The U.S. Recession And the Global Crisis

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Peter Morgan/Reuters

THE END OF UNINTERRUPTED EXPANSION

Economic recession hit the United States together with anthrax and quickly spread to the rest of the world, threatening to turn into a global crisis of huge proportions. The destabilizing effect of the September 11 terrorist attacks in New York and Washington and their impact on the economy and levels of confidence reinforced recessionary trends that had been incubating for months beforehand. The "new economy," the name given to the technological transformations associated with telecommunications, computer sciences and the Internet which would supposedly ensure the uninterrupted expansion of the economy, employment and income, turned out to be —as has always happened with long periods of expansion in capitalism— a new ideology that attempted to mask the growing contradictions of the system in the era of financial globalization.[1] Equally unfounded was the thesis held by the U.S. Federal Reserve (commonly called "the Fed") that prudent handling of monetary policy would allow a soft landing of the economy and avert a recession.

The deceleration of the U.S. economy began in the third quarter of 2000 when GDP growth dropped abruptly from an annualized 7 percent in the second quarter to 2.7 percent in the third. Production weakened sharply in the last quarter of 2000, continuing in the same range during the first two quarters of 2001 (see graph 1). In the third quarter, it contracted by 0.4 percent, a figure that does not yet include the impact of the terrorist attacks.

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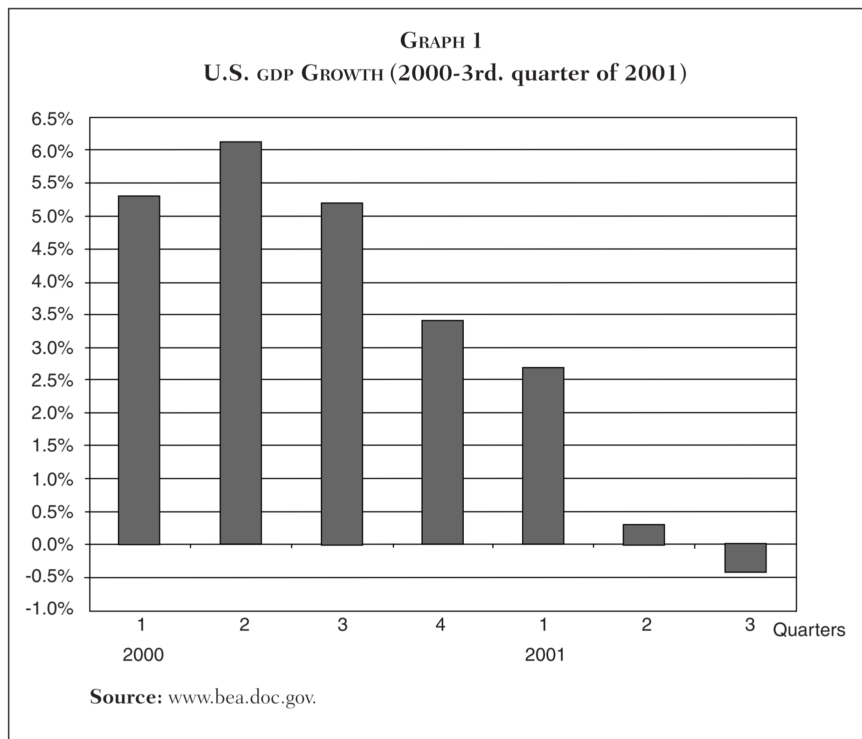


Source: www.bea.doc.gov.

The warning that the boom was coming to an end came from Wall Street when the Dow Jones Index stagnated in mid-1999 (see graph 2). During the Asian crisis, the New York Stock Exchange had registered a spectacular rise when it became the refuge from the instability of emerging markets. A similar phenomenon occurred in the European stock markets, whose indices rose like soap bubbles. Between July 1997, when the Asian crisis began, and August 2000 when the Dow Jones reached its zenith, the Dow Jones increased 36.3 percent, going from 8,523 to 11,215 points. The NASDAQ index, for its part, fed by the myth of the unlimited growth of the "new economy," soared from 1,594 points to 4,573 points from July 1997 to March 2000, an amazing 186 percent.

Stock market speculation was bolstered in this period by Fed monetary policy which, despite its concern over the eventual return of inflationary pressures and the "irrational exuberance of financial markets," began to be less restrictive, lowering interest rates to avert a systemic crisis of the international financial system due to the impact of the Asian crisis.

