

# Italy Overwhelmed by Poor African Immigrants

**WASHINGTON** – Italy has two major demographic problems. Both of them carry bad outcomes. Italy is the destination of too many immigrants from poor countries in Africa and the Middle East; while its native population is shrinking due to extremely low fertility rates. In plain language: not enough new babies.

## **Gloomy picture**

Here is the gloomy end game. Italy's population is progressively becoming more African/Middle Eastern. And this trend brings no economic gains, because most of the new residents are either illiterate or low skilled, while at the same time they are entitled to receiving costly social services.

## **Crisis point**

Add to this social and political tensions caused by the new immigrants. Indeed, according to public officials, Italy has reached a crisis point when it comes to its ability to welcome and integrate immigrants arriving mostly from Africa and the Middle East. Piero Fassino, former Mayor of Turin, a major city in Italy's North West, recently stated that: *"In terms of numbers [of new immigrants] we are at the point of surpassing what can be managed by the public authorities. Unless we deal with it, this immigration problem may overwhelm us"*.

## **Political tensions**

Among other issues, Fassino pointed out that immigrants come up on top of the waiting list for low-cost housing, because they usually have large families (unlike the Italians), and large families have a priority among those waiting for these units.

This way immigrants end up getting the housing originally planned for low income Italians. And this unforeseen development clearly breeds strong anti-immigrant resentment.

### **Lowest fertility rates**

*And it gets worse. If we look at the never-ending immigration tidal wave in conjunction with low fertility rates among Italian women, then we have the elements of a demographic/political crisis. Italy now has the lowest number of new births per unit of population in the entire European Union. Simple math: fewer native Italians and more Africans permanently settled in Italy will transform the country's ethnic composition—rather rapidly.*

Indeed, Italy is now at the point in which deaths have surpassed new births. This means a progressively shrinking native population. If we consider that in Italy, (like in most other developed countries), social services and pensions going to current recipients are paid for through contributions by active workers, it is obvious that the entire fabric of the Italian welfare state will soon become unsustainable. There will not be enough revenue to finance benefits. Simply stated: too many retirees, and not enough active workers paying into the system.

### **Immigrants do not add to the quality labor pool**

From this perspective, the arrival of large numbers of new immigrants should be viewed as good news, no? More young people with jobs paying into the welfare system, should help re-balance it. Right?

Well, not really. Because these new immigrants are unskilled and mostly illiterate. These new arrivals have hard time get real jobs. They often become part of an informal, underground economy. To put it mildly, they do not add to the quality of Italian human capital. They are a net cost to the country.

## No way out

*Is there a way of this? Probably not. Italians do not have more children because of a changed culture in which family is no longer thought of as important, and in part because children are deemed to be too expensive for millions of struggling lower income Italians who can barely make ends meet.*

## Immigrants driven by poverty

At the same time, abject poverty will continue to drive hundreds of thousands of poor Africans out of their Continent. Same thing for Middle Eastern people trying to escape from civil wars, and political chaos in their native lands. Many of them end up in Italy because Italy is close to Africa, Syria, and Iraq. Once the new immigrants get there, hard to move them elsewhere.

So, here are the facts. Soon enough, Italy and others parts of Europe, especially Southern Europe, will look more like Africa and the Middle East.

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**[Maersk Warning About Global](#)**

# Slow Down – Recession In the US?

**WASHINGTON** – Maersk, (based in Denmark) is the largest shipping conglomerate in the world. Their business is to transport every day tens of thousands of containers from exporters to importers around the world. The company just announced losses for 2015. Just a temporary setback? Well, apparently not. Maersk ascribes this setback to shrinking global trade volumes. Their profits are way down because a much weaker world economy generates much less shipping of goods.

## **The worst since 2008**

*Maersk's CEO is quoted by the WSJ saying that the conglomerate is facing a "massive deterioration", adding that this is the worst they have seen since the onset of the Great Recession of 2008. Got that? We are back to a 2008-like scenario. I suggest that this is really bad.*

And Maersk believes that this weak trade flows trend will continue in 2016. We should pay close attention to what Maersk managers say. Global shipping volumes are a very good proxy for world economic health. 95% of all manufactured goods are transported via containers that get to destination thanks to global shipping companies like Maersk.

## **Less activity in ports world-wide**

Maersk is not alone in predicting bad times. DP World, a very large Dubai based port facilities management company, with operations in 70 terminals in practically every continent, chimed in, indicating that their business (handling the containers moved by Maersk and other shipping companies) is down, significantly. And the IMF confirms this pessimism about a global economy that run out of steam. They have lowered

their forecasts for both growth and international trade flows.

So, here we go. The big companies that handle global trade are hurting. Their business is down because the world economy is slowing down, at a rapid pace. They are worried.

### **Weak economies**

And why is that? Because the day of reckoning is finally getting close. The jig is up. For several years we have lived in a fools' paradise created by easy money created by central banks that caused asset price inflation in developed countries, and too much easy credit in emerging markets. Underlying economic conditions all over were rather weak, but everything looked good because of the artificial froth created by monetary easing.

### **Central banks to the rescue**

Until recently, when stock market worldwide showed signs of weakness, investors simply waited for central banks in the US, the EU, UK, and Japan to come to the rescue. And they were never disappointed. Trying to boost sagging economies, central bankers would launch, or relaunch, monetary easing, and zero per cent interest.

They would ladle quantitative easing, or QE. If it wasn't enough, they would ladle some more. When that did not do the trick, they went further. Some of them (Japan's Central Bank just joined the group) stopped paying interest to commercial banks parking their funds with them.

