic trading and other complicated technicalities. And, sure enough, the market recovered. Still, it is to remembered that this one-day

collapse never happened before. ***I repeat: "never"***. Besides, notwithstanding the relatively quick come back, the market was down almost 600 points at the close of trading.

### **Weak world economy**

As we know, the US market's rapid ascent was due in large measure to the unprecedented US Fed policy of zero interest rates that encouraged investors to put their money in stocks, not because the US economy is in particularly good shape, but simply because there is practically no alternative. Investors know this. They know that they are not on firm ground. And therefore they can be very skittish whenever something unusual happens. And the unusual is China's sudden bad health.

### **No more fizz in emerging markets**

Indeed, underneath the Wall Street lofty valuations, what we see is a relatively weak US economy that now will have to deal with a world engulfed in a full deflation originating in Asia. The rapid collapse of all commodity prices is a clear indication that the China-driven absurd level of demand for "everything" was not sustainable.

This means that several emerging markets whose ascent was largely led by growing exports of expensive raw materials to China now are confronted with slow growth or worse. Brazil is now in negative territory. Official forecast look at a 0.3% growth in 2016. Hardly inspiring. Therefore do not expect Brazil, Australia or Indonesia to help world growth. They are done. Likewise, the world's big mining conglomerates are trying to survive.

### **Weak Asia**

At a different level, soft Chinese exports also mean lower demand for key components produced by South Korea, Thailand or Vietnam that go into the assembly of made in China products. Add these stagnating emerging countries to the drag on the

world economy.

Likewise, major European exporters will sell less to China. From luxury goods to BMWs, a slow-growing Chinese economy means soft demand for imported consumer goods.

### **US doing barely OK**

So, where does all this leave the US? Not in a particularly good place. Granted, the knee-jerk Wall Street reaction to the latest Shanghai stock exchange plunge was overdone. Overall, the US economy is not that dependent on business with China. We sell mostly agricultural products to China, and that is likely to continue. The Chinese still need to eat.

However, we do a lot of business with the rest of the world. The fact that Japan, South Korea and Germany are directly affected by China's slow down matters to us.

### **Dumping and deflation**

And there is more. China will try its best to dump abroad its mountains of excess manufactured or semi-finished products in practically any sector. Therefore, we can expect that America will be hit by exports of super cheap Chinese steel, solar panels, and almost everything else. This will hurt many US companies that will be unable to compete with under priced Chinese imports. This wave of dumped imports will force US corporations to lower their prices. Some of them will go out of business, with consequent loss of jobs. (See above about deflation).

Besides, many of the large US multinationals, from GE to Caterpillar to United Technologies, now get most of their revenue from sales abroad. However, growth strategies based on increased foreign sales will have to be revised. Stagnating or declining foreign economies in Asia, Latin America and Europe cannot absorb more US products.

## **The impact of collapsed oil prices**

*Here at home, we have to deal with the consequences of collapsed oil prices. (WTI is now under \$ 39 per barrel). While there is some benefit down the line for American consumers, this is a disaster for the entire energy sector and a seriously bad development for the broader US economy. Soon enough, North Dakota, Texas, Oklahoma and other states will feel the impact of new unemployment or under employment among oil workers, engineers, geologists, pipe and drills suppliers, and many others. Expect additional ripple effects on local real estate prices, restaurants, shopping malls, and a lot more.*

### **Disaster ahead?**

Are we on the brink of disaster? No, we are not. However our fragile growth is threatened by weak fundamentals, (in part hidden by the impact of Fed policies on stock prices), and a weakening global economy.

*The Dow Jones 1,000 point drop was a freakish event. But it did happen. This is a reminder that when investors know that they are holding a lot of stocks whose market value is not determined by a solid economy, they are ready to dump them, the entire lot, at the first sign of big trouble. And, by the way, the rebound from minus 1,000 is not that strong. On August 24, the day of the collapse, the Dow Jones closed down 588 points. Of course, in the days and weeks ahead all this can change. Still, this is not what I would call a display of investors' confidence.*

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# Governor John Kasich Is A Credible New Republican

WASHINGTON – Among the many Republicans (17 contenders) trying to get their party's nomination, there are only a couple of serious candidates. No, I do not include Donald Trump, simply because it will be difficult for him to expand his significant but narrow base.

