ECONOMIC COLLAPSE, ECONOMIC CHANGE

GETTING TO THE ROOTS OF THE CRISIS

Arthur MacEwan and John A. Miller

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Arthur MacEwan dedicates this book to his grandchildren
Milo, Cyrus, and Olive, and to any future grandchildren who join them.

John A. Miller dedicates this book to his partner Ellen and his son Sam.

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Preface

Over the last several years, as economic conditions deteriorated so seriously in the United States and in many other countries, we have been increasingly presented with questions about what has been happening. We addressed many of these questions in our classes and in *Dollars & Sense* magazine, for which we have both been writing for many years. We felt, however, that our answers were inadequate, too brief to deal with the many aspects of the economic crisis that has developed. Also, if one tries to treat important issues too briefly, the result is often an opaque and confusing explanation.

So we decided to write this book. Our intention was to do three things. First, we wanted to provide a widely accessible account of the economic collapse of recent years. Economic events, especially financial events, are usually presented in an unnecessarily complex manner, leaving many people feeling that the economic world is beyond their understanding. So we have tried to explain things in a language that will enlighten people rather than confuse them.

Second, we wanted to go beyond a description of what has happened in recent years and provide a deeper explanation of the economic crisis that has emerged. This has meant a focus on the way economic inequality, elite (undemocratic) control of power, and a perverse leave-it-to-the-market ideology have been so important in bringing about the crisis. Also, we have found it important to provide a historical context for understanding the current situation, and we have therefore explained important changes that have occurred over the last several decades.

Third, what we really care about is how economic conditions can be improved. So we have built upon our "deeper explanation" to suggest the kinds of changes that must be undertaken to bring about better, more stable economic conditions—and such changes would also mean more democratic conditions. The changes we suggest, while not ignoring immediate efforts to repair the economy, would bring about broader changes in economic and social relations. We do not have a blueprint for how to fix things, but we do have some ideas.

Our hope is that this book will contribute to the efforts of many people, working through an array of social movements, to bring about progressive change.

In writing this book, we have benefited from the advice, questions, and comments of many people. Our students and the readers of *Dollars & Sense* have been helpful in many ways. Advice from the editors of *Dollars & Sense,* Amy Gluckman and Chris Sturr, have been valuable at many points, as have the suggestions from other members of the *Dollars & Sense* collective. Important comments and advice have been provided by various friends and colleagues—including John Gildea, Arjun Jayadev, and Itai Lourie. Jim Campen was extremely helpful in reading large parts of an early draft of the manuscript, correcting our errors, and pushing us in useful directions. Also, we very much appreciated Kate Davies' work in preparing the graphs, and we are grateful to Apostolos Koutropoulos for making the diagram in Chapter 6 look nice. None of these people, of course, bear any responsibility for the errors that remain.

We are, in addition, especially grateful and indebted to Margery Davies and Ellen Lapowsky, who encouraged us as we labored through this project.

Contents

List of Table, Figures, and Boxes

Part I
Economic Crisis, Causes, and Cures

1
What Ails the U.S. Economy?
Understanding Causes to Find Cures

Once upon a time, not so very long ago, we in the United States pretended that our economic situation was pretty good. The doldrums of the 1970s and early 1980s were ancient history. Yes, there was a recession in the early 1990s, but then we had a decade of economic growth, and many people saw new technology—computers followed by the advent of biotechnology—as ushering in an era of prosperity. The dot-com bust and another recession just after the turn of the twenty-first century put a damper on the enthusiasm, but then the economy started to grow again. Not very fast, but after all, there had been the events of September 11, 2001, and, the government claimed, it was necessary to fight the so-called war on terror. Besides, with housing prices soaring, lots of ordinary people were getting rich—or so they thought.

"Housing prices soaring." There was the clue that something was wrong—if anyone had cared to notice. The rapid rise in housing prices during the early part of the new millennium was a speculative "bubble." People were paying more and more for houses because they believed that prices would continue to go up and up. Manipulations by banks and mortgage companies along with a perverse set of government policies had encouraged the inflation of the bubble. When the bubble burst, as all bubbles eventually do, the impact spread economic disaster far and wide. A virtual collapse of the financial system followed and led into a general economic crisis.

