THE FIRST GREAT DEPRESSION OF THE 21ST CENTURY: CAUSES AND IMPLICATIONS

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I. Historical Context

II. Profitability Is the Driver of Growth

III. Empirical Evidence for the United States

IV. A Look at the World Situation

V. Depressions, Recovery Mechanisms and Government Spending

VI. Implications for the Present Period

I. Historical Context

- **Mortgage crisis is the trigger**, not the cause of the crisis: 30% of total securitized market assets

- **Immediate cause** is the huge credit bubble which preceded it for decades: technology bubble (dot.com bubble) collapses, but interest rates were lowered which permitted huge rise in borrowing by consumers and a real estate bubble
  - **Along with this is the** gradual undoing of regulation and creation of new unregulated arenas

- Deregulation has been going on since the 1970s because banks and businesses <u>were pushing it for reasons of profitability</u>.

- **Deeper question**: why was there a huge credit bubble in the first place?

I. Historical Context

- Was the credit bubble just Greenspan's Folly or some other instance of mismanagement?

- No. What we are experiencing is **a structural crisis**, **part of a recurrent pattern**

- Economic historians speak of the Great Depression of 1840's, 1880's, 1930's, and 1970's (Great Stagflation)
- Some of these were sharp collapses of the real economy: late 1840's and 1930's
- Others were long drawn out periods of decline and stagnation: 1870's, 1970's
- We have just entered the Great Depression of 2008
  - The **form** it takes depends on what we collectively do

II. Profitability Is the Driver of Growth

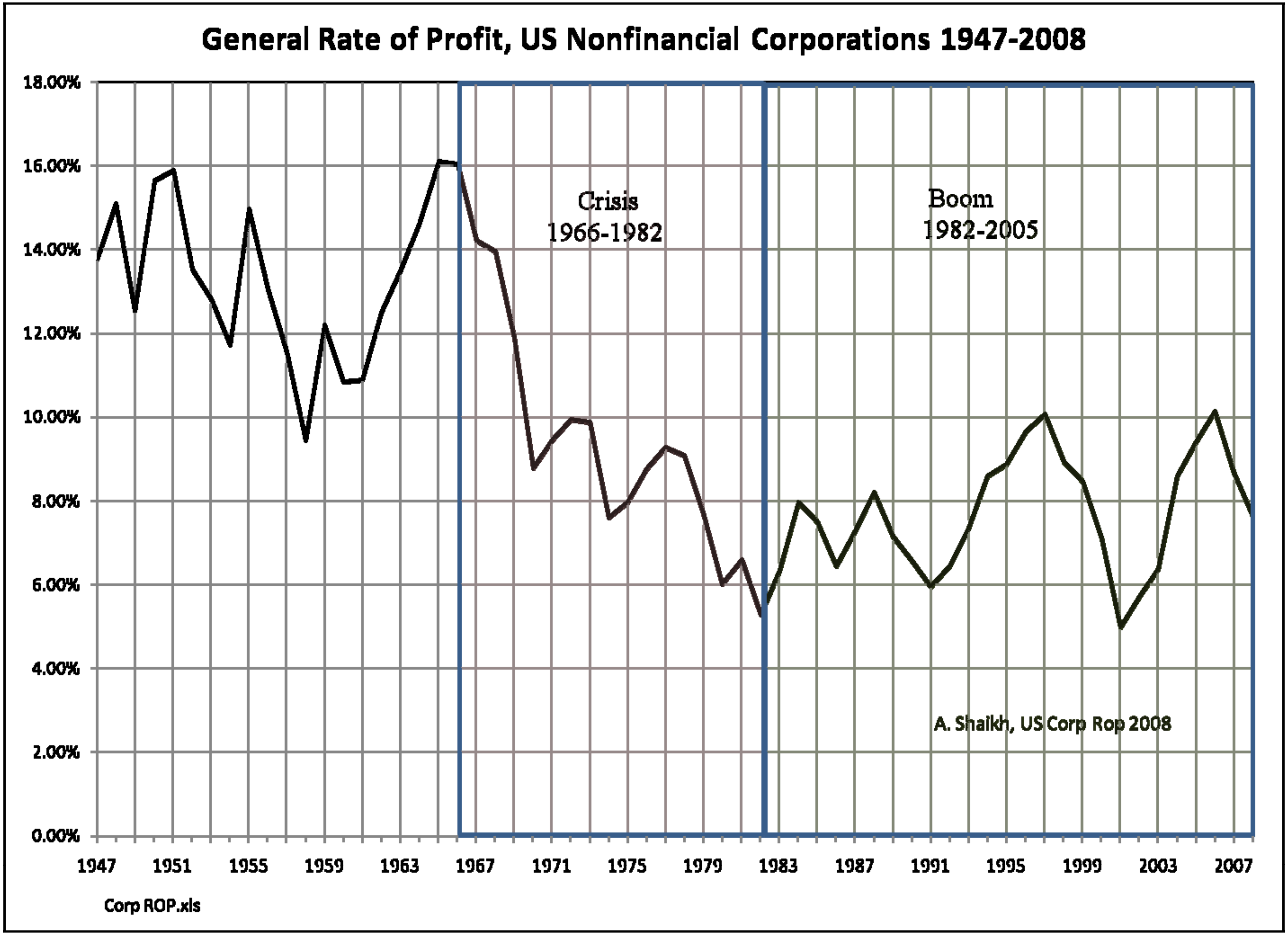
- Accumulation is a function of the rate of profit of enterprise = **excess of profit rate over interest rate**
- $g_K = f(r - i)$

