September 11 Sparks A Long-Awaited Recession[1]

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Brad Rickerby/Reuters

Even before the September 11 terrorist attacks, the prognosis for economic growth in the United States was not very encouraging. A little more than a year ago, a few brave souls prophesied the end of economic cycles. But despite end-of-term statements by the Clinton administration about the health of what had been dubbed the U.S.'s "New Economy," by mid-2000 it was already showing signs of weakness and of the prospect of a recession before the end of 2001. The attack on two of the United States' most important symbols of its economic and military power was a death blow to the consumer confidence that had already begun to wane before the fatal events that devastated New York's World Trade Center, damaged the Pentagon and marked the end of the longest economic expansion that the country had ever seen. Now it will be practically impossible to distinguish between the long-awaited recessive trend and the negative impact that the attack inevitably had on the main macroeconomic indicators.

Precisely because we are dealing with such a long expansion —it began in the second quarter of 1991— some optimists thought it could last indefinitely, while pessimists predicted a slump at the turn of every corner. But, in gener-

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al, one way or another the negative effects of the previous recession, which lasted for a very long time after the upturn in general economic growth, were overshadowed by the advances made in the second half of the 1990s. Despite the political and personal scandals in which former President Clinton was involved and his not infrequent defeats in Congress, his administration can take credit for certain important economic achievements: the drop in unemployment, low inflation rates, recovered productivity and the elimination of the fiscal deficit together with continual growth of the gross domestic product (GDP).

The Clinton administration attributed the favorable simultaneity of the low unemployment and inflation rates to the interaction of 1) recent innovations in computer and information technology and telecommunications, which in turn had a positive impact on many other sectors; 2) changes in the organization and functioning of corporations —in other words, flexibility, cutbacks and restructuring— and, naturally, 3) public policies that created a favorable climate for innovation and investment, particularly the fiscal discipline that turned the deficit into a surplus, thus stimulating the drop in interest rates that spurred and facilitated private investment.[2]

The Beginning of the End Of Expansion

Between 1996 and 1998 gross private investment registered significant growth unusual at that stage of a period of expansion. This increase in investment is associated with advances in the computer and information technology that seem to be related in turn to recent years' overall increase in productivity. Today, about 35 percent of companies' capital spending goes for information technology.[3] From the mid-1990s to mid-2000, productivity increased an average of 2.5 percent a year, its best performance in almost 30 years. Since then, it seems to have returned to its previous level of about 1.5 percent a year.

It remains to be seen which of these growth rates will prevail in the medium term. This depends in turn on the vigor and profundity of recent technological innovations. "If the current technological wave does represent a third Industrial Revolution, the upturn in productivity growth could last for a couple of decades or more."[4] Alan Greenspan, for example, is among those who consider, "We are only part way through a technological expansion."[5] In accordance with this opinion, it is to be supposed that the medium-term prospects for productivity growth, and therefore of the GDP, are good.

Despite his optimism about the future in the medium term, the head of the Federal Reserve had already lowered the discount rate six times between January 3 and September 11, 2001, in a rather unsuccessful attempt at countering immediate negative trends. In fact, Mr. Greenspan is considered one of the main architects of the extraordinary economic expansion that lasted more than 10 years. However, by September 2001, not even the prime rate, at its lowest since April 1994, could prop up ebbing industrial production, which in August registered its eleventh consecutive monthly decline, dropping 5 percent below its level at the same time of the previous year. Only 77 percent of capacity was being used, the lowest level since July 1983.[6]

When the labor market is tight and productive activity low, companies generally prefer to shorten the work day instead of laying off workers. Despite this, the unemployment rate rose from 3.9 percent in October 2000 to 4.9 percent in August 2001. Manufacturing was the hardest hit, with 1.1 million jobs lost between July 2000 and September 2001, a drop of 6.6 percent. These decreases coincide with dwindling investment in new facilities, equipment and technology in this sector. From August to September, a total of 199,000 jobs were eliminated, the greatest monthly number reported since February 1991 when there was a recession. In recent months, there were lay-offs not only in manufacturing, but also in the service sector which employs 80 percent of the work force. "Supermarkets, restaurants, clothing stores, movie theatres and temporary-help agencies all cut thousands of jobs in late August and early September."[7]

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What Lasted the Longest Of the Expansion

The question inevitably arises: Why did low income groups begin to feel this great bonanza in the U.S. economy so late? It was only in 1996, after six years of uninterrupted growth, that the relative deterioration of the lowest income groups began to be pushed back. In terms of an equitable distribution of the fruits of economic growth, the 1990s compares favorably to the 1980s. But despite the high growth rates over most of the last 20 years, the comparison is less favorable vis-à-vis the advances of the more overall economic well-being achieved during the first three decades after World War II.