### **More of everything**

And when even that proved to be insufficient, some of them started charging interest on deposits as a way to force banks to lend more in order to induce more growth. (Even Janet Yellen, the Chairwoman of the US Fed, just declared during a congressional testimony that negative interest rates could be

looked at here in the US as a policy option, in some scenarios).

All these gimmicks produced some results. But nothing stellar. With all this gigantic monetary stimulus, the US has been growing at a modest 2%. Europe, at roughly 1%, has done much worse. Still, notwithstanding meager results, the international financial community seemed to be comfortable.

As long as the central banks seemed to be in control, busy doing one thing or another to prop up markets and keep stock markets reasonably buoyant, (regardless of the weak underlying economic fundamentals), it all looked promising.

### **Artificial valuations**

Except that everybody, unless totally insane, must have known that nothing was right. Here is the thing. The extravagantly long season of monetary easing did not do much to grow the economies. But zero interest rates pushed cash from savings into stocks, therefore artificially boosting stock prices.

This cannot go on for ever.

***Therefore, investors paying high prices for inflated assets must know that these high valuations were and are artificial. What happens when the central banks cannot provide any more monetary easing?***

### **Governments have done nothing**

It is true that central banks intervened so heavily mostly because governments did practically nothing. Sadly, in most western countries there has been no serious attempt to launch new pro-market, pro-growth, pro-investments policies. And it is obvious that, without a business friendly policy environment, there will be fewer investments, less innovation, less enterprise, fewer new companies, and fewer new jobs. And this means no growth, or lackluster growth.

But policy-makers, paralyzed by their ideological blinders that privilege spending on social issues as opposed of investments in future growth, sat on their hands.

It is true that central bankers, at least in the US and in the EU, pleaded with governments. They wanted action, real reforms that would free up resources, favor enterprise and therefore new growth. They did say that they could not manage the economies all on their own. But nobody listened, and almost nothing happened.

### **No reforms in the US**

In the US nothing has been done about reforming entitlement spending (Social Security, Medicare and Medicaid) and a horrendously complicated, burdensome federal tax system that discourages business creation. On the contrary, instead of reducing regulations, the US government keeps adding more, this way suffocating enterprises with unnecessary mandates.

In Europe, if anything, it is even worse. In Japan, Prime Minister Shinzo Abe back in December 2010 announced “Abenomics” a major reform plan consisting of “three arrows”: fiscal stimulus, monetary easing and structural reforms. Well, thanks to a subservient Bank of Japan, he got the monetary easing. But the rest –especially the structural reforms– did not happen. Abe simply could not deliver. Japan continues to stagnate.

### **Central banks keep easing**

So, confronted with systemically weak economies, and no help from policy-makers, the central banks tried to provide more oxygen via monetary stimulus. And it worked; but only a little. However, in so doing, the central banks created unprecedented asset price distortions and misdirected the allocation of capital. Trying to buy some time, they created a gigantic mess.

## **Nervous investors**

And now investors are very uneasy. They are on the lookout for any signs that may indicate the imminent collapse of this house of cards. They know that China, the most astonishing example of fake growth almost entirely financed (since the 2008 Great Recession) by unprecedented levels of new debt, is doing poorly. How poorly? Well, we do not know, because we cannot trust Chinese economic statistics. But global investors know that something really bad is brewing there. There is massive industrial over capacity, and no new demand. There is capital flight. For how long can the Chinese Government keep so many virtually bankrupt companies open? Not for ever.

And the same investors know and fear the cascading effects of the China retreat, some of them already unfolding, (and captured by Maersk's warning on world trade flows deterioration). Indeed, South Korea, Thailand, Japan, Indonesia, Australia and others are closely tied to the Chinese economy. Many of their companies are part of China's supply chains. So, as China goes down, they follow. This means a broader contraction.

## **Commodities down**

And then you have all the commodities producing countries, also hurt badly by China's slow down. This would be bad enough as it is. But it is made a lot worse by the fact that the rapid growth of many sectors (not just commodities) in emerging markets was debt-financed. Now that business is down, and profits have disappeared, where is the money to pay back the loans? These companies are going down, while their fall causes losses in the financial sector. This means more negative ripple effects.

So, here is the picture. Stock markets are over valued. Commodities producing countries are in bad shape because of lack of demand from China and over supply. There is too much



bad debt.

### **Too much debt**

Now, is this another September 2008 in the making? Who knows really. It is clear that no major economy is in high gear. On top of that, at least some highly indebted companies will be unable to make it. There are nasty rumors of troubled European banks with too many non performing loans on their books. Now they are abandoned by investors who fear the worst.

In China, at least for now, the losses are disguised through heavy-handed interventions by the state. But what about elsewhere? In the US, for instance, many of the companies that participated in the now defunct shale oil boom borrowed heavily to finance their operations. Because of the oil price collapse, now many of them will go under. This already hurt producers, contractors, suppliers and vendors, not to mention tens of thousands of high paying jobs lost. And you have to add the banks that financed the energy boom to the list. More broadly, the global financial system is exposed to a lot of non recoverable loans in emerging markets.

### **Bad news**

***So, there you have it. The global economic slow down is here to stay, according to Maersk and others. I would trust them. It is their core business to properly understand trends in trade flows.***

Commodities prices are not going to rebound. Mining multinationals from Glencore to BHP Billiton to Vale are in bad shape. China got a massive indigestion and stopped buying. Brazil is in a recession. Russia is doing poorly because of low oil prices. Europe is fragile. And there is a lot of bad debt in distressed emerging countries.