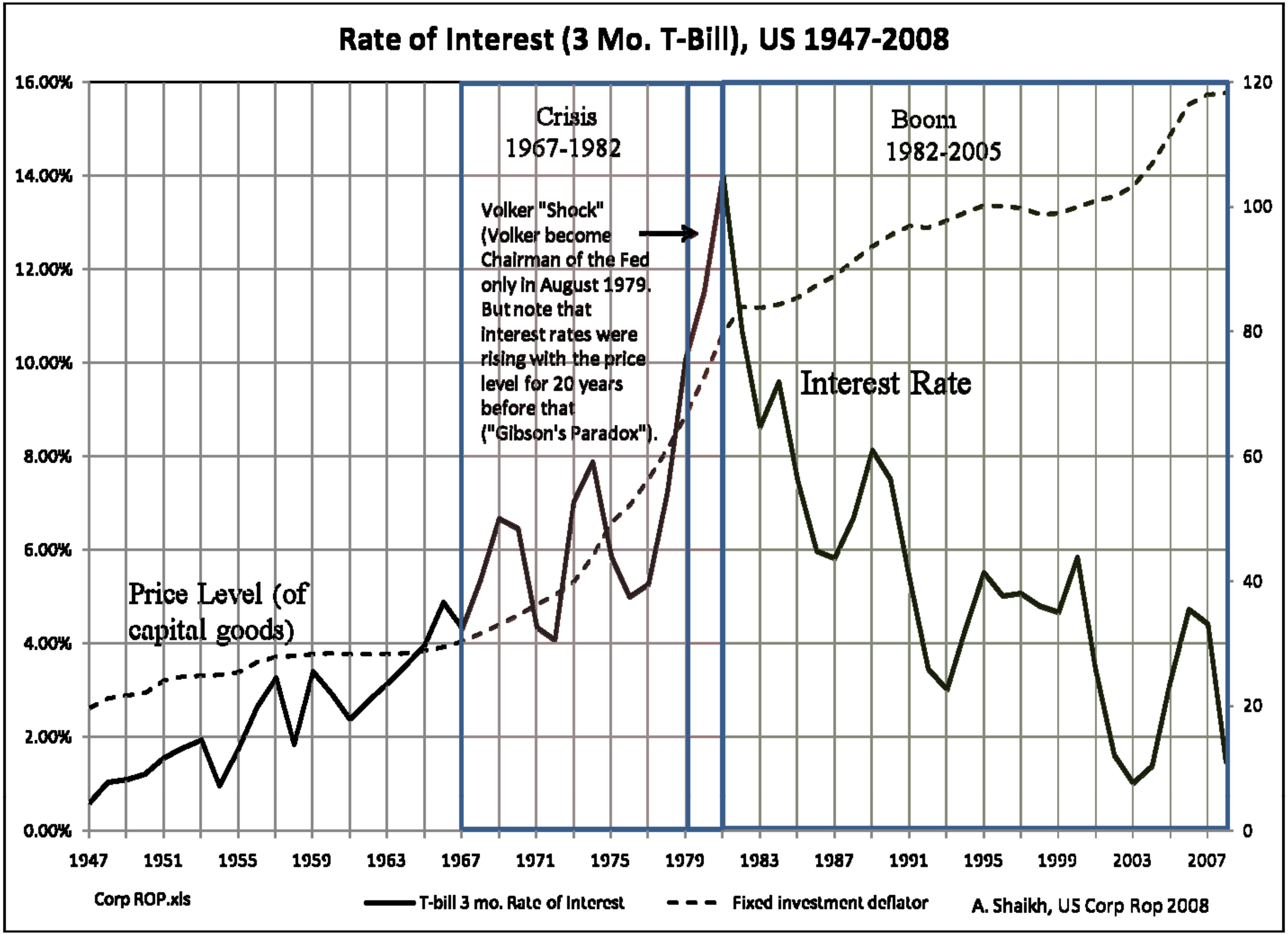
- Point of Absolute Overaccumulation is when the mass of real profit of enterprise stagnates or falls
  - This triggers a phase change in the behavior of the system
  - The long boom turns into a long downturn, and all sorts of inherent problems become exposed

- *"You only learn who's been swimming naked when the tide goes out" (Warren Buffet)*

III. Empirical Evidence for the United States

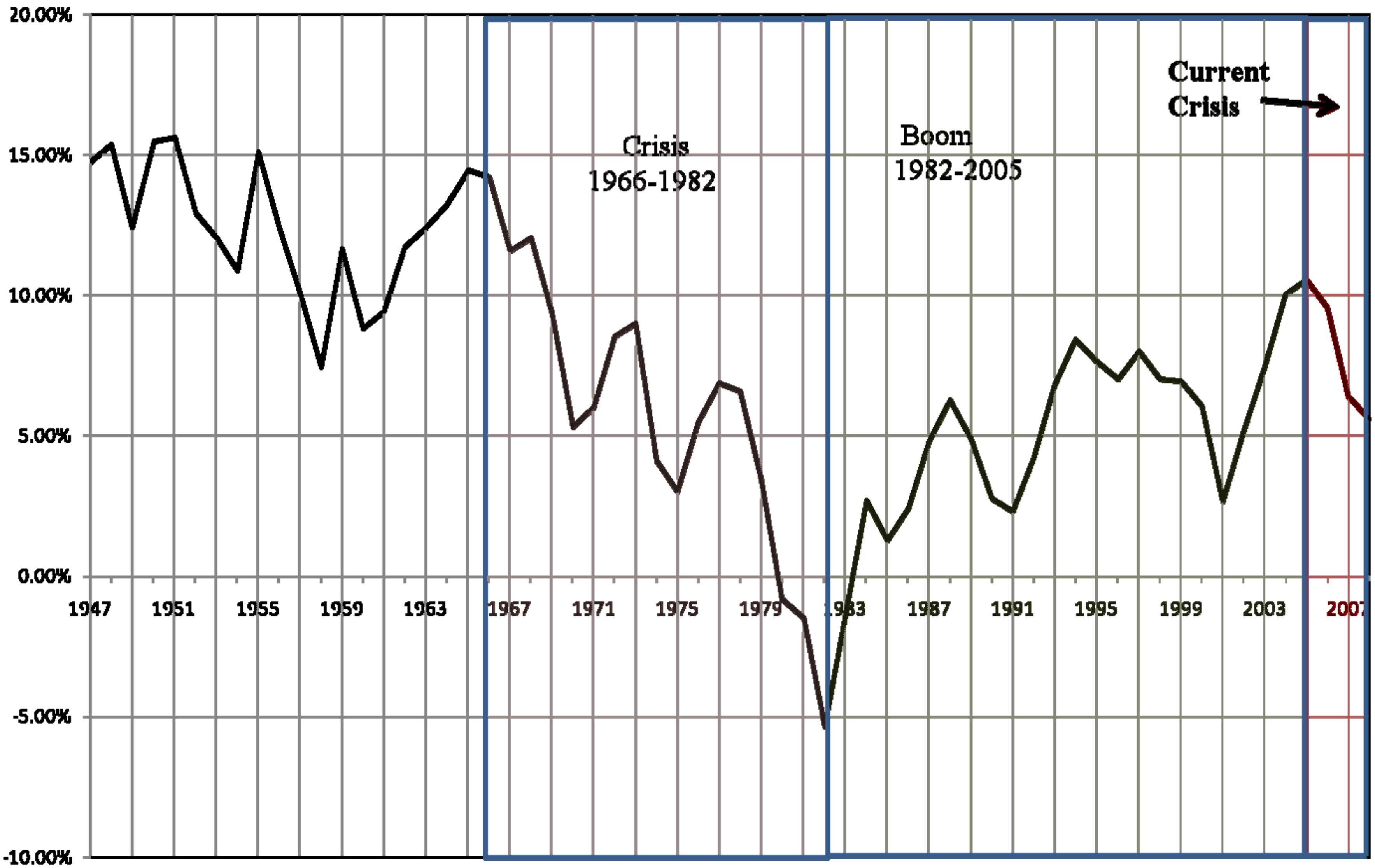
1. Path of the General Rate of Profit (r)
2. Path of the Rate of Interest (i)
3. Path of the Rate of Profit of Enterprise (r-i)
4. Path of Total Amount of Real Profit of Enterprise
5. Paths of Real Wages, Productivity, and Real Income of the Vast Majority
6. Paths of Household Debt Burden and Debt-Service Ratios