Yet the housing bubble and its inevitable bursting were only symptoms of much deeper maladies in the U.S. economy. Most important, even while the economy was growing and average incomes were rising, many, many people were being left out. The United States had become a very unequal society, with a small group at the top getting most of the benefits of economic growth. For others, wages were stagnant and the number of people living in poverty was growing. This rising inequality was at the center of the economic fiasco that the country was to experience.

Inequality, however, was not the lone cause of the economic crisis that began in 2007. Rising inequality was tied up with a greater and greater concentration of economic and political power in the hands of the wealthy and with the ascendance of a pernicious leave-it-to-the-market ideology, which was an instrument of that power. Inequality, power, and ideology worked together, reinforcing one another and forming a vicious circle, creating the conditions that generated the economic crisis. Several other factors were involved, all very important, including: the housing bubble, the growing role of debt in the whole economy, the general deregulation of financial markets (as well as other markets), and a lack of coordination and regulation of the global economy. These factors, however, are best understood as transmitters of our economic problems, arising from the inequality-power-ideology nexus that lay at the core of the current crisis.

A main purpose of this book is to elaborate this point, to develop the argument that the economic crisis, which is causing such hardships in the United States and, in fact, around the world can best be understood as arising from the conditions of inequality, power, and ideology that have dominated life in the United States in recent decades. Understanding the origins of the crisis is an issue of substantial practical importance if we are to have any hope of dealing with it and overcoming the economic hardship.

An economic crisis might be likened to an infectious disease, and economics is a bit like medicine. In medicine, until we gained an understanding of the way bacteria and viruses cause various infectious diseases, it was virtually impossible to develop effective cures. Of course, dealing with many diseases is complicated by the fact that germs, genes, diet, and the environment establish a nexus or intertwined set of causes. The same is true in economics. Without an understanding of the causes of the current crisis, we are unlikely to develop a solution; certainly we cannot create a solution with lasting impact. And determining the causes is complicated because several intertwined factors are involved.

As doctors are concerned with the causes of disease in order to find cures, we are concerned with the causes of economic crisis in order to find cures. If we focus on the wrong factors, the symptoms rather than the underlying disease, we will have no more success than the doctor who treats a serious illness by focusing on the headache and providing only aspirin. The aspirin may provide some short-term relief, which can be a good thing, but the underlying disease is still there. Even antibiotics may do little good if the patient, cured of the immediate illness, continues to face a nexus of deeper, underlying problems—a weak immune system; a germ-infested, polluted environment; and poor dietary habits (and smoking)—that create a risk for recurrence of the ailments.

So the ultimate purpose of this book is to suggest cures and to get others to think about cures for what ails our economic lives—cures that make sense in relation to what we argue are the fundamental causes of the crisis. Economic stimulus; a program to deal with the limited liquidity (i.e., the limited availability of funds) in the financial sector; mortgage support for stressed home owners (and parallel programs for renters); effective regulation of the financial sector; and new approaches to international economic relations are all necessary steps. They can help—just as aspirin and antibiotics can help a sick person—but they do not deal with the whole nexus of deeper, underlying problems. Moreover, like a doctor prescribing a dosage that is too small to be effective, the U.S. government has been far too timid with its economic stimulus package and its new regulations for financial institutions. Worse yet, like the doctor's prescription of an insufficient dose of antibiotics that then generates resistant and dangerous bacteria, the financial bailout that originated with the Bush administration and was continued by the Obama administration is likely to reinvigorate the perverted financial operations that wreaked such havoc on people's lives (to say nothing of the way the bailout transferred more wealth to the financial nabobs who brought us to this point).

Our approach is very different and follows from our analysis of the economic crisis. Because we identify the inequality-power-ideology nexus as the cause of the crisis, we believe that changes in income and wealth distribution, in who has power in our society, and in the ideology