In April 2000 the NASDAQ began a free fall after reports of drops in dividends from stocks in the "new economy" sector. Although in August of last year it made a slight recovery, since then it has not been able to revert its nosedive. Between March 2000 and November 1, 2001, it has plummeted spectacularly, dropping 62.9 percent from 4,573 points to 1,696. The technological market has not exactly suffered a crack —a drop of more than 10 percent in a single day— but rather a persistent decrease over a period of more than a year and a half. Although the Dow Jones has not yet registered a similar drop —since to a certain extent it has been the refuge for repositioning investors' portfolios after they shed high-tech stocks— it has fallen 16.6 percent, from 11,215 points to 9,348 points from August 2000 to November 1, 2001.

As the deceleration continued and spread to other countries, the stock markets of other developed and emerging economies were significantly weakened, not to mention the Tokyo stock exchange, which, in the framework of the stagnation and deflation that Japan's economy has faced since the 1990s, is now at its lowest level since 1984.

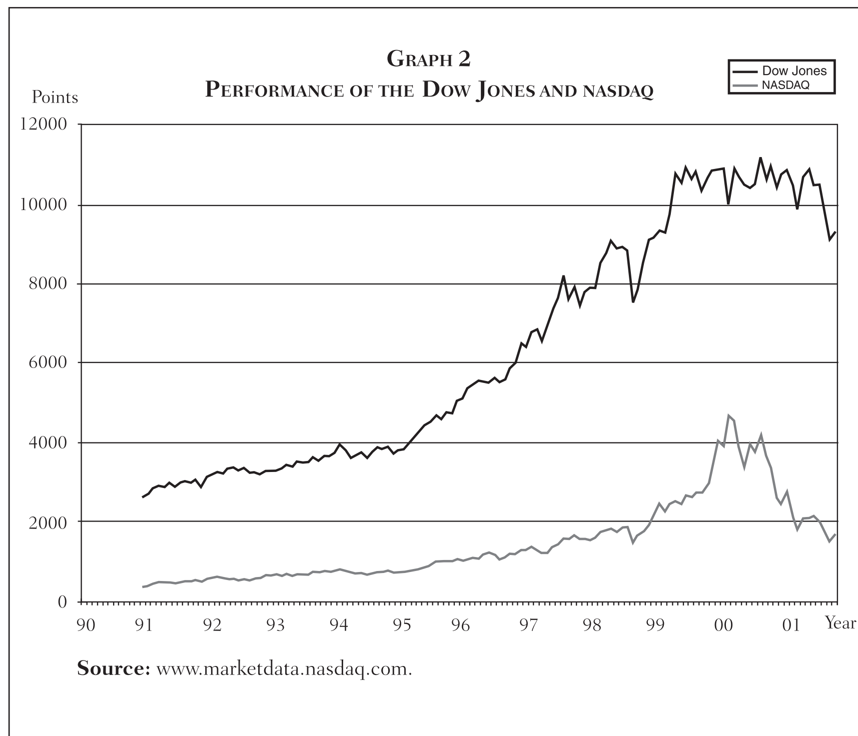
The simple magnitude of the plunge in technological stocks would be a sufficient indicator to infer that behind the deceleration there were important structural problems. Just as the speculative boom was due to the increase in profit margins, the deceleration of production and the change in the trends in the stock markets coincided with a significant reduction in profits particularly in the companies of the "new economy."[2] The drop in profit margins caused an adjustment in corporate investment programs, starting with the high-tech firms. Capital spending diminished abruptly, thus changing expectations and causing the collapse of NASDAQ. To eliminate surplus inventory, the corporations are going to have to reduce their capital spending by approximately 16 percent between 2001 and 2002.

The deceleration, then, was caused by a drop in effective profits and, above all, in expected profits, in a context of uncertainty created by the stock market plunge and the abrupt drop in investments. The "new economy" turned out to be just as dynamic in contraction as it had been before, in expansion. In a context of uncertainty, companies of both the "new" and the "old" economy reduced capital spending and postponed plans to increase plant size —including their computer science

platform— with the same intensity that they had tended to increase them during the upturn. The new economy turned out to be markedly cyclical: that is, it grows faster than the economy as a whole during upturns, but more slowly during downturns. To remain competitive in a tight market, the corporations have increased their programs for cutting back on personnel; more than one million workers are expected to be laid off in 2001.