General Rate of Profit, US Nonfinancial Corporations 1947-2008
Crisis
1966-1982
Boom
1982-2005
A. Shaikh, US Corp Rop 2008
18.00%
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
1947
1951
1955
1959
1963
1967
1971
1975
1979
1983
1987
1991
1995
1999
2003
2007
Corp ROP.xls



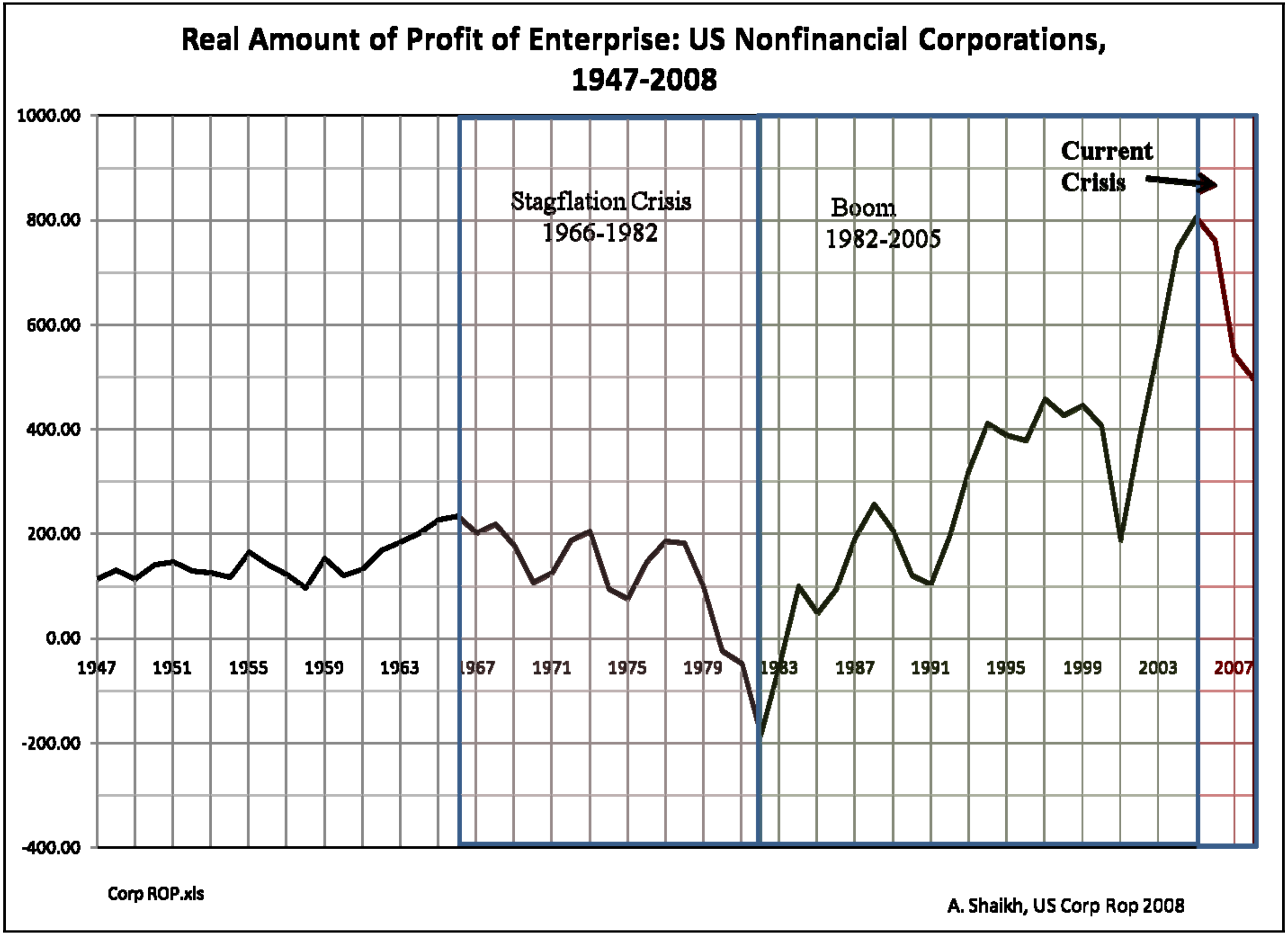
Rate of Interest (3 Mo. T-Bill), US 1947-2008
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
120
100
80
60
40
20
0
Crisis
1967-1982
Boom
1982-2005
Volker "Shock" (Volker become Chairman of the Fed only in August 1979. But note that interest rates were rising with the price level for 20 years before that ("Gibson's Paradox").
Interest Rate
Price Level (of capital goods)
1947
1951
1955
1959
1963
1967
1971
1975
1979
1983
1987
1991
1995
1999
2003
2007
Corp ROP.xls
T-bill 3 mo. Rate of Interest
Fixed investment deflator
A. Shaikh, US Corp Rop 2008