### **US cannot insulate itself**

It is true that in this rather gloomy context the US is not doing so badly. We have some growth, (a bit more than 2%), and unemployment is way down, (4.9%). The point is that the US is not strong enough to be able to insulate itself from these global currents. While the American economy is less dependent on foreign trade, many large US companies are tied to world markets. (Think about Caterpillar, or General Electric). If they suffer because of lost foreign sales, there will be ripple effects. At some point America as a whole will also feel the pain.

And if this happens while investors lose confidence in the Fed's ability to keep propping up markets with some more tricks, then all bets are off. At that point expect a mad rush for the exit.

Right now a US recession seems a very distant possibility. But may be it is a lot closer than we think.

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## **Thanks To The Central Banks, The Equity Bubble Is Getting Bigger**

**WASHINGTON** – Imagine this. There are lots of chronically sick patients in the hospital. Many of them are deteriorating rapidly. The right therapies cannot be administered because of absurd delays caused by infighting within the Ministry of Health.

**Give them morphine**

The physicians in charge of the hospital know what is needed to take care of the patients. But they have no resources. The only thing they have got is morphine, lots of it.

Well, since we cannot cure the patients, at least let's alleviate their severe pain. "Morphine for everybody!" orders the Director of the hospital. "But sir, this is no cure", argues a young doctor. "What do we do when the effect of morphine wears off?", he asks. "Well, we will give them some more. We have ample supply", replies the Director.

### **Quantitative Easing is morphine**

This may be a far-fetched analogy, but here it is. The patients are the sick economies in Europe, Japan, the US and now –in a major way– China. The Ministry of Health are the Governments incapable of tackling the structural issues of lack of productive investments, labor market rigidity and high public spending. The hospital Director are the Central Bankers. And the morphine is an ample supply is Quantitative Easing, (QE).

### **Central Bank left alone to manage the economies**

The Western economies are really sick. There is too much leverage, low productivity, too much private debt and out of control public spending. But Governments do essentially nothing about any of this. They are paralyzed by ideological disputes and bogus arguments about austerity and income redistribution. The only institutions that can do "something" are the Central Banks. They have no real "cure" for any of this. But they can provide temporary relief by keeping interest rates close to zero, (here is the morphine, in the form of QE), thereby giving everybody the illusion that the situation, while difficult, is manageable. The patients are still very sick. But (thanks to ample doses of QE-morphine) they feel no pain; and so they are led to believe that they have been cured.

## **More QE, it is still party time!**

This is totally absurd. But this is exactly what is happening. The European Central Bank, after having launched its own QE a while ago, just declared that the Eurozone economies need some more monetary easing. The Central Bank in China just announced some more easy money measures, in a country, mind you, that accumulated a monstrous amount of debt (much of it bad debt) in just a few years.

Watching all this unfold, Wall Street correctly concluded that in this environment where everybody is injecting even more liquidity there is no way that the US Federal Reserve will go against this powerful current and raise interest rates in 2015. With US rates still near zero, it still makes sense to put money in equities, since everything else will give you no financial reward.

Investors got the message. "It is still party time!" And so, Wall Street shot up on Thursday. The Dow Jones added 300 points. There was further growth on Friday. Has this optimism about equities got anything to do with the real economy? Not really.

## **Perverse incentives**

This is yet another Fed-induced rally. (By indirectly signalling that it will not raise rates in 2015, the Fed gave the green light). Needless to say, this is madness. Equity prices in developed economies now are largely disconnected from the fundamentals.

Even worse, thanks to QE governments in highly indebted countries, from Europe to the US, are under no pressure to reform their public finances, because they can keep borrowing at very low interest, this way creating and sustaining the insane delusion that more and more debt is a good way to finance chronic over spending.

## **Commodities took a dive**

In the meantime, though, emerging countries whose commodities fueled the crazy debt-driven Chinese construction investments binge are feeling the pain. As China could not sustain its own truly over sized madness, it stop buying stuff.

Therefore, commodity prices collapsed. As a result, Brazil, Australia, South Africa, Chile, Argentina, Zambia, and many others are suffering, in a major way. They built their budgets with the unwarranted assumption that commodity prices would stay in the stratosphere for ever. Now they have to go back to the drawing board.

In the meantime, their semi-impoverished people have no extra cash to buy new things, while their currencies are worth a lot less. This penury will further depress exports from industrial countries, this way further reinforcing the global downward spiral.

## **No incentives to engage in serious reforms**

So, here is the picture. The global economy is doing poorly, in large part because of minimal growth in the debt-burdened West where Governments still spend money on unaffordable entitlements instead of creating a business friendly environment that will encourage private investments in wealth-creating innovation.

Most emerging markets are in recession or close to it.

But at least in Europe, Japan, the US (and now China) the real extent of the problem is disguised. Developed countries enjoy a drug-induced financial markets buoyancy (QE is morphine) because the Central Banks keep pumping in liquidity, this way allowing the stock market bubbles to continue.

## **Another big bubble**

This is a gimmick. A dangerous gimmick. At some point it will

have to stop. I am not sure when. But it cannot go on for ever. I do not even want to think about what will happen when this gigantic bubble will explode.

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## Can We Find Decent People To Fix Our Democracies?

**WASHINGTON** – Democracy and free markets anyone? By this I mean opting for a real republican government with fair rules, transparency, honesty, and constructive debates. And office holders who really believe that their job is to further the public good, while allowing private citizens who play by clear and fair rules to engage in whatever activity they may be interested in.

### **What happened to liberal democracies?**

Does any of this still exist? The answer is a qualified yes. However, the real article is almost extinct. There are only approximations. Unfortunately, most self-described liberal democracies are only distant relatives of the original model.

