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US/World Economy

# Devastating Crisis Unfolds

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**THE CURRENT CRISIS could well turn out to be the most devastating since the Great Depression. It manifests profound, unresolved problems in the real economy that have been “literally” papered over by debt for decades, as well as a shorter term financial crunch of a depth unseen since World War II. The combination of the weakness of underlying capital accumulation and the meltdown of the banking system is what’s made the downward slide so intractable for policymakers and its potential for disaster so serious. The plague of foreclosures and abandoned homes “often broken into and stripped clean of everything, including copper wiring” stalks Detroit in particular, and other Midwest cities.**

[<https://internationalviewpoint.org/IMG/jpg/dollarsqueeze.jpg>]

The human disaster this represents for hundreds of thousands of families and their communities may be only the first signal of what such a capitalist crisis means. Historic bull runs of the financial markets in the 1980s, 1990s and 2000s “with their epoch-making transfer of income and wealth to the richest one per cent of the population” have distracted attention from the actual longterm weakening of the advanced capitalist economies. Economic performance in the United States, western Europe and Japan, by virtually every standard indicator “the growth of output, investment, employment and wages” has deteriorated, decade by decade, business cycle by business cycle, since 1973.

The years since the start of the current cycle, which originated in early 2001, have been worst of all. GDP (Gross Domestic Product) growth in the United States has been the slowest for any comparable interval since the end of the 1940s, while the increase of new plant and equipment and the creation of jobs have been one third and two thirds, respectively, below postwar averages. Real hourly wages for production and non supervisory workers, about 80% of the labor force, have stayed roughly flat, languishing at about their level of 1979.

Nor has the economic expansion been significantly stronger in either western Europe or Japan. The declining economic dynamism of the advanced capitalist world is rooted in a major drop in profitability, caused primarily by a chronic tendency to overcapacity in the world manufacturing sector, going back to the late 1960s and early 1970s. By 2000, in the United States, Japan and Germany, the rate of profit in the private economy had yet to make a comeback, rising no higher in the 1990s cycle than in that of the 1970s.

With reduced profitability, firms had smaller profits to add to their plant and equipment, as well as smaller incentives to expand. The perpetuation of reduced profitability since the 1970s led to a steady falloff in investment, as a proportion of GDP, across the advanced capitalist economies, as well as step-by-step reductions in the growth of output, means of production, and employment.

The long slowdown in capital accumulation, as well as corporations’ repression of wages to restore their rates of return, along with governments’ cuts in social spending to buttress capitalist profits, have resulted in a slowdown in the growth of investment, consumer and government demand, and thus in the growth of demand as a whole. The weakness in aggregate demand, ultimately the consequence of the reduction in profitability, has long constituted the main barrier to growth in advanced capitalist economies.

To counter the persistent weakness of aggregate demand, governments, led by the United States, have seen little choice but to underwrite ever greater volumes of debt, through ever more varied and baroque channels, to keep the economy turning over. Initially, during the 1970s and 1980s, states were obliged to incur ever larger public deficits to sustain growth. But while keeping the economy relatively stable, these deficits also rendered it increasingly stagnant:

In the parlance of that era, governments were getting progressively less bang for their buck, less growth of GDP for any given increase in borrowing.

### **From Budget-Cutting to Bubblenomics**

In the early 1990s, therefore, in both the United States and Europe, led by Bill Clinton, Robert Rubin and Alan Greenspan, governments moving to the right and guided by neoliberal thinking (privatization and slashing of social programs) sought to overcome stagnation by attempting to move to balanced budgets. But although this fact does not loom large in most accounts of the period, this dramatic shift radically backfired.

[<https://internationalviewpoint.org/IMG/jpg/salehouse.jpg>]

#### **In some parts of Detroit it's cheaper to buy a house than a car**

Because profitability had still failed to recover, the deficit reductions brought about by budget balancing resulted in a huge hit to aggregate demand, with the result that during the first half of the 1990s, both Europe and Japan experienced devastating recessions, the worst of the postwar period, and the U.S. economy experienced the so-called jobless recovery. Since the middle 1990s, the United States has consequently been obliged to resort to more powerful and risky forms of stimulus to counter the tendency to stagnation. In particular, it replaced the public deficits of traditional Keynesianism with the private deficits and asset inflation of what might be called asset price Keynesianism, or simply Bubblenomics.

In the great stock market runup of the 1990s, corporations and wealthy households saw their wealth on paper massively expand. They were therefore enabled to embark upon a record-breaking increase in borrowing and, on this basis, to sustain a powerful expansion of investment and consumption. The so-called New Economy boom was the direct expression of the historic equity price bubble of the years 1995-2000. But since equity prices rose in defiance of falling profit rates and since new investment exacerbated industrial overcapacity, there quickly ensued the stock market crash and recession of 2000-2001, depressing profitability in the non-financial sector to its lowest level since 1980.

Undeterred, Greenspan and the Federal Reserve, aided by the other major Central Banks, countered the new cyclical downturn with another round in the inflation of asset prices, and this has essentially brought us to where we are today. By reducing real short-term interest rates to zero for three years, they facilitated an historically unprecedented explosion of household borrowing, which contributed to and fed on rocketing house prices and household wealth.