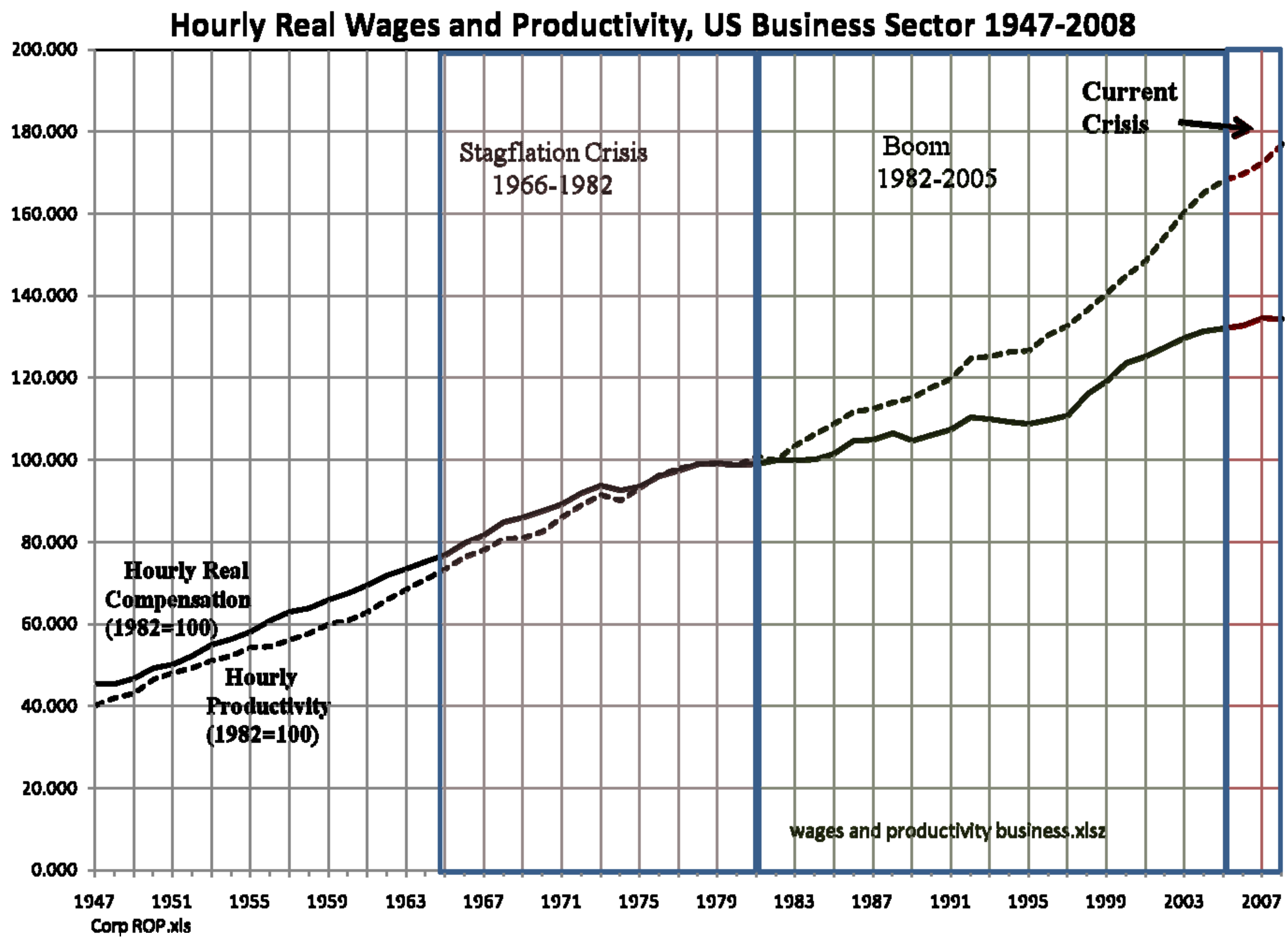
Rate of Profit of Enterprise: US Nonfinancial Corporations, 1947-2008



Corp ROP.xls

A. Shaikh, US Corp Rop 2008


Real Amount of Profit of Enterprise: US Nonfinancial Corporations, 1947-2008
1000.00
800.00
600.00
400.00
200.00
0.00
-200.00
-400.00
1947
1951
1955
1959
1963
1967
1971
1975
1979
1983
1987
1991
1995
1999
2003
2007
Stagflation Crisis 1966-1982
Boom 1982-2005
Current Crisis
Corp ROP.xls
A. Shaikh, US Corp Rop 2008

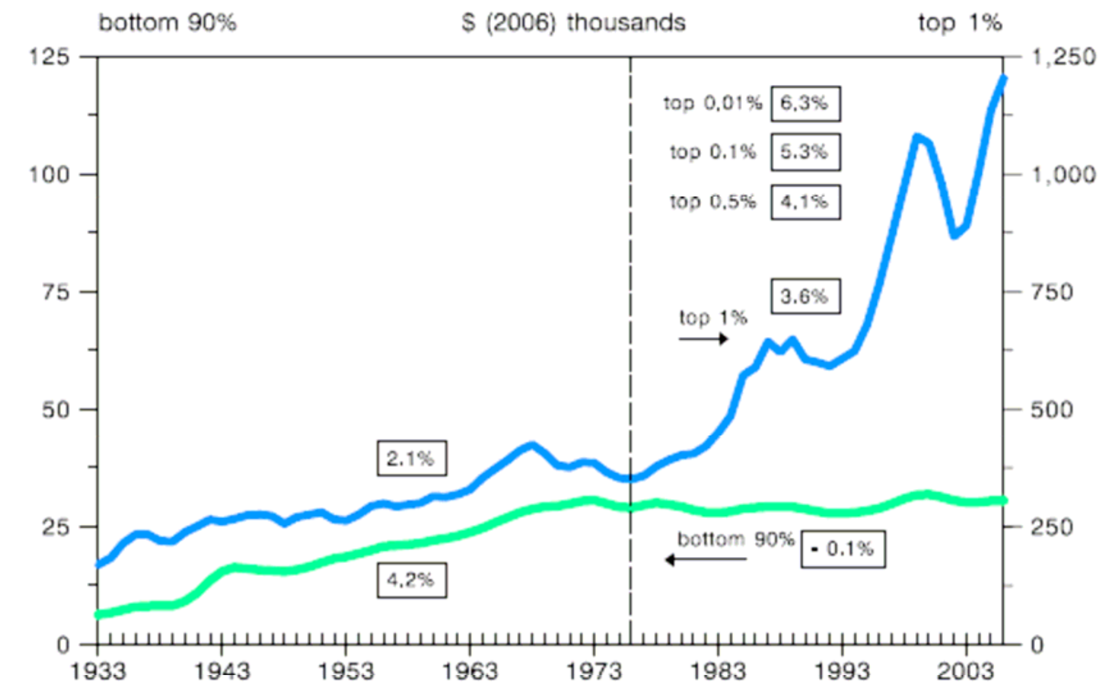


Hourly Real Wages and Productivity, US Business Sector 1947-2008
200.000
180.000
160.000
140.000
120.000
100.000
80.000
60.000
40.000
20.000
0.000
Stagflation Crisis
1966-1982
Boom
1982-2005
Current
Crisis
Hourly Real
Compensation
(1982=100)
Hourly
Productivity
(1982=100)
wages and productivity business.xlsz
1947
1951
1955
1959
1963
1967
1971
1975
1979
1983
1987
1991
1995
1999
2003
2007
Corp ROP.xls

PERI: Epstein March 2009

FIGURE 2

US: average Income of the bottom 90% and of the top 1%, 1933-2006



- Percentages shown in the graph are average annual real rates of growth between 1933-73 and 1973-06 (as explained in footnote 5, the turning point in this and other graphs is shown in 1976). 3-year moving averages.
- ***Source***: as in Figure 1 (includes capital gains).