Until the second quarter of 2001, private consumption, which represents two-thirds of total spending in the U.S. economy, looked solid, holding back the recession. However, symptoms of weakness began to show during the third quarter, with lower growth in retail sales in important sectors like the automotive industry. Even before the attacks on the Twin Towers, it was predictable that private consumption would contract for two reasons:

1. The so-called "wealth effect" on consumption, that is a drop in the demand for consumer goods derived from a depreciation in financial assets that consumers were increasingly involved with; and
2. The impact of growing unemployment on the aggregate demand, as a result of the deceleration itself and lay-offs. Total lay-offs since the beginning of the deceleration come to one million workers, a figure close to the 1.2 million jobs lost during the 1990-1991 recession and not very far from the two million registered during the 1974-1975 and 1980-1982 recessions. Of more concern is that 43 percent of workers laid off are white collar employees, a great many of whom were management and whose consumption levels and indebtedness are higher than those of average workers.[3]



GRAPH 2
PERFORMANCE OF THE DOW JONES AND NASDAQ

Source: www.marketdata.nasdaq.com.

A few days before the attacks, the consumer confidence index dropped to its lowest point since 1993. With the attacks, uncertainty overtook Americans. Consumer spending plummeted 1.8 percent in September, its greatest drop in 40 years. In that framework, consumers will tend to curtail spending, pushing the economy more clearly toward recession.

In recent years the Fed has applied a contradictory monetary policy. When the Asian crisis broke out, it applied a policy that mixed its domestic responsibilities with its growing but unrecognized role of world banker. It relaxed its monetary policy and lowered interest rates to promote liquidity in the international financial system and avert a systemic crisis. This policy, by the way, increased stock market speculation in the central countries and encouraged consumer and corporate indebtedness.

At the end of the Asian crisis, the Fed began to apply a restrictive monetary policy to deal with a phantom of inflation that nobody could see and more than anything worried by stock market speculation.[4] Despite the fact that a relaxation in monetary policy has checked a sharper drop in the stock market and injected liquidity into the financial system, the Fed has been incapable of reverting the recessive trends in the economy until now. The Bush administration's tax-cut program has shared the same fate. In addition, the cuts approved for the current year are quite modest, representing only 0.4 percent of GDP.

THE CAUSES OF THE RECESSION

For U.S. officials, the economic slowdown was merely an adjustment pro-

Table 1. Real GDP Growth (%)

Country	1997	1998	1999	2000	2001e	2002e
World total	4.2	2.5	3.4	4.8	1.3	1.6
Country	2.9	2.2	3.2	4.1	0.9	1.1
Developed Countries						
European Union			2.6	3.4	1.8	
United States	3.9	3.9	4.2	5.0	1.3	
Germany	1.8	2.3	1.6	3.0	0.8	
Japan	-2.8	1.0	0.2	1.7	-0.5	
France	2.3	3.2	2.9	3.2	2.0	
United Kingdom	3.5	2.2	2.1	3.0	2.0	
Italy		1.5	1.4	2.9	1.8	
Turkey					-3.0	
Canada		3.3	4.5	4.7	2.0	
Developing Countries		3.5	3.8	5.8	2.9	1.1
Asia	6.6	4.1	5.9	6.7	5.1	
Thailand	-1.3	-9.4	4.2	5.0	2.0	
Indonesia	4.7	-13.7	0.8	4.8	3.0	
South Korea	5.0	-5.9	10.7	8.8	2.5	
Malaysia	7.7	-6.7	5.8	8.5	1.0	
China	8.8	7.8	7.1	8.0	7.5	
Taiwan	6.8	4.9	5.4	6.0	-1.0	
Hong Kong	5.3	-5.1	3.1	10.5	0.6	
India	5.5	5.8	6.6	6.4	4.5	
Pakistan		2.6	4.3	5.1	3.9	
Phillippines	5.2	-0.5	3.3	3.9	2.5	
Singapore	9.0	0.3	5.9	9.9	-3.0	
Australia			4.7	3.7	2.3	
New Zealand			3.9	3.5	1.8	
Russia	0.9	-4.6	3.2	7.5	4.0	
Latin America	5.3	2.2	0.2	4.1	1.7	
Brazil	3.7	0.1	0.8	4.2	2.2	
Chile	7.6	3.4	-1.1	5.4	4.0	
Argentina	8.1	3.9	-3.4	-0.5	-1.4	
Venezuela	5.9	-0.7	-7.2	3.2	3.3	
Mexico	7.0	4.6	3.5	6.9	0.0	
Colombia	2.8	0.6	-4.3	2.8	2.1	
Ecuador	3.5	0.4	-7.3	2.3	4.0	
Peru		0.3	1.4	3.6	0.5	
Uruguay		4.6	-3.2	-1.0	1.0	

Source: IMF, World Bank and other sources.
e: estimate.

cess, a pause to correct some imbalances created during the long period of expansion, particularly the accumulation of excess inventory of consumer and capital goods.[5]