Undeniably, recent U.S. performance has been surprising and very favorable in terms of the main macroeconomic indicators. However, the levels of equality that existed some 30 years before have not been reestablished. In 1965, a CEO earned 20.3 times what an average worker earned, while in 1999, he earned 106.9 times more. It should be pointed out that U.S. CEOs earn about 2.5 times more than their counterparts in other countries.[10] On the other hand, although they have dropped gradually since 1993, general poverty indices and that of minor children are higher than those of any other industrialized country and are still above the historic U.S. low points of 1973.

The strong economic growth of the last two decades was accompanied by growing inequality in the distribution of family and household incomes. The slight recovery in wage levels during the second half of the 1990s is rather insignificant when compared with the growing accumulated profits during the unprecedented stock market bonanza.

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Despite this, wages represent approximately three-fourths of total family income and even more for broad middle layers of the population. Therefore, wage inequality is the determining factor in the growing inequality in the distribution of income. This has been amply documented and debated in both government and nongovernmental publications.[11] At the same time, the most frequent explanations say that wage inequality is due to a growing demand for workers with high educational levels, the increase of women and immigrants in the work force, the absolute and relative increase in jobs in the service sector, the expansion of international trade, the drop in union membership and the decrease in the real value of the minimum wage, among other factors.[12]

In addition, the new practices and strategies associated with industrial restructuring in the last two decades have generated more job instability and insecurity for most workers, cutting back their negotiating power. The labor market has become increasingly segmented and stratified. The new job niches for immigrants that offer working conditions and wages unacceptable for most Americans grow at the same rate as the apparently inexhaustible supply of recent arrivals who are willing to take what for them is a much higher wage than they could earn in their countries of origin. Families of professionals, workers and skilled employees who responded to the vicissitudes of the 1970s and 1980s with the growing incorporation of women into the work force are dealing with the new demands of the market by working longer hours. They therefore demand more consumer goods and personal services provided by lesser skilled workers whose pay has dropped markedly in relative terms with regard to the rest of the population.

Despite high per capita income and the accelerated growth of GDP, the United States displays greater inequalities and fewer prospects for socioeconomic mobility than the other industrialized countries. The most prosperous households tend to have high-

er incomes while those with lower incomes tend to be worse off than their counterparts in other rich countries.[13] As has already been mentioned, there is more poverty in the United States, particularly among children under 18, than in any other highly industrialized country. In addition, these disadvantages are especially notable in the case of ethnic and racial minorities.

The New Course Of Bush's Budget

Since before the September terrorist attacks, a spirited debate was expected in the Congress about the federal budget. Generally speaking, the Republicans proposed more tax cuts and the Democrats wanted to use the surplus for social spending. But President Bush, at the same time that he wanted to limit the growth of annually funded programs to 4 percent, had promised a plan to pay for retirees' medications and reforms to the educational system. He had also requested an increase in the defense budget that implied the use of part of the payroll tax earmarked for social security, formerly considered untouchable.

The fact that these funds, now a surplus due to turn into a large deficit in a few years because of the increasing number of retirees, can be used for other ends as long as they last, might not have been permitted under other conditions. The decision to even break into this lockbox was criticized by some members of both parties, although the debate has been overwhelmed by the emergency.[14]

For his part, Alan Greenspan, among others, would have liked to use the federal surplus to reduce the U.S.$3.3 trillion national debt over the next 10 years. However, any plan to do so has been left on the drawing board for the moment. Before there was a budget surplus for the next fiscal year (previously projected at about U.S.$300 billion for the fiscal year of 2002 that began October 1), it in fact disappeared. The most optimistic projections are predicting a more or less balanced budget, but most members of Congress think that a deficit will be inevitable for 2002. Democrats on the House Budget Committee estimated that the federal spending budget of about U.S.$2 trillion will have a deficit of about U.S.$8 billion in the best-case scenario and that under the least favorable conditions could come to U.S.$70 billion.[15] Despite this, there is consensus that the additional spending will have to be significant. "Members of both parties said it was entirely appropriate for the government to run a deficit for a year or two under the circumstances. There are no higher priorities, they said, than national security and reestablishing economic growth."[16] There also seems to be agreement between both parties and between the executive and the legislative branch that the package approved must be short-term and sufficiently large to stimulate the economy, but without causing future fiscal problems.