In most Western countries, citizens mistakenly believe that it is perfectly alright to bend the political process and the state institutions so that they will provide for them, or at least subsidize them. This entitlement mind frame is a perversion of any honest notion of the state as guardian of the public good. And yet, the “welfare state” model is now the standard, with plenty of intellectuals willing to affirm its legitimacy and high moral standing.

### **Welfare and statism**

To make things worse, the welfare state goes hand in hand with a statist economic model. Many people do not believe that public institutions should limit themselves to the role of impartial arbiters and enforcers when economic rules are broken. No, the state should run things, (banks, utilities, airlines, railways, factories), or at a very least dictate via minute regulations how they should be run.

All this amounts to a state that got bigger, more expensive and more powerful, and in most cases more wasteful. As a consequence, some people in charge of powerful institutions that control huge assets or resources have enormous power. And this often unchecked power is an open invitation to corruption.

## **Corruption**

Corruption in turn has the effect of a chronic, debilitating disease. It is nasty parasite that eats up resources, while engendering cynicism and sometimes despair. Who will have the enthusiasm to think about starting a new business when they know that at each step of the way there will an intrusive bureaucracy run by voracious corrupt officials demanding bribes?

Well, this is the picture. In some instances, it gets to be too much. And people protest, loudly. (Witness what is going on right now in Brazil, with daily street protests and demands for the impeachment of President Dilma Rousseff).

Ironically, even semi-dictators complain about corruption. Vladimir Putin commented that there is way too much corruption in the recently annexed Crimea. Think of that. According to Putin, the once oppressed ethnic Russians of Crimea, instead of showing gratitude towards their Russian liberators, engage in all sorts of shady practices. The level of corruption in Crimea is now so bad that even Putin thinks it is way too much.

## Here is the picture

Well, without being too gloomy, here is the picture. Europe is slowly sinking under the weight of unsustainable public debt. Indeed, lacking enough revenue, this is the only way to finance all the benefits. Too much debt weighs on the economy. Too many regulations impede innovation, business formation, and therefore the creation of new employment. A bloated public sector fosters waste and corruption.

These days, confronted with economic stagnation, lack of opportunity and high unemployment, people are restless and unhappy. This being the case, they could opt for better political leaders.

But no, they do not do this. With few and limited exceptions, no way that any political force proposing to go back to the original free market, liberal democratic model could get vast popular support and succeed. *"Yes, reforms may be nice, but don't even think of touching my benefits"*.

## Looking for a "Big Man"

As real world solutions are excluded, the only alternative seems to be escapism. Yes, let's elect someone –A *Big Man*– who will make all this go away. Let's elect someone who will tell us that we are the innocent victims of a vicious cabal made out of corrupt politicians in bed with exploitative financiers. And then we have all the illegal immigrants who steal our jobs, not to mention unfair trading partners who cheat. Therefore, let's elect someone who will clean house, throw all the rascals in jail, and start fresh. *(Of course, the magic broom will steer clear of all my benefits and subsidies. And don't you dare raise my taxes)*.

Hence the appeal of Beppe Grillo and his 5 Stelle movement in Italy, the National Front in France, Podemos in Spain, and Syriza in Greece. And, most recently, the British Labor Party choose as new leader Jeremy Corbyn, an old (age 66),



unreconstructed Socialist whose ridiculous ideas have the fresh fragrance of the 1950s.

### **Bad news from America**

But what about America, the reliable bastion of democratic capitalism? Bad news from that front. Right now, in what is supposed to be a serious exercise aimed at selecting candidates for President, the leading contenders on the left and on the right are people who in ordinary circumstances would be dismissed as laughable populists.

### **Bernie Sanders and Donald Trump**

But no, they are not dismissed. They are in fact adored. On the left, Vermont Senator Bernie Sanders is an eccentric museum piece, a socialist who talks with passion about income redistribution. On the right, businessman Donald Trump argues passionately that he is really smart, while everybody else is stupid; and this is his main qualification for becoming President.

All this is disheartening. Confronted with this detachment from reality and consequent lowering of the level of policy debates, many commentators argue that this is a “healthy rebellion” against an ossified political system dominated by worn-out elites made out of professional politicians.

*“You see, the people got fed up with the establishment, and so now they vent their frustrations by supporting populists who make outlandish claims. Perfectly understandable, no?”*

### **Venting frustration is not smart**

***No, not at all! While we can understand that frustrated people may engage in foolish behavior, this does not make foolish behavior smart. It is in fact stupid and destructive. If we accepted this logic, then we should accept as “normal” the fact that some unemployed workers become thieves, while others***

***become alcoholics or drug addicts.***

Indeed, let's agree that "the system is inefficient and corrupt". Let's assume that this is true. Well, then let's try to find more honest and more competent people to run it.

Electing Jeremy Corbyn in the UK, or Bernie Sanders or Donald Trump here in the US will solve nothing.

**We no longer understand what this is all about**

***But then, why are socialists, populists and demagogues so in fashion, these days? Why the appeal of politicians who loudly promise easy fixes? Very simple: because many members of our societies have lost the meaning of the fundamental values that make republican government possible.***

A republican government is supposed to manage the sectors that individuals cannot take care of on their own, while allowing people to freely live their lives. Government should take care of the truly needy; but it is not a philanthropy tasked with delivering plenty of goods at no cost. Government has costs that need to be financed through fair taxation; but it is not a mechanism for redistributing wealth.