## **Trumps' base**

Trump is doing very well with the disaffected and skeptical Americans who have lost faith in "the system". They do not believe that the establishment connects with them. They do not believe that traditional politicians are capable to get anything done. Hence their support for Donald Trump, the iconoclastic businessman. The "non-politician politician" who will fix things, in no time.

## **Large numbers, but not a majority**

Fine. We understand all that. That said, there are only so many truly disaffected Americans. Besides, I suspect that some of these enthusiasts sooner or later will realize that Trump does not have any strategy to win a general election.

Sure enough, he can ride and interpret the mood of the angry voters. But, while numerous, they are not the majority. Not even close. Then, how do you win over a large portion of all the others? Certainly not by promising to deport 11 million illegal immigrants.

Beyond the obvious fact that this extreme position means no chance of getting any support from Hispanics, (and their votes now are critical to win many states), there are millions of independents who do not like this type of "immigration reform" platform. And there is more strange stuff put forward by

Trump, including the promise to start a trade war with China, Japan and Mexico.

## **Bush and Kasich**

Well, assuming that the Trump phenomenon, while real, will not completely transform this campaign, who else is out there? Very simple. Former Florida Governor Jeb Bush, and incumbent Ohio Governor John Kasich.

Leaving aside a few details, from a policy standpoint these two are almost identical. They are both good executives with significant experience. They are fiscal conservatives. They have been and are popular in their own states. Most important, they propose a re-engineered Republican agenda that recasts the GOP as the party of “expanded opportunity for all”.

They both sincerely believe in actively promoting inclusiveness for all Americans. They support social services. They support good public education. They talk about ways in which we should transform the current welfare system into programs aimed at making recipients self-sufficient.

## **Uninspiring Bush**

Now, in a campaign context, the real issue is which of the two is better at articulating this message. Jeb Bush has been accused of being an uninspiring stump speaker. Beyond that, there is reluctance to support yet another Bush for President. (This would be number 3). And, finally, Bush comes from a privileged background. The average American may believe that a rich guy who had all the opportunities to advance and succeed may not be able to really connect with him or her.

## **Governor Kasich**

Well, then let’s give a better look at Governor John Kasich. He certainly comes from humble origins. His father was a mailman. And yet Kasich did well, without going to Yale, and

without the benefit of powerful family connections.

He was a member of the House. He became the Chairman of the Budget Committee. In that capacity he contributed to craft the only balanced budgets the US has had in decades. While serving in Congress, he also gained national security experience.

Then Kasich left politics. He went into the private sector. He did well both in TV journalism and in financial services, working at Lehman Brothers. He also authored 3 books. And, finally, he was elected and then re-elected Governor of Ohio, a state that traditionally leans left. And he has done very well as Chief Executive. These are excellent credentials.

### **Conservatives care about all people**

Beyond that, Kasich is doing his best to break the stereotype of the GOP as the party focused only on small government, low taxes and strong national security.

*"Why do conservatives allow themselves to be put in a trap in which they are afraid to talk about these things [He means social issues]?...I balanced the budget in Ohio, I spent 10 years trying to balance the US budget, I've cut taxes more than any living governor, we have a rock solid credit rating [in Ohio]. **And because I care about the mentally ill and drug addicted and those in prison, that's not conservative? I believe that helping people have opportunity is all about conservatism. My mother used to say it's a sin not to help people who need help but equally a sin to continue to help people who need to learn how to help themselves**" [bold added]*

### **A New Republican?**

So, here is a "New Republican". Forget about the worn GOP mantra of "the rising tide that lifts all boats". Forget about "trickle down economics". Kasich is eager to help the disadvantaged. He is eager to craft public policy so that it will create opportunity for all. But at the same time he will

structure assistance so that it does not become dependence.

### **The “War on Poverty” did not succeed**

The Democrats tried with the “War on Poverty”. Well, it did not work. Over many decades, the US government spent a fortune trying to help the needy, and we still have poverty. This is largely due to the fact that public assistance programs tend to create dependence. They are not designed to make recipients self-sufficient.

### **Can Kasich do this?**

Can a Republican with a humble background prove to his party that reaching out beyond the base is not a betrayal of hard-core conservative principles? And, beyond that, can he convince middle America that conservatism is about creating expanded opportunity, and not a mean-spirited ideology?