Beyond that there is no agreement. In general terms the Democrats favor an increase in certain social spending and measures that would reinforce consumer purchasing power, particularly among low-income groups, while Republicans propose measures to support and create incentives for investors.

In any case, the bailout package cannot prevent the inevitable. Everything points to the recession as a reality. Given the conjunction of this long-awaited recession with the tragic events of September 11, it is difficult to separate out the effects of the attacks and the previously existing negative trends in the U.S. economy. This unhappy coincidence also makes it more difficult to predict the depth and duration of the downturn in economic activity. The Bush administration will be forced to implement an economic bailout and increase the federal budget to the point of deficit spending that it would have liked to avoid.

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Economic policy in the last two decades has emphasized growth over equality. This new recession comes just when the lower socioeconomic layers of the population were beginning to be benefitted by so many years of economic boom. In times of crisis, they are always the hardest hit.

Regardless of the measures adopted to deal with the recession suddenly set off by the terrorist attack —thus thwarting any attempt at a "soft landing" for the economy— the most probable scenario is that, as always, the most seri-

ously affected part of the population will be those with low incomes and that the already enormous —and shameful— inequalities that exist in the world's richest country will grow. VM

NOTES

[1] A longer version of this article will be published in Spanish in a collection of papers presented at the colloquium "Globalidad y conflicto: Estados Unidos y la crisis de septiembre" (Globality and Conflict: The United States and the Crisis of September), held September 27 and 28 by the UNAM's Center for Research on North America, School of Political and Social Sciences and Institute for Legal Research.

[2] Council of Economic Advisers, Economic Report of the President 2001 (Washington, D.C.: Government Printing Office, 2001).

[3] Peter Coy, "The Real Economy, How Real Is It?" *BusinessWeek*, 27 August 2001, pp. 80-85.

[4] Darren Williams and Richard Reid of Schroeder Salomon Smith Barney in their new report, *Back to the Future*, quoted in Coy, op. cit., p. 84.

[5] Coy, op. cit., p. 85.

[6] Robert J. Samuelson, "Economic Shockwaves," *Newsweek*, 25 September 2001, p. 60; and Coy, op. cit., p. 83.

[7] David Leonhardt, "Job Cuts Increased Even Before Sept. 11," *The New York Times*, 6 October 2001, http://www.nytimes.com/2001/10/06/business/06ECON.html

[8] Economic Policy Institute, quoted in Aaron Bernstein, "The Human Factor," *BusinessWeek*, 27 August 2001, p. 120.

[9] Bernstein, op. cit., p. 120.

[10] Lawrence Mishel, Jared Bernstein and John Schmitt, *The State of Working America 2000-2001* (Ithica, N.Y.: Cornell University Press, 2001), p. 113.

[11] See, for example, *The Economic Report of the President 1997* (Washington, D.C.: USGPO, 1997), chapter 5; and Lawrence Mishel and Jared Bernstein, "Income Deterioration and Inequality in the United States" and "America's Continuing Wage Problems: Deteriorating Real Wages for Most and Growing Inequality," *Beware the U.S. Model* (Washington, D.C.: The Economic Policy Institute, 1995), pp. 101-196.

[12] Ibid.

[13] Mishel, Bernstein and Schmitt, op. cit., Chapter 7.

[14] Glen Kessler and Juliet Eilperin, "Deal Reached on 8% Spending Boost," *The Washington Post*, 3 October 2001, p. A1.

[15] Richard W. Stevenson, "Budget Surplus Is Expected to Turn into Deficits," *The New York Times*, wysingw://65http://www.nytimes.com/2001/10/01/politics/01BUDG.html

[16] Ibid.