According to *The Economist*, the world housing bubble between 2000 and 2005 was the biggest of all time, outrunning even that of 1929. It made possible a steady rise in consumer spending and residential investment, which together drove the expansion. Personal consumption plus housing construction accounted for 90-100% of the growth of U.S. GDP in the first five years of the current business cycle. During the same interval, the housing sector alone, according to *Moody's Economy.com*, was responsible for raising the growth of GDP by almost 50% above what it would otherwise been — 2.3% rather than 1.6%.

Thus, along with G. W. Bush's Reaganesque budget deficits, record household deficits succeeded in obscuring just how weak the underlying economic recovery actually was. The rise in debt-supported consumer demand, as well as super-cheap credit more generally, not only revived the American economy but, especially by driving a new surge in imports and the increase of the current account (balance of payments and trade) deficit to record levels, powered what has appeared to be an impressive global economic expansion.

### **Brutal Corporate Offensive**

But if consumers did their part, the same cannot be said for private business, despite the record economic stimulus. Greenspan and the Fed had blown up the housing bubble to give the corporations time to work off their excess capital and resume investing. But instead, focusing on restoring their profit rates, corporations unleashed a brutal offensive against workers. They raised productivity growth, not so much by increasing investment in advanced plant and equipment as by radically cutting back on jobs and compelling the employees who remained to take up the slack. Holding down wages as they squeezed more output per person, they appropriated to themselves in the form of profits an historically unprecedented share of the increase that took place in non-financial GDP.

Non-financial corporations, during this expansion, have raised their profit rates significantly, but still not back to the already reduced levels of the 1990s. Moreover, in view of the degree to which the ascent of the profit rate was achieved simply by way of raising the rate of exploitation — making workers work more and paying them less per hour — there has been reason to doubt how long it could continue. But above all, in improving profitability by holding down job creation, investment and wages, U.S. businesses have held down the growth of aggregate demand and thereby undermined their own incentive to expand.

Simultaneously, instead of increasing investment, productiveness and employment to increase profits, firms have sought to exploit the hyper-low cost of borrowing to improve their own and their shareholders' position by way of financial manipulation — paying off their debts, paying out dividends, and buying their own stocks to drive up their value, particularly in the form of an enormous wave of mergers and acquisitions. In the United States, over the last four or five years, both dividends and stock repurchases as a share of retained earnings have exploded to their highest levels of the postwar epoch. The same sorts of things have been happening throughout the world economy — in Europe, Japan and Korea.

### **Bursting Bubbles**

The bottom line is that, in the United States and across the advanced capitalist world since 2000, we have witnessed the slowest growth in the real economy since World War II and the greatest expansion of the financial or paper economy in U.S. history. You don't need a Marxist to tell you that this can't go on.

Of course, just as the stock market bubble of the 1990s eventually burst, the housing bubble eventually crashed. As a consequence, the film of housing-driven expansion that we viewed during the cyclical upturn is now running in reverse. Today, house prices have already fallen by 5% from their 2005 peak, but this has only just begun. It is estimated by Moody's that by the time the housing bubble has fully deflated in early 2009, house prices will have fallen by 20% in nominal terms — even more in real terms — by far the greatest decline in postwar U.S. history.

Just as the positive wealth effect of the housing bubble drove the economy forward, the negative effect of the housing crash is driving it backward. With the value of their residences declining, households can no longer treat their houses like ATM machines, and household borrowing is collapsing, and thus households are having to consume less.

The underlying danger is that, no longer able to putatively "save" through their rising housing values, U.S. households will suddenly begin to actually save, driving up the rate of personal savings, now at the lowest level in history, and pulling down consumption. Understanding how the end of the housing bubble would affect consumers' purchasing power, firms cut back on their hiring, with the result that employment growth fell significantly from early in 2007.

Thanks to the mounting housing crisis and the deceleration of employment, already in the second quarter of 2007, real total cash flowing into households, which had increased at an annual rate of about 4.4% in 2005 and 2006, had

## Devastating Crisis Unfolds

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fallen near zero. In other words, if you add up households' real disposable income, plus their home equity withdrawals, plus their consumer credit borrowing, plus their capital gains realization, you find that the money that households actually had to spend had stopped growing. Well before the financial crisis hit last summer, the expansion was on its last legs.

Vastly complicating the downturn and making it so very dangerous is, of course, the sub-prime debacle which arose as direct extension of the housing bubble. The mechanisms linking unscrupulous mortgage lending on a titanic scale, mass housing foreclosures, the collapse of the market in securities backed up by sub-prime mortgages, and the crisis of the great banks who directly held such huge quantities of these securities, require a separate discussion.

One can simply say by way of conclusion, because banks' losses are so real, already enormous, and likely to grow much greater as the downturn gets worse, that the economy faces the prospect, unprecedented in the postwar period, of a freezing up of credit at the very moment of sliding into recession "and that governments face a problem of unparalleled difficulty in preventing this outcome.

[This statement was written by Robert Brenner, a member of the ATC editorial board and author of *The Economics of Global Turbulence*. References for all data cited here can be found in this book, especially in the Afterword.]

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