### **Not easy**

I happen to believe that Bush and Kasich have their heart in the right place. May be Kasich can connect with the American people in a more enthusiastic manner. We shall soon find out.

That said, let’s be clear. Recasting the image of the party in order to widen its national appeal, while keeping the support of the “true believers” will be incredibly difficult.

However, precisely because it is difficult, I would feel a lot more confident if the messenger were a sincere believer with a good record as experienced Chief Executive of an important state.

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# China's Economy "Worse Than You Think"

WASHINGTON – A few years ago, Jim Chanos of Kynicos Associates made news because he had the temerity to call a spade a spade by telling the world that China's construction-driven economic growth was in fact a big bubble.

## **A bubble economy**

Chanos argument was that China's construction frenzy was not led by real demand. Soon enough this enormous property boom driven by speculation, and by the political need to show consistent GDP growth, would cause huge problems.

And he argued that the crunch would be felt first among the international companies that supply the raw materials that feed the Chinese construction industry. He argued that the Australians, the Brazilians and other commodities exporters would get hit first.

## **Impossible**

At the time Chanos looked like a really odd character who really did not understand China. China was doing very well, fueling the almost universal expectation that its super successful "New Economic Growth Model" would allow it to surpass America, thereby affirming that there is indeed something better than capitalism.

Indeed.

## **Now we see**

Well, fast forward to today, and it is quite a different story. Now Chanos looks like a prophet.

Indeed, with all the bad news about China's economic slow

down, smaller exports, lower industrial production, huge over capacity funded by mountains of debt, the Shanghai Stock Exchange implosion, and –yes– the real estate disaster, it is hard to challenge his negative forecasts.

When Chanos speaks, now people listen to him. So, how bad is the Chinese economy? *“It’s worse than you think”*, replied Chanos in a CNBC interview. *“Whatever you might think, it’s worse”*.

Got that? It is bad beyond imagination. Well, this assessment is certainly not very detailed. But you get the idea. Underneath a relatively calm, in fact almost airbrushed, surface, there is a badly mismanaged country.

## **Clueless**

But how is this possible? We thought that the Chinese meritocracy only promoted the super smart. We were told that China is run by carefully trained technocrats.

Well, may be not. *“People are beginning to realize the Chinese government is not omnipotent and omniscient,”* Chanos said to CNBC. *“In fact, like many of us, sometimes they don’t have a clue.”*

There you go: *“Clueless China”*.

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# **A Very Weak American Economy**

**WASHINGTON** – The slow but steady decline of the US economy should be the main theme of this unfolding and contentious presidential election campaign. But it is not. The recent steep Wall Street drop may change all this, (the Dow Jones lost another 530 points on August 21, making it the worst day

of a very bad week), but I would not bet on it. In fact, optimistic analysts are on TV telling investors that this huge Wall Street loss is in fact just another temporary glitch, and thus a wonderful opportunity to buy really cheap stocks.

### **“Anchor babies”**

Regarding the presidential campaign, forget about the economy. The most recent headline is about Donald Trump’s proposal to repeal or modify the 14th Amendment to the US Constitutions that grants citizenship to all those who were born in the US. His point is that the Constitution has been abused by armies of pregnant foreign women who slip into the US in order to deliver what are now called “*anchor babies*” on US soil. As they are now mothers of US citizens, they can try to make a case to stay in America, despite their foreign status.

### **Millions of babies?**

So, there you go. “*Anchor babies*”. This is the burning issue. And how many “*anchor babies*” do we have? Millions? Hundreds of thousands? No, we are talking about a few thousand, at most.

Look, there is plenty of evidence of criminal enterprises that provide logistical and medical support to pregnant foreign women, so that they can come here, and give birth in the US. All this needs to be stopped. But, while real, this is hardly a crisis of catastrophic proportions.

### **Under performing US economy**

The real issue that should be discussed by all those who aspire to be President is a consistently under performing US economy. (For a cogent, detailed and rather scary depiction of US economic decline, read the [WSJ](#) op-ed by Mortimer Zuckerman, *Who Will Get the Dreary Economy Going?* August 21, 2015).

Unfortunately, it is very difficult to fight against economic mediocrity, especially since more than half the country,

including respected analysts, have gotten used to it. In fact many tell us that this mediocrity is after all quite good.