Source: G. Palma, from Saez and Piketty

PERI: Epstein March 2009

B. Wages Relative to Non Farm Private Sector

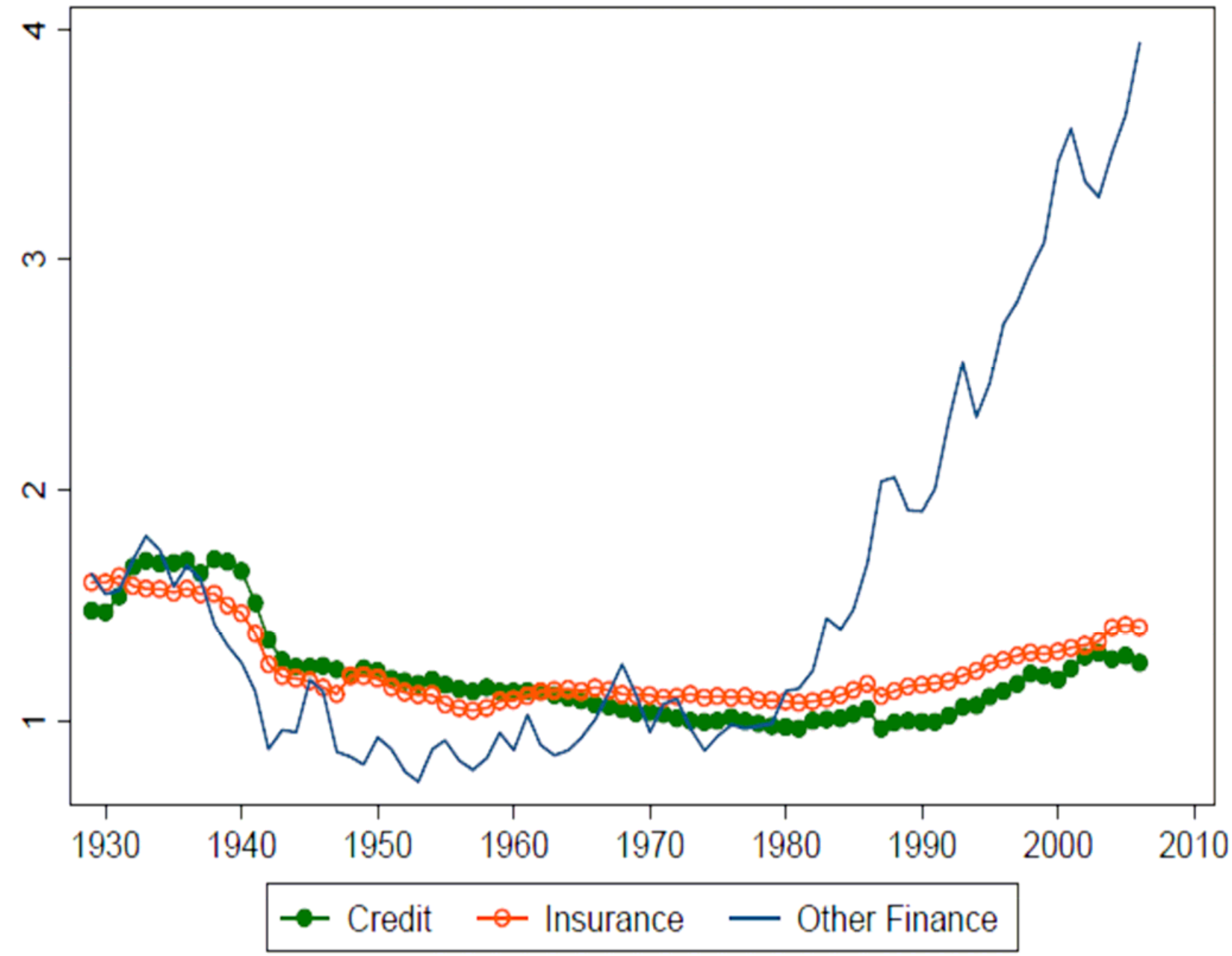
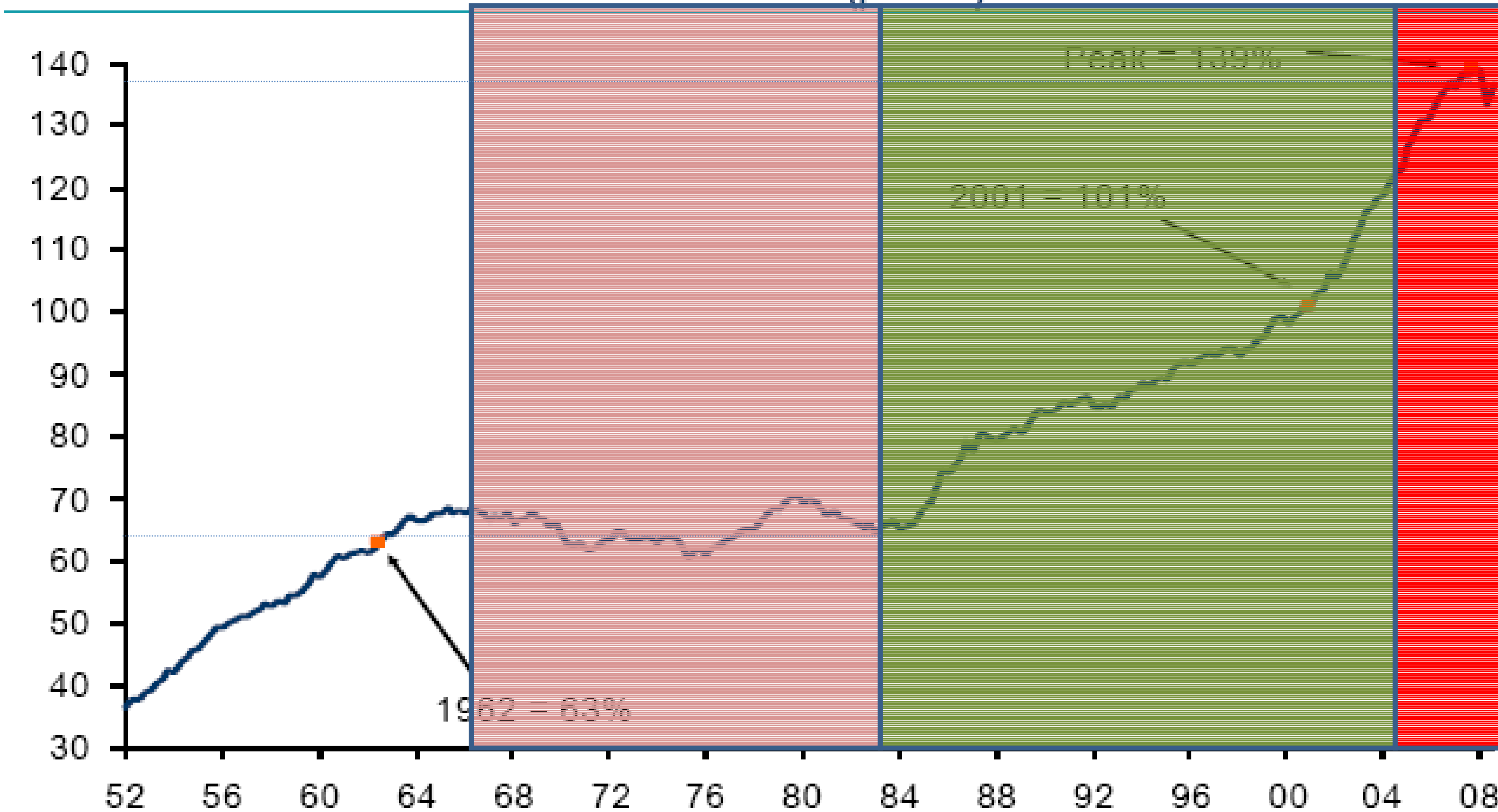