In contrast with this optimistic view, I think the recession expresses profound contradictions arising out of the long expansionist phase. The recession was caused by a drop in corporate profit margins, particularly among those firms that operate in the "new economy." This drop is linked to the kind of production techniques used in this new wave of technological transformations. There is growing evidence that it favored the use of capital-deepening or capital-absorbing techniques. If, as occurred during the previous expansion, the capital stock grew at a faster rate than the work force and productivity, then the production process becomes more and more a capital intensive process, thus lowering the rate of profit.[6]

The new economy rests on the growth of capital spending, driven by permanent technological transformation, although this increase in the density of capital is not accompanied by a proportional increase in the efficiency of the productive sector (whether industrial or primary). This is because, as I pointed out in another article, the use of new technologies is concentrated in the tertiary sector (trade, banking, finances, services); that is, the increase

in productivity is restricted to non-productive sectors that do not enter into workers' consumption.[7]

When the rate of profit drops and expected profits decline because of uncertainty, the process of autonomous investment in the branches that led the expansion stops, just as is happening. This means that at the end of the cycle of expansion, just when investment should continue growing in both absolute and relative terms to be able to absorb growing savings, it contracts because of a decline in expected profits. Induced investments —that is, all those that depend on a growth in income— also contract. Under these conditions, a considerable part of savings is not absorbed by an increase in the aggregate demand, which means that the process of expansion increasingly weakens and a recession starts.

The drop in expected earnings would not be of such concern if it were not associated with a fragile financial framework, but it is. The upturn was associated with a sharp process of liberalization, deregulation and financial globalization; a stock market frenzy comparable only to the one that preceded the Great Depression of the 1930s; accelerated consumer and corporate indebtedness to banks and non-bank banks; the diversification of financial products, particularly the derivative market and other high-risk instruments.

With the deceleration in production and the plunge of the NASDAQ, this complex financial superstructure that commands the capital accumulation process became fragile. With the recession in full flower, the possibilities of a financial crisis multiply. The weak chains of the pyramid of indebtedness are:

- consumers;
- corporations, mainly in the high-tech sector;
- non-banking financial intermediaries.

Consumers got into debt because they believed that the stock market would continue its upward spiral and that their real wages would increase. However, as the market began to weaken, consumers saw their incomes drop and increased their debt to keep up with their payments. As a recent UNCTAD report recognizes, "If families and the business sector simultaneously limited their spending to the current income, there could be a considerable drop in GDP."[8]

Corporations of the new economy and many of the old economy are facing serious financial problems. Venture capital operations and initial public offerings that were important sources of financing for technological firms during the boom have dropped to practically nothing. As a result, these companies face grave difficulties in refinancing their debt in bonds and commercial paper. The banks are restricting and increasing the selectiveness of their loans, which affects not only corporations but also non-banking financial intermediaries who substantially increased their indebtedness to the banks based on the unrelenting rise in the stock market. But now that the roulette wheel has stopped, the mechanism itself is brought into question. The drop in short-term interest rates has facilitated refinancing, but does not solve the problems of excessive leveraging by consumers, corporations and financial organizations. The spread between short-term and long-term interest rates has increased significantly, which means that general financial conditions are very restrictive despite the relaxation in Fed monetary policy.

Given these problems, different analysts have drawn a parallel between the current situation in the United States and that of Japan, whose financial bubble broke in the early 1990s. And, although there are still differences with Japan, the dangers of a financial crisis with a deflationary aftermath for the entire world are a real threat.

Global Crisis, A Real Threat

As mentioned above, the U.S. economic recession is determined by a drop in effective and expected profit margins in a context of uncertainty provoked by the stock market plunge and a drop in investment. The drop in expected profits is associated with fragile financial surroundings, characterized by stock market speculation; sharp increases in household, corporate and financial institution indebtedness; and a proliferation of financial derivatives and other high-risk instruments.

The terrorist attacks on the Twin Towers and the Pentagon strengthened the recessive tendencies in the U.S. economy, which were already operating before September 11, and broaden out the probability that the U.S. ultra-right, the main beneficiary of the terrorist actions, will try to impose a military solution on the crisis and management of the world's problems.

The weakness of the U.S. economy has increased the risks of a global crisis. In the last three decades, the neoliberal financial globalization has internationalized the circuits of capital, but at the cost of intensifying, generalizing and synchronizing crises.