### **Mediocrity looks OK**

In truth, the US economy is not facing imminent disaster. On the contrary, it has been chugging along for a number of years at a slow, but semi-respectable 2% a year rate of growth. Not great, but a lot better than Europe. Unemployment has gone down, and it is now back to about 5%.

Most analysts who speak on Bloomberg TV, CNBC or Fox Business say that things are more or less OK. Not great, perhaps. But alright. You see, more Americans are employed. And this means more disposable income. And this will translate into more sales, and therefore more demand for goods and services that will lead to better economic performance. As for the steep Wall Street decline, we are told not to worry. We always have corrections every now and then. The important thing is that the economy is on solid foundations.

Really?

### **Fragile foundations**

Look, the fact is that the US economy is fundamentally fragile, notwithstanding the ZIRP, (zero per cent interest policy) decreed by the US Federal Reserve many years ago. Which is to say that, despite this extraordinarily long period of monetary easing, economic activities have not picked up.

2% growth is well below our 3% historic average. On top of that, we have the lowest level of labor force participation in decades. This means that far fewer adult Americans are employed, compared to our historic averages. Millions of those who now are lucky enough to have a part-time job would rather have full-time employment. And most new jobs are in low pay service industries. Very little new employment is created by wealth-generating manufacturing.



## **The end of the energy boom**

All this indicates an anemic economy. But wait. It gets worse. Much of the (modest) growth that America experienced in the last few years was due to the extraordinary shale oil boom. But now the world is awash in oil. And there is no sign that this glut will go away. This means a real recession in the oil sector that is driving down energy companies and all their suppliers. Translation: depressed energy and energy related stocks, with dramatic loss of what used to be good jobs for all the oil companies and for the vast universe of suppliers and vendors connected to them. Add to this the negative ripple effects on communities that started thriving because of the extra money brought in by the energy business, and you get a rather dark picture.

## **Diminished China**

Last but not least, we have China on the verge of a crisis. The US may not have much direct exposure to the Chinese economy. But the rest of the world does. Japan is affected, and so are Germany, Taiwan, Thailand, and South Korea. And we do business with all of them.

Beyond that, China's slow down has already had a dramatic impact on the economic performance of all its raw materials suppliers. Brazil, Australia, South Africa and Indonesia are in big trouble. Major mining companies are looking at disastrous numbers, because China does not buy much from them anymore.

Can anybody seriously believe that, while the world is headed towards an economic freeze, America will be miraculously unaffected?

Now, if China's woes were just a glitch, well, this problem would go away. But we have many indications that China has entered a new slow growth economic era, while it is trying to deal with monumental debt, and massive industrial over

capacity. Here is one sobering statistic. The Caixin China Manufacturing Managers' Index just fell to a 77 month low. As I said, this looks like a new trend.

Therefore, forget about China growing at 7%. Forget about its ability to absorb massive amounts of iron ore, copper or whatever else.

## **Shaky America**

So, here is the picture. The American economy has recovered since 2008, but very slowly, notwithstanding the historically unprecedented monetary stimulus. Consumption is not buoyant because most Americans are still recovering from the over spending of 10 years ago. The US oil industry, a rare bright spot, is now clearly in serious crisis, while world trade is depressed because of China's slow down.

Are we headed for a recession? Probably. (If nothing else, as we get a recession every 7 or 8 years, we are due for one anyway). Certainly there is nothing out there that inspires great confidence.

## **Wanted: An economic growth agenda**

So, how do we get out of this? It is not difficult to identify the issues that need urgent attention in order to strengthen our foundations. We would need a skilled combination of tax reform, public education reform, targeted training programs, regulatory reform, and a lot more. The problem is that putting all this together in an eye-catching, compelling campaign platform is really difficult.

Sadly, it is a lot easier to listen to Donald Trump and others talking about "*anchor babies*". As for Trump's recipe for fixing the economy, he has one, and it is very simple. "*You should elect me president, because I am the only one who has the proven experience to get things done. I know these things. The professional politicians are all talk and no action. I'll*

*take care of things*". Well, this is the level of detail we are getting, so far.

I hope that someone else can do better than this.

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## **Trump's Strategy – Not So Crazy**

**WASHINGTON** – Republican presidential contender Donald Trump has provided more details about his immigration reform plan that could be accurately named "immigration denial plan". Here is the summary: "Kick out all the illegal aliens, freeze permits for all the others".