Chart 20: US Debt-to-Income Ratio Rose As Much In The Past 7 Years As It Did In The Previous 39 Years Household Debt-to-Income Ratio (percent)

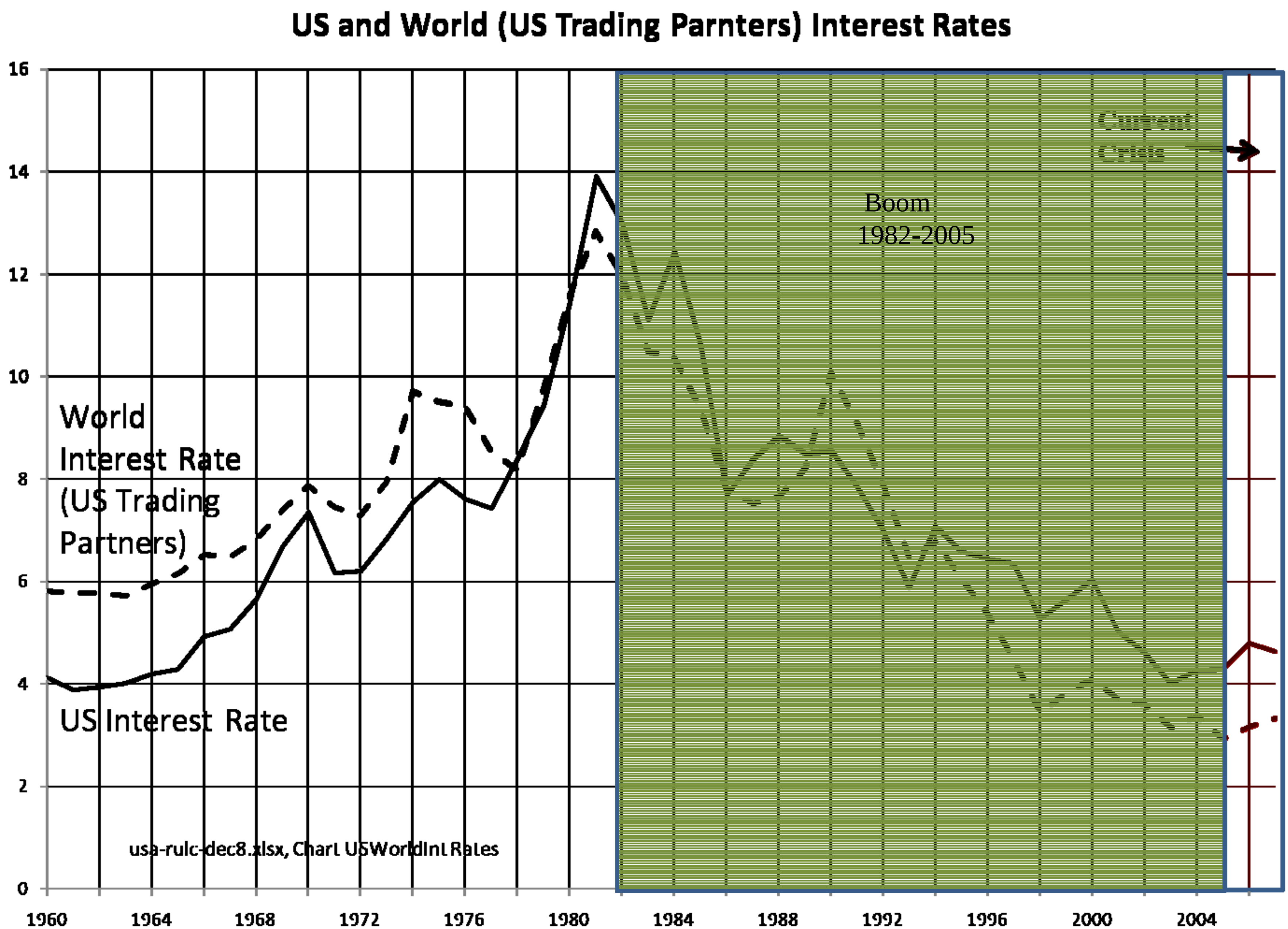


Source: Federal Reserve Board, Banc of America Securities-Merrill Lynch

Chart 21: Debt-Service Ratio Still Close To An All-Time High

Household Debt-Service Ratio

Source: Federal Reserve Board, Banc of America Securities-Merrill Lynch



US and World (US Trading Parnters) Interest Rates
16
14
12
10
8
6
4
2
0
1960
1964
1968
1972
1976
1980
1984
1988
1992
1996
2000
2004
World
Interest Rate
(US Trading
Partners)
US Interest Rate
Boom
1982-2005
Current
Crisis
usa-rulc-dec8.xlsx, Chart USWorldIntRates

V. Depressions, Recovery Mechanisms and Government Spending

The Great Depression was followed by a recovery from 1933- 1937

– 1936 saw a phenomenal record of 14 percent growth

The Roosevelt Government then sharply cut back the budget deficit in 1937, and the unemployment rate rose again <u>but only for one year</u>

– Roosevelt cut back on the level of government spending to reduce the budget deficit.

– But this only caused the economy to slip back into a recession in 1938.

In 1939 the Government borrows and spends $1 billion to build its armed forces.

– From 1939 to 1941, when the Japanese attack Pearl Harbor, U.S. manufacturing shot up a phenomenal 50 percent!

– At very end of 1941 (Dec 7, 1941), US officially enters WWII

- **The unemployment rate was already falling sharply from 1933-1936, well prior to the US buildup for WWII beginning in 1939**
  - **A recovery was already under way well before the war**
  - **<u>WWII was not the cause of the recovery, although it certainly accelerated it</u>**