Government should be about the protection of individual rights, within clear and transparent rules. Government should allow all law-abiding private citizens to engage in wealth-producing activities. In other words, I can do my own thing, but this pursuit positively excludes taking advantage of others.

**We got ourselves in this mess**

***Sadly, we forgot all this. And so we are caught between our deep dissatisfaction with our sorry-looking, stagnating democracies and our inability to see that we got here precisely because we lost our understanding of what the state is, and what it should do.***

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# 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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## **The Real Problem With Welfare Is Dependence, Not Cost**

**WASHINGTON** – The standard argument in favor of the welfare state and its multiple entitlement programs is that modern, relatively affluent societies have a moral obligation to help their disadvantaged citizens.

### **Help the needy**

The poor, the elderly, single mothers supporting sometimes many children struggle to survive. Quite often they fall

further behind, and so they get into a negative spiral that leads them from poverty into despair.

Benign policy-makers cannot ignore this plight. Hence the idea to come up with various support programs. This is the “social safety net” that will prevent the weak from falling into the abyss of the perennially destitute.

### **Benefits for ever**

Fair enough. However, while theoretically these programs are supposed to help people to “*get back on their feet*”, in practice it is not so. In practice, temporary assistance has a way to become permanent, while little is done to enable recipients to become once again (or for the first time) self-sufficient.

Moreover, once we have accepted as a society that there are some deserving categories of individuals who must be helped, we have also created an almost irresistible drive to augment the ranks of the deserving, while increasing, little by little, the range of subsidies, free services and more they are entitled to receive.

### **Huge cost**

And this explains the huge financial burden created over time by large and growing social programs. In political terms, the “fiscally responsible” argue that all this public largesse is unaffordable. Therefore the ranks of the “entitled” have to be reduced, while restrictions have to be enacted regarding how much can be given out and for how long.

### **Let the rich pay**

The socially minded “progressives” argue that one can find the money to pay for all this by increasing taxation on the (undeserving) rich, many of whom gained their extraordinary fortunes by gaming the system.



Within most western democracies the political divide is indeed on these issue: *“How much social spending is necessary, and how much can we afford”*.

### **Welfare breeds apathy**

But this is not the whole story. Empirical evidence shows that societies that devote a huge amount of resources to social programs tend to be affected by economic stagnation. Little innovation, no dynamism, no real growth. Many welfare state critics argue that there is a clear cause and effect relationship between spending a lot on entitlements and feeble growth.

### **Dependence is the issue**

But allow me to look at the issue from a different angle. The real problem with entitlement programs is not that they cost too much. The real problem pointed out by many but difficult to express in political language is that they cause unhealthy dependence.

In other words, individuals who get progressively used to get enough to survive through public assistance programs lose the drive to look after themselves. They have little incentive to look for better jobs. Likewise, they have no motivation to learn new skills that would help them move up in the labor market.

***Dependence: this is the insidious, unintended consequence of public assistance not tied to a commitment to self-improvement.***

### **Self-sufficiency is the goal**

Broadly speaking, modern psychology argues that a self-sufficient individual is also a more balanced person. It is now recognized that facing challenges is good for you, assuming that they are not in the shape of overwhelming

calamities. Which is to say that reasonably competent, mature individuals can rise to the challenge of looking for a new job. Dealing with cancer, or with the consequences of a devastating hurricane is another matter.

So, where do we go with all this? If we accept the above, then we should agree that all public assistance to the needy has to be geared to make the needy self-sufficient within a reasonable period of time.

### **From assistance to independence**

The emphasis should be not in giving enough money so that the person or family will not fall into destitution. The emphasis should be in devising "customized strategies" that will lead the recipients to increasing their chances of self-improvement. Learning new skills, getting more education, receiving training in marketable skills increases the chances of getting a job, or a better job.

If we accepted this approach, welfare programs would be redesigned so that they are no longer a life raft. They will become a ladder to self-sufficiency. In so doing, in the long term we achieve positive goals. We progressively reduce the cost of entitlement programs; and at the same time we increase the ranks of productive, self-confident citizens who are better positioned to be economically independent, while contributing to society.

### **Resistance to change**

As you can imagine, the large, established constituencies of "the perpetually needy", all the bureaucracies created to attend to their needs and their political patrons will resist reform, claiming that any proposed change is really a thinly disguised effort to cut benefits, this way condemning so many of our fellow citizens to be destitute outcasts.

### **A difficult task**

Indeed, even with sufficient political support, this is going to be very difficult. Teaching people to find motivation from within, at the same time accepting that in life one has to learn how to face challenges is difficult.

Teaching these life skills to adults who never had the opportunity to learn any of this at a younger age is even more daunting. And yet this is the only way to overcome this dependence on costly welfare that condemns millions to be forever semi-marginalized.

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## Japan's Slow Suicide

**WASHINGTON** – Japan is slowly sinking. This is due to the impact of many self-inflicted wounds, starting with the collapse of fertility rates. “*Civilizations die from suicide, not by murder.*”, wrote revered British historian Arnold Toynbee. Considering that not enough babies eventually means the death of a society, his words truly apply to Japan. Indeed, as baffling as this may sound, it is true that civilizations implode for non material causes. Their demise is not due to wars or natural catastrophes. It is about lack of confidence in the future that brings about loss of vigor and optimism.

### **From greatness to decline**

And this is today's Japan. And what is most remarkable is how fast Japan changed from its role of unchallenged Asian Superstar to yet another “has-been” case. Think about it. Throughout the 1980s Japan was the shining example that demonstrated to the entire world the triumph of “Asian

Values". At that time it was thought that Japan had the skills, the drive and the determination that would have allowed it to surpass America as the leading global economic power.

### **Not enough babies**

But now Japan is one of the best examples of a civilization's "slow motion suicide". High debt, massive public spending and slow growth point to a bleak future. While there are many factors contributing to this picture, the most visible is the incredible collapse of fertility rates, (average of 1.39 children per woman) . Very few children and extended life expectancy for older Japanese mean a net population decline (minus 244,000 in 2013), and a society that will soon resemble a giant geriatric ward. And this is not a temporary phenomenon. This decline has been going on since the 1970s.

### **Population decline**

***Indeed, a study by the Japanese Ministry of Health and Welfare indicates that, if the country keeps its present demographic trends, by 2060 Japan's total population will go from 127 million down to 87 million, of which 40% will be 65 or older. This is a real catastrophe.***

### **Very few workers, many pensioners**

Imagine the implications of this shrinkage. Japan will have a substantially reduced work force, and this is bad news for future economic expansion. At the same time, there will be a need to increase public spending for more and longer lasting old age pensions. Likewise, many more senior citizens mean higher health care and nursing home costs due to the needs of millions of old people who cannot rely on a social safety net provided by large extended families. The sad truth is that millions of elderly Japanese live alone.

### **Larger welfare programs, more debt**

In all this, please remember that Japan already has –today– a monstrous public debt, now 240% of GDP. A reduced working population will translate in reduced tax revenue, while the state will have to keep or even enlarge all its welfare programs in order to provide for tens of millions of older Japanese. This means even more spending and therefore more debt. And it also means that most of Japan's financial resources will be devoted to support the elderly. Where will the money for R&D and therefore new economic growth come from?

The government led by Prime Minister Shinzo Abe is aware of all this and it is trying to think about ways to reverse this rapid population decline. But I suspect that there is no public policy “silver bullet”. Of course, a simple solution would be to encourage immigration, on a massive scale. But this is almost unthinkable in a society that does not welcome foreigners. And Japan would need millions of newcomers to stabilize its population.

### **The role of women**

Many think that the key issue is about changing the role of women in Japan. Some believe that if more Japanese women worked, then they would have more babies. However, others argue exactly the opposite. If more young and productive Japanese women could work, then they would postpone marriage and motherhood.

### **Reinvent Japan?**

Ideally Japan would need to reinvent itself. Right now it is a society suffocated by strict social norms, economic rigidities and high taxes. The country would need a real breath of fresh air. Lower taxes and substantial deregulation, plus incentives for genuine economic competition would create a new pro-growth environment for would-be entrepreneurs. If this were possible, who knows, may be more people would marry and have more children.

Shinzo Abe is trying to revive Japan's dormant economy with turbo-charged Keynesian policies. Higher spending, cheap money and an artificially depressed currency should boost consumption and exports. Sure enough exports are growing, and the stock market is booming. But the overall economy is doing at best so-so, while the national debt is growing, and the population continues to decline.

***This is Japan's slow suicide.***

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## **The Economy Grows Modestly, While Wall Street Is At An All Time High**

**WASHINGTON** – When it comes to US higher and higher stock prices I am struck by something truly odd, in fact frightening. There is an obvious disconnect between all time Wall Street highs and relatively weak economic data.

### **Mediocre economy**

The US economy is doing OK, but not especially well. After the weakest recovery in recent history, America is growing at 2% a year, may be a little better. However, unemployment around 6% is still too high. Labor participation is at historic lows. Real incomes have not grown for decades. A new generation of college graduates is coming into the labor market saddled with the heavy burden of gigantic student loans. These huge financial obligations prevent even the lucky ones who find

decent jobs to spend, buy homes, etc. All in all, I would not call this a booming economy.

### **Forget about the BRICS**

Add to this not particularly inspiring US picture the obvious fact that the global economy is doing poorly. Remember the BRICS? Not even one of them has met expectations. Brazil was all about its short-lived commodities export boom. Now it is in poor shape. Forget about Russia and sorry-looking South Africa. India, now under new management, may hold some promise. China's economic miracle story is over. The spectacular 30 year export-led model has run its course. At this time China is desperately trying to meet inflated growth targets by pumping more cash into a so-so economy already suffering of a serious case of "too much bad debt", coupled with massive overcapacity in some key sectors, like steel.

### **Europe and Japan are in decline**

In all this, Europe and Japan are in seriously bad shape. Simply stated, these are old, in fact exhausted societies with way too much public debt, negative birth rates, too many old people, negligible investments, bloated public sectors, and huge entitlement programs no longer supported by a large active work force paying into the system.

These old countries, mostly run by mediocre political leaders, simply cannot keep up any more. Italy has zero growth, an unemployment rate of 12%, with youth unemployment in the South up to 60%, and a national debt now equal to 130% of GDP. Japan is once again in a recession, while its national debt is 230% of GDP. None of this is fixable.

Now, let's point out the obvious. These are America's main trading partners. How can it be that the US economy is doing so-so, the rest of the world, including those who buy our goods and services, is in mediocre to bad shape and the US stock market is booming? It used to be that stock prices

reflected basic fundamentals. Well, not any more.

## **Stock valuations driven by Central Bankers**

These days stock prices have little to do with the real economy. They are determined by the presumed positive impact of supposedly benign monetary policies implemented by Central Bankers. And what kind of magic are they doing? Well, the Central Bankers throw more and more invented money into the system while purchasing assets in order to ignite growth.

The evidence is that this does not increase the volume of productive investments; but it pushes up the valuation of stocks. Indeed, since real interest rates are kept below zero by the monetary authorities, where else will you put your money? Therefore, all the smart people buy more stocks, counting on Fed or ECB policies to push valuations higher and higher, no matter what the fundamentals may be. Japan's economy is not growing, but its stock market valuations doubled. Have we gone totally mad? The answer is "Yes".

## **David Stockman's analysis**

Here is how David Stockman sees it. Writing in his own [www.davidstockmancontracorner.com](http://www.davidstockmancontracorner.com) he says:

*"The global financial system has come unglued. Everywhere the real world evidence points to cooling growth, faltering investment, slowing trade, vast excess industrial capacity, peak private debt, public fiscal exhaustion, currency wars, intensified politico-military conflict and an unprecedented disconnect between debt-saturated real economies and irrationally exuberant financial markets.*

*Yet overnight two central banks promised what amounts to more **monetary heroin** [bold added] and, presto, the S&P 500 index jerked up to 2070. That is, the robo-traders inflated the PE multiple for S&P's basket of US-based global companies to a nose bleed 20X their reported LTM earnings.*



*And those earnings surely embody a high water mark in a world where Japan is going down for the count, China's house of cards is truly collapsing, Europe is plunging into a triple dip and Wall Street's spurious claim that 3% "escape velocity" has finally arrived in the US is soon to be discredited for the 5th year running. So it goes without saying that if "price discovery" actually existed in the Wall Street casino, the capitalization rate on these blatantly engineered earnings (i.e. inflated EPS owing to massive buybacks) would be decidedly less exuberant.*

*In truth, nothing has changed about the precarious state of the world since yesterday. Except.... except the Great Bloviator at the ECB [President Mario Draghi] made another fatuous and undeliverable promise-- this time that he would do whatever he "must to raise inflation and inflation expectations as fast as possible"; and, at nearly the same hour, the desperate comrades in Beijing administered another sharp poke in the eye to China's savers by lowering the deposit rate to by 25 bps to 2.75%.*

*Let's see. Can it possibly be true that European growth is faltering because it does not have enough inflation? Or that China's fantastic borrowing and building boom is cooling rapidly because the People Bank of China (PBOC) has been too stingy?*

*The answer is not on your life, of course. So why would stocks soar based on two overnight announcements that can not possibly alleviate Europe's slide into recession or the collapse of China's out-of-control investment and construction bubble?"*

### **This boom is unsustainable**

Well, there is no valid economic reason for these incredibly high stock valuations, except for the crazy belief held by most investors that Central Bankers have magic wealth creation

powers.

As long as the monetary authorities of the US, Europe, Japan and now China can keep their magician tricks going, (buying assets while keeping interest rates at zero), everybody in America will continue to believe that the stratospheric Wall Street valuations are justified.

I do not know when, but there will be a point when the Central Bankers will run out of tricks, and therefore this whole Wall Street boom will unravel, because it is based on nothing real.

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## **The Bad “Lesson” of The EU Debt Crisis Is That There Will Always Be A Bailout**

**By Paolo von Schirach**

July 31, 2013

**WASHINGTON** – The situation in Europe turned from really dramatic into just chronic. No more talk of a “Greece Exit”. There are no defaults on the horizon. Still, there has been no qualitative change. Therefore it would be highly deceptive to call this calmer state of affairs a real improvement. The reality is that Southern Europe cannot travel at the same speed of its better organized Northern counterparts relying on its own means. This means that Club Med will have to receive aid and/or special treatment for a long, long time. Who knows, may be in perpetuity.

## **Bailout does not affect the fundamentals**

Mostly for political reasons, wealthier Northern Europe (read: Germany) decided that it was and still is in its own self-interest to bail out its Southern poor, and perennially disorganized, cousins. Better to pay now, then to face the headwinds and possible chaos that may result from a sovereign debt default.

Still, nobody believes at this juncture that the bailout money and/or the indirect fiscal support via ECB bond buying programs or easy credit to battered banks will cause a real qualitative transformation within the South. While economic conditions may improve somewhat, the fundamentals remain bad. For example, Sergio Marchionne, the CEO of FIAT, still the largest Italian industrial conglomerate, in a call with analysts indicated that ***“Italy continues to have an impossible environment for industry”***.

Now, consider this rosy assessment on the economic fundamentals within the third largest Eurozone economy, coming as it does from a pretty seasoned practitioner. How is a profoundly uncompetitive country that continues to have impossible conditions for industry (i.e. growth) going to produce the extra wealth that will allow it to get out of its impossibly high national debt? The simple answer is: “Never”. Italy will probably limp along, supported by ECB bond buying and some other half measures. It may not drown, but it will never become an energetic, competitive economy. In other words, thanks to extra help it will not go under, even though the best it can hope for is survival.

## **Everybody gets a rescue package**

***And here comes the real point. If you are a policy maker in Slovenia, Poland or Hungary, having noted that Germany decided that Greece and the others are indeed “too big to fail”, you will conclude that, if your country gets into serious trouble,***

*it will be considered too big to fail, just like all the others. Help will come. You will not be allowed to go under. This "message" unfortunately has a perverse effect, because it diminishes the pressure on other mediocre economies to get busy in order to jump-start serious growth.*

**Michigan allowed Detroit to go under, a lesson for all other troubled municipalities**

In a different, but somehow related, context the State of Michigan allowed battered Detroit to go under. Michigan decided that its own domestic "Greece" was not "too big to fail". It did not bail it out. It forced it into bankruptcy. The just initiated bankruptcy process in turn allowed the rest of America to see and evaluate the compounded effects of unfavorable economics and bad public administration, combined with over generous pensions to public employees.

As a result, local administrators in Chicago, Oakland and other challenged cities now have a strong extra incentive to get their own house in order. If Detroit is not "too big to fail", chances are that their own municipalities, all of them headed Detroit's way, may also go under. Therefore some at least may conclude that it is time to get busy and make changes, (renegotiating unsustainable pension benefits would be a good start), before it is too late.

**Rescue packages are a disincentive to implement reforms**

In contrast, policy-makers in Europe get essentially the opposite message. *"Your countries are perennial economic under achievers. Your public accounts are headed the wrong way. But not to worry. Just as they did with Greece, the wealthy Northern partners will bail you out"*. If this is indeed the "lesson" of the catastrophic debt crisis that began back in 2009, then you can bet that with the exception of a more solid North most of Europe will lack the incentive to do better and therefore will continue to underperform.

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# Detroit's Bankruptcy Is About Unaffordable Pension Obligations

By Paolo von Schirach

July 22, 2013

**WASHINGTON** – The convenient narrative about the Detroit bankruptcy is that the city is the main (and quite innocent) victim of the auto sector crisis. As GM and Chrysler went under, Detroit was sunk by the gigantic downdraft created by this epic collapse. Convenient story. Except that it is mostly untrue. In fact, the auto sector (however diminished) is back, while Detroit got worse. Of course Detroit was going to feel the negative impact of the auto sector crisis. But the real truth is that Detroit is the victim of the ill effects of racial and social conflicts coupled with decades of poor administration.

## **The 1967 Detroit riots**

Detroit's problems started after the gigantic 1967 riots, among the worst in US history. Sparked by police action that seemed unwarranted, Detroit's Blacks went on a rampage that lasted five long days. There was so much violence that Governor George W. Romney (Mitt Romney's father) called the National Guard and President Johnson sent in the US Army. A curfew was ordered. At the end, there were 43 dead, 1189 injured, 7, 200 arrests and 2,000 building destroyed.

Seeing all that destruction, Whites felt unsafe and started

leaving the city, this way causing a progressive shrinking of its tax base. How did the municipality cope? Poorly. Over many years, the city administration, caught between a shrinking revenue base and mounting pension obligations, quite foolishly decided not to renegotiate pensions, going instead for more tax hikes in order make ends meet.

### **Making it worse**

Well, not surprisingly, higher taxes going to pay for outstanding pension obligations, as opposed to funding new city projects, encouraged even more people to leave the city, therefore making the lack of revenue problem worse, year after year. Short of cash, Detroit did what other cities did and do: it issued bonds. Investors believed that those high interest bonds would be "safe", because it seemed unthinkable to anybody that one of America's largest cities, even though in bad shape, would be allowed to go belly up.

### **High pension costs, no money to pay for them**

And this is Detroit's story: Too many costly obligations towards large number of retirees, high taxes but not enough revenue, (after having lost most of the tax base due to tax hikes), and growing debt issued for the sole purpose of paying for pensions.

The only way to rebalance the fiscal outlook would have been a combination of renegotiated (meaning lower) pension benefits and measures aimed at encouraging economic growth and thus a larger and healthier revenue base. But the city did neither. The pension agreements stayed, while taxes remained too high to encourage new business. And so, year after year, things got a bit worse.

### **Bankruptcy**

And now, here we are: bankruptcy. This is of course a tragedy for all those who trusted the word of city administrators. And

this includes retirees who will see cuts in benefits and bond holders who will not see their money back.

That said, as painful as this is, it is welcome news that Detroit is not *"too big to fail"*. Detroit failed because it had unwisely created massive obligations, (due to the political deals between public services unions and public officials), that it could not meet. Its attempts to raise more revenue while city services were deteriorating made matters worse. It lost its tax base, while it created an army of (now) angry bondholders.

### **Other cities headed the same way**

The cautionary tale in all this is that Detroit is only the tip of the iceberg. Many other large US municipalities, (like Chicago), are headed exactly in the same direction: too many unfunded liabilities to retirees. Trying to make up the difference through a combination of higher taxes and more borrowing is both suicidal and not enough, as Detroit's story demonstrated. Tax payers will vote with their feet. They will simply move somewhere else in order to avoid paying higher taxes.

### **Just Like Greece**

Ultimately, Detroit's problems are not that different from Greece's problems: too much spending on over generous social programs, without a growing economy that will generate the necessary revenue. While this bankruptcy is a mess, it is a good thing that Detroit is not *"too big to fail"*. Numbers should mean something, and when something is unsustainable it is wise to put an end to it. In the case of Greece, for the moment numbers do not count. Greece's future is about political calculations on the part of its EU partners willing to keep the bail out going, despite all. Indeed, notwithstanding its stubborn inability to embrace serious reforms, Greece's EU partners decided to support this

virtually bankrupt country. This would be the equivalent of Detroit, whatever its financial outlook, seeking and getting more credit.

### **US Federal Government has the same problem**

Long term the US Federal Government faces a similar scenario. Even though the short term fiscal picture, thanks to the impact of the dreaded "sequester" has improved somewhat, long term America is faced with growing debt. And why? Yes, you guessed it, it is mostly about social spending obligations (mostly health care to seniors) completely out of line with Federal revenue. For the time being, the world is eager to lend money to Uncle Sam, trusting America's creditworthiness. But what if global credit markets stop believing that America will pay back? As a minimum they will demand higher interest rates, this way making the fiscal outlook a lot worse.

Of course, Detroit is much, much smaller than the entire United States. And yet, until recently all creditors were comforted by the notion that such a large city would never go into bankruptcy.