### **Serious voters turned off**

I argued in a previous piece that, in the long run, when serious voters will look at Trump's most unrealistic and sketchy proposals, they will turn away from him.

But I also argued that there will be a core group of Trump followers who will stay loyal, no matter what he says; simply because they love his outrageous, take-no-prisoners, anti-establishment, bombastic style.

### **Core group of supporters**

And may be it is Trump's awareness that he can count on a core group of enthusiastic supporters who simply love his radical approach that now drives his campaign strategy. May be Trump deep down knows that he will never be the Republican Party nominee, simply because there are too many likely voters who do not believe he is a credible candidate.

But Trump is also confident that his core group of supporters, while not the majority or even a large plurality, is big enough to make him relevant until the very end of this campaign, and possibly beyond it.

## **Red meat**

And what do these supporters want from their candidate? Very simple. Red meat. Lots of it. Every day.

If this analysis is correct, it may help explain Trump's immigration reform agenda that is mostly about the positively absurd plan to deport all 11 million plus illegal immigrants now in America. (This number is an unofficial estimate).

Trump put this plan forward because he knows that there are many nativist, xenophobic Americans who really believe that it is both necessary and possible to enforce existing immigration laws. They want to see US federal agents rounding up all the illegals so that they can be sent back to their countries of origin –all 11 million.

## **How do you do this?**

Yes, let's go ahead and do this. Let's enforce the laws. Wonderful. Except that according to existing laws, there have to be court procedures and adjudications in order to legally order any individual deported.

Well, guess what. The immigration system is unable to process the existing, relatively light, case load. People have to wait for months to get their hearing.

For starters, there are just not enough immigration judges, while many of them are close to retirement age. Besides, processing each case costs on average \$ 12,000, all paid by US taxpayers.

Given all this, imagine the impact of millions of new cases suddenly unloaded on this already slow and over stretched

system. Even if this massive deportation process were competently administered by staggering the number of cases over a long period of time, it would be chaos –for many, many years.

### **Social and economic disruption**

And this is only half the story. Imagine the scenes of despair in thousands of communities across America delivered by the nightly TV news. What Trump proposes is a gigantic, involuntary population movement enforced by federal agents.

Nothing on this scale has ever been attempted in America. (After Pearl Harbor the US government ordered the internment, within the United States, of most Japanese Americans on the ground that they might be on the side of Imperial Japan. That was a big operation. But it included only 120,000 people. Now we are talking about rounding up 11 million).

Who in his right mind thinks that it is possible (let alone humane) to uproot and deport millions of people, keeping in mind that many of them have been living in the US for decades, and therefore realistically have no place to go back to?

Besides, imagine the cost of all this for local businesses and communities. Consider how many people will be wrongly accused of having forged papers when in fact they are law-abiding. Imagine the economic disruptions and the countless personal tragedies.

All these rather elementary considerations would tell any would-be policy maker that massive deportation is not an option.

### **A more reasonable approach**

A more reasonable approach is to provide a path to a legal status –not amnesty leading to citizenship– to all law-abiding illegal immigrants, making sure in the process that they do

indeed follow all US rules, pay taxes, and so on. Federal authorities will also identify and apprehend the dangerous criminals among the illegal immigrants.

*At the same time, there will be serious efforts to stop fresh illegal immigration through better border security, while making it absolutely clear to the whole world that from now on all new illegal immigrants will be deported. The only exception will be genuine asylum seekers.*

A robust temporary guest workers visa program will provide the manpower needed by American farmers who require extra workers depending on the seasons.

Last but not least, the new system will give priority to highly skilled people seeking legal entry and work permits, ending the current system that privileges reunification of families.

### **There is more**

Beyond deportations, there is a lot more in Trump's plan. He will build a wall at the border with Mexico in order to stop all new illegal immigrants. He will force Mexico to pay for it. Besides, Trump intends to freeze all legal immigration, at least for a while. Thereafter, he will reduce or eliminate temporary visas for foreign skilled workers. Finally, he would also try to modify the 14th Amendment to the US Constitution that grants US citizenship to all those who were born in the United States.

Anyway, you get the picture.

Most of the measures included in his immigration "plan" are outlandish. But, if indeed Trump has calculated that he needs to feed his base with truly radical ideas and solutions that will clearly separate him from all the other candidates, his approach is not as crazy as it looks.