Friedrich Engels' 1894 observation about the internationalization of the economy at the end of the nineteenth century is pertinent here:

> The colossal expansion of the means of transportation —ocean-going steamships, railroads, telegraphs, the Suez Canal— have really established a world market....Given all this, most of the old focuses of crisis and occasions for creating a crisis have been eliminated or immensely weakened....In this way, each of the elements that tends to counter the repetition of the old kinds of crisis contain the germ of a much more formidable future crisis.[9]

It is estimated that world GDP growth will diminish drastically this year, plummeting from 4.8 percent in 2000 to 1.3 percent in 2001, a drop of 3.5 percentage points, a much higher loss than the two points of growth in output lost during the Asian crisis (see table 1). Japan's economy is increasingly caught in deflation with no sign of a road to recovery. With a real interest rate of zero, a very large bank overdue loan portfolio and a fiscal policy unable to reactivate growth, Japan is sliding into a new recession. Meanwhile, Europe and particularly its driving force, Germany, that also seems to be entering into a recessive phase, has significantly lowered its growth rates, just when it must face uncertainty deriving from the introduction of the Euro and the disappearance of national currencies.

The prospects for the economies of the periphery are somber. Institutions like the Interamerican Development Bank are now talking about the possibility of a new "lost decade" for development, similar to the 1980s. The flow of private capital toward the emerging economies has practically stopped. The recovery of the Southeast Asian economies has been stymied by the U.S. recession. The economies most integrated into the United States (Singapore, Taiwan, Canada, Mexico) have entered into recession. Several of the so-called emerging economies (Argentina, Brazil and Turkey) are performing on the edge of financial crisis and bankruptcy. Argentina is falling apart economically and politically. It is a dying patient, declared terminal some time ago, that wants to expire tightening the noose of the Currency Board (the monetary system tied to incoming hard currency) that oppresses it and depending on charity from the International Monetary Fund (IMF) and foreign financial capital. Brazil, although in a more comfortable position due, among other things, to its having maintained greater monetary autonomy, accompanies its neighbor and partner in decline. And even Mexico, once again the star pupil of the IMF and Washington, is taking advantage of its "less bad" situation to attract capital from abroad, but creating the conditions for a future financial and exchange rate crisis with an overvalued peso and the recession. Like in Argentina, its loyalty to neoliberalism threatens to hinder the democratic transition.

The global crisis is not the end of the world because sooner or later recovery will bring a higher concentration and centralization of capital, but it may have a devastating effect on the economies of the world and on the millions of poor and wretched who have sprung up like mushrooms thanks to neoliberal globalization. The precarious world peace of the unipolar era is also seriously at risk. The fight against terrorism is tearing at the flesh of globalization itself and trade and financial flows, inhibited by the search for greater security inside the borders of each nation. The U.S. military budget is rising to the levels of the Cold War and war is bleeding Afghanistan while areas of conflict like the Middle East, Kashmir and others are becoming a powder keg. VM

NOTES

[1] About the economic reach and effect of the technological revolution associated with the "new economy," see my "La nueva economía y la recesión estadounidense," in issue 7 of *Trayectorias*, the social sciences magazine of the Autonomous University of Nuevo León, currently at press.

[2] In the second quarter of 2001, profits among the companies on the Standard and Poors stock index registered a drop of 17.3 percent.

[3] Stephen Roach, "Global Economy: No Breathing Room," Global Economic Forum, New York, Morgan Stanley, 10 September 2001.

[4] In May 2000, it decided a half point increase in the federal funds rate. The rest of that year, the Fed remained on the alert and applied a neutral policy despite the multiplication of signs of weakness in the economy. On January 3, given the plunge in the NASDAQ, it decided to change its policy and suddenly lower interest rates a half a point. Since that time, it has lowered the federal funds rate another four points to its current 2 percent. [On Dec. 10 the Fed lowered the benchmark rate dropped to 1.75 percent. Editor's Note.]

[5] Alan Greenspan, *Federal Reserve Board's Semiannual Monetary Policy Report to the Congress* (Washington, D.C., The Federal Reserve Board, 2001), p. 7.

[6] In a study published in 2000, Stephen Oliner and Daniel Sichel concluded that almost half the growth in productivity in the previous decade was due to the use of capital intensive techniques, which meant that a decline in the investment in computer technology would have serious implications for the future growth of productivity. See "What's left?", *The Economist*, 10 May 2001.

[7] Arturo Guillén, op. cit.

[8] UNCTAD, *Informe sobre el comercio y el desarrollo* (New York: United Nations, 2001), p. 3.

[9] Friedrich Engels, in Karl Marx, *El capital*, book III, vol. 7 (Mexico City: Siglo XXI, 1977), p. 630.