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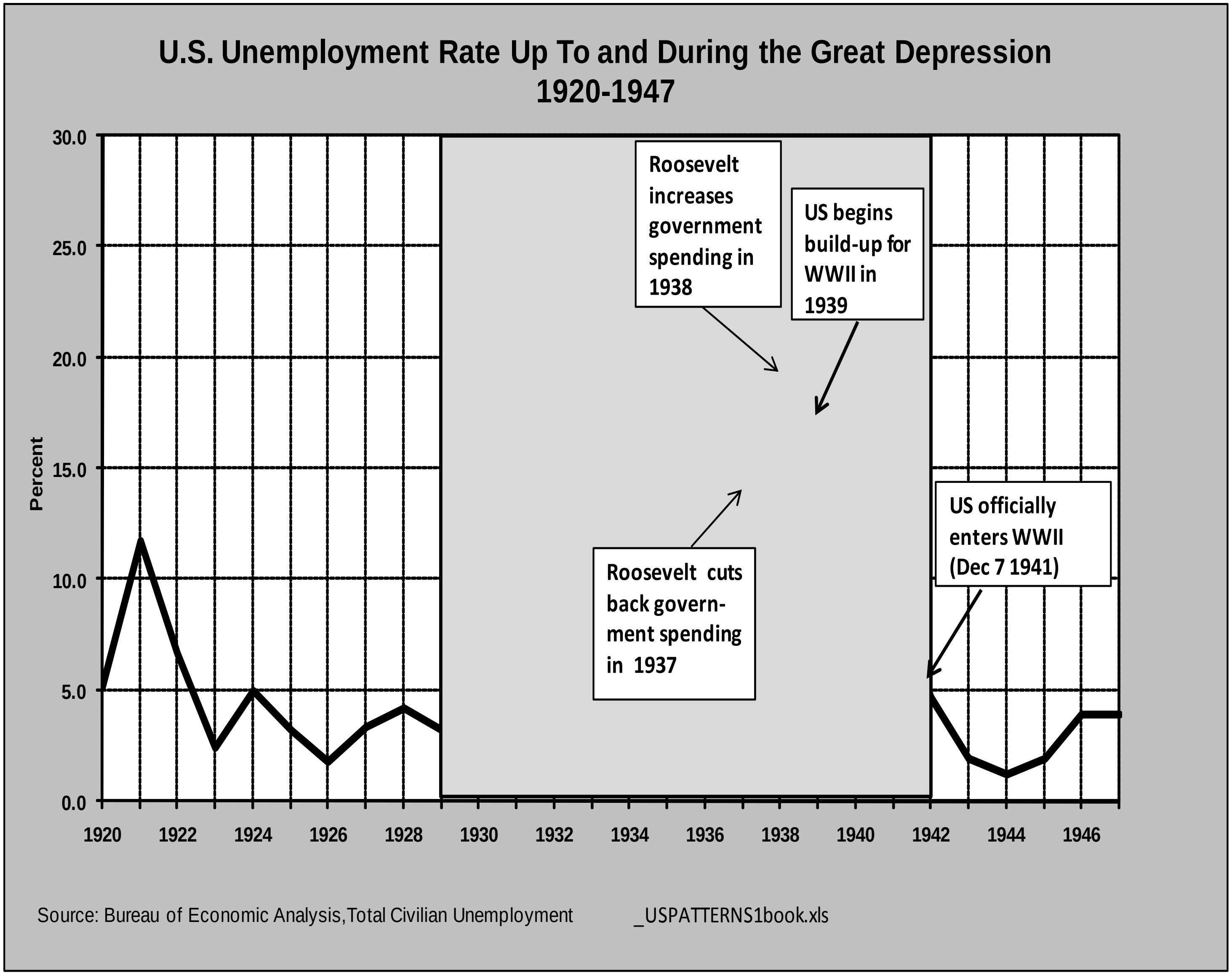
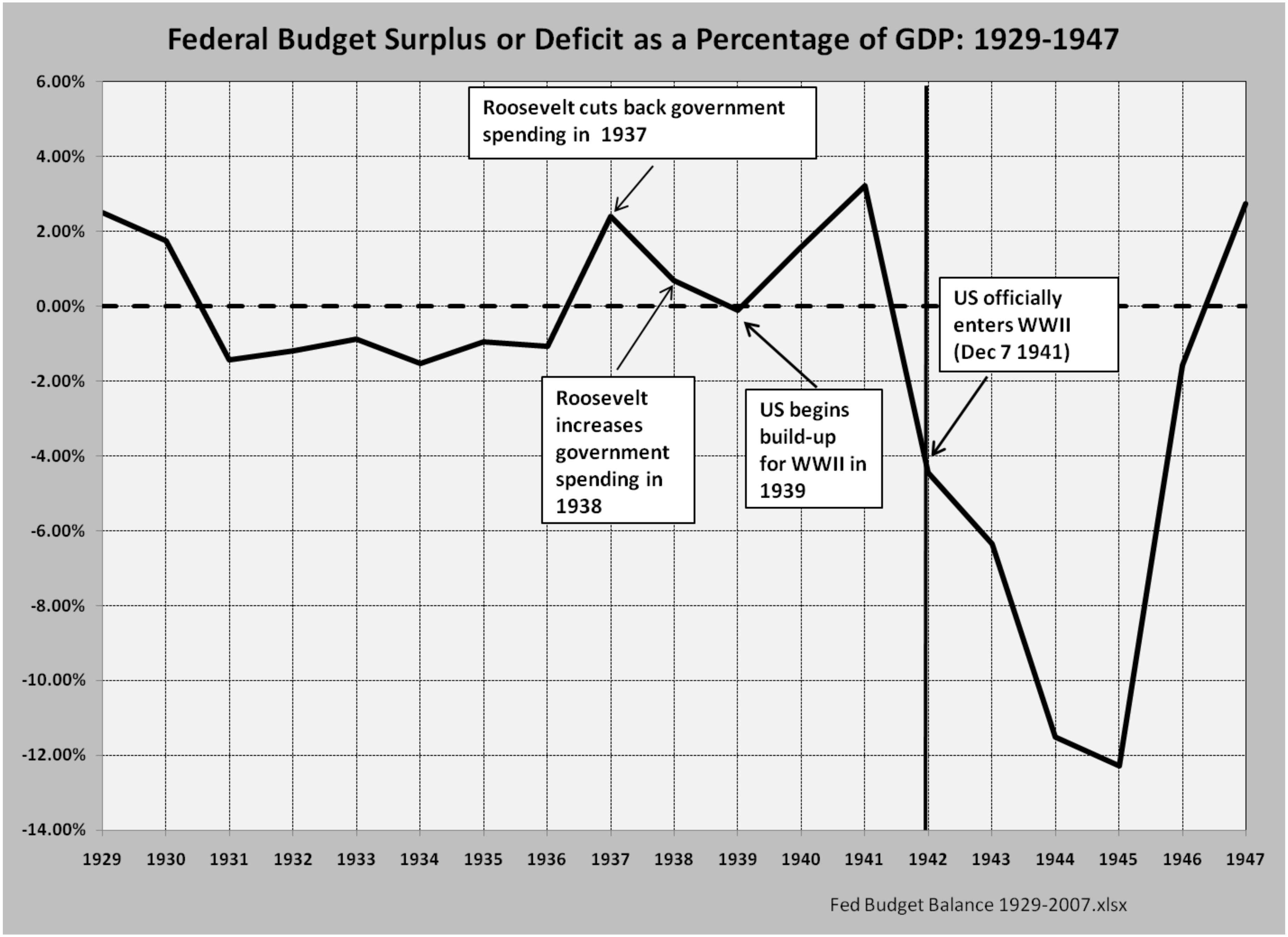
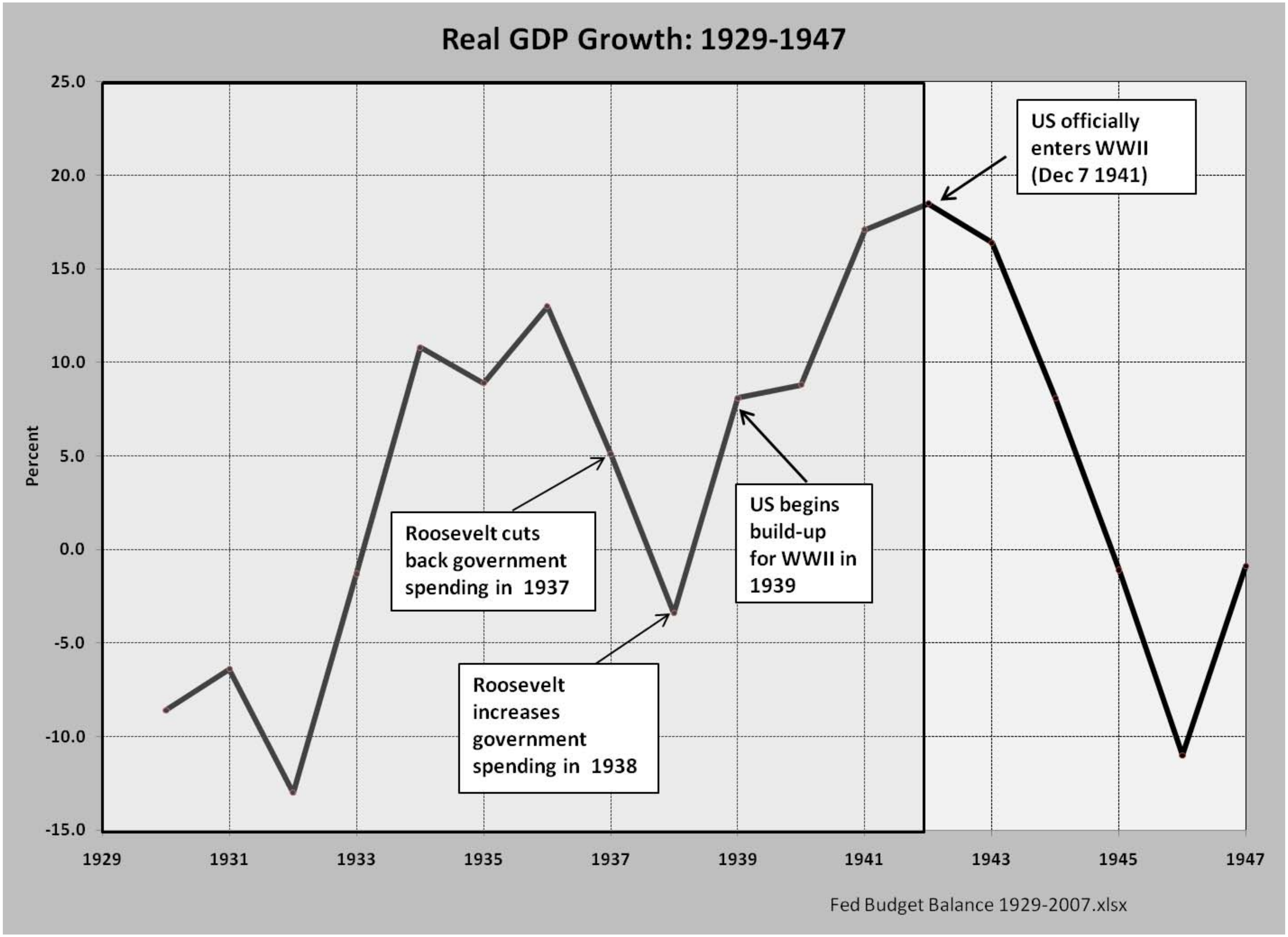
  - **WWII was not the cause of the recovery, although it certainly accelerated it**


U.S. Unemployment Rate Up To and During the Great Depression
1920-1947
Percent
30.0
25.0
20.0
15.0
10.0
5.0
0.0
1920
1922
1924
1926
1928
1930
1932
1934
1936
1938
1940
1942
1944
1946
Roosevelt increases government spending in 1938
US begins build-up for WWII in 1939
Roosevelt cuts back govern-ment spending in 1937
US officially enters WWII (Dec 7 1941)
Source: Bureau of Economic Analysis, Total Civilian Unemployment
_USPATTERNS1book.xls



Federal Budget Surplus or Deficit as a Percentage of GDP: 1929-1947
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
-6.00%
-8.00%
-10.00%
-12.00%
-14.00%
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939
1940
1941
1942
1943
1944
1945
1946
1947
Roosevelt cuts back government spending in 1937
Roosevelt increases government spending in 1938
US begins build-up for WWII in 1939
US officially enters WWII (Dec 7 1941)
Fed Budget Balance 1929-2007.xlsx



Real GDP Growth: 1929-1947
Percent
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
1929
1931
1933
1935
1937
1939
1941
1943
1945
1947
US officially enters WWII (Dec 7 1941)
Roosevelt cuts back government spending in 1937
US begins build-up for WWII in 1939
Roosevelt increases government spending in 1938
Fed Budget Balance 1929-2007.xlsx

Implications for the present period

Wars are <u>one</u> form of <u>social mobilization</u> for increased production and hence employment, financed by deficit spending.

- Some part of the resulting employment is derived from increased demand (employment in the defense sector)
- But another part is direct (employment in the armed forces, security, state, public works), which gives rise to demand derived from increased employment

So we have to distinguish between two different forms of fiscal stimuli

- Government stimulation of demand, in which spending on goods leads to employment stimulation as a side effect if the money is not saved or used to pay down debt.
- Government stimulation of employment (public works) which leads to stimulation of demand as employed people spend their wages.

Implications for the present period

The crucial difference is that the first mode operates by first stimulating businesses, while the second operates by first stimulating employment

- But for that very reason, the first mode is the preferred one for capital
- On the other hand, since the second one makes the profit motive subordinate to social goals, it is correctly seen as a threat to the capitalist order as "socialistic"

Implications for the present period

Long term demands made in Developing World

- Minimum standard of provisioning
  - consumption
  - health
  - education
- Employment and retraining for those who need it
- Elimination of gender barriers in these and other arenas of social life

Implications for the present period

Long term demands made in Developed World

- Social Security: retirement income and insurance safeguarded
- Social Safety Net: guaranteed access to health and education
- Employment and retraining for those who need it
- [Separate Taxes for Defense and Social Expenditure?]