He is telling millions of Americans exactly what they want to hear.

*Again, the assumption here is that Trump is not creating a strategy and a message that will allow him to forge a broad-based coalition that will allow him to win the GOP nomination and then a national election. As I indicated above, may be he realizes that, current popularity notwithstanding, he cannot win a majority. Of course, Trump is popular. But he has hit, or will soon hit, his popularity ceiling. Some Americans like Trump a lot. But only some.*

### **A national leader**

However, while not favored by the majority, Trump has a pretty good chance to establish himself as the national leader of a vocal, anti-Washington, xenophobic, America-first, confrontational national movement, with a sizable following.

And he is well on his way to accomplish this.

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## **What We Learnt From The Tianjin Tragedy**

**WASHINGTON** – More bad economic news from China. Notwithstanding highly publicized official support for the stock market, after a few days of relative calm, the Shanghai Stock Exchange took another serious hit.

### **Shanghai Index takes another hit**

On August 18, the Shanghai Index lost more than 6%. this would

be the equivalent of the US Dow Jones index losing about 1000 points in just one day. (Analysts call losses of 200 points or more pretty bad. Losses above 300 really scary. Imagine 1,000). In early trading the following day the market extended its losses by another 3%.

### **Government actions ineffective**

This -6% (possibly -9%) hit is especially bad because the government is now officially committed to supporting share prices through a variety of interventions. Indeed, because of these well advertised actions, one would think that the smart investors should stay put, or may be buy some more stocks. "After all, these shares are guaranteed by the government. They must be a safe investment".

Well, it seems that heavy government interventions are not enough. And this is bad. Apparently, average Chinese investors do not believe that the all-powerful government can deliver. Just think about for a moment of the possible political ramifications of this new belief, should it become entrenched. *"The Chinese government cannot deliver on its promises"*.

### **The Tianjin tragedy**

On a separate but related note, we have seen the catastrophic chemical explosion in the city of Tianjin. Hundreds of people dead. Many more wounded. Extensive damage to properties. Thousands of imported vehicles ready for final delivery destroyed. And now the danger of additional contamination brought about by the chemical reactions of the released compounds with rain.

Let's be clear. The issue in Tianjin is not the accident itself. Sadly, there are plenty of major industrial accidents all over the world, including in the United States.

But here is the difference. Usually accidents are caused by human error, or negligence. In some cases they are caused by



someone deliberately cutting corners in one particular instance.

## **Broken laws**

Tianjin's case is different. In Tianjin there are permanent warehouses containing extremely large quantities of hazardous, potentially flammable or explosive material located within populated areas. Both the location of the warehouses and the amount of hazardous material stored in them are in open contravention of existing Chinese laws that prescribe that such facilities must be at a safe distance from homes, businesses, or high traffic areas. The laws also prescribe how much material can be safely stored. Well, the laws are there, but they have been ignored, most likely because some public officials have been paid to ignore them.

***So, here we are not talking about someone making a fatal error in a particular instance. This is about a practice of routinely breaking or circumventing laws and regulations, thereby creating a systemic risk. Therefore this horrible accident is not about what someone did one day. This is about what many people conspired to do over many years, with full knowledge of the hazard they created.***

## **Not just in Tianjin**

Where am I going with this? Very simple. It would be naive to believe that this deliberate circumvention of established safety procedures somehow is confined to some unscrupulous public officials and influential business people in the city of Tianjin. Bribing officials is common practice in China. Everybody who can will do it, if they think this is necessary in order to safeguard their economic interests.

And this means that warehouses that contain hazardous material are in the wrong places. Materials that do not meet safety specifications are used in buildings. Dangerous additives are illegally used in processed food. Toxic waste is dumped

everywhere. Information about pollution levels in soil, water or air is unavailable or unreliable.

## **False data**

And, yes, talking about shady practices, economic data is routinely manipulated to make it look better. But, somehow, it is not polite to point out this practice of deception. When really bad economic news from China comes out, some Western analysts (at best) cautiously say that *“May be the underlying situation is worse than what the more optimistic official data would indicate”*. Well, let's be real. What they really mean to say is that we have been fed false data. And now the facts prove it.

In the case of the illegal warehouses in Tianjin it took a massive tragedy to expose the ugly truth of routine violations of elementary safety rules.

What will it take to expose the deception of official economic statistics containing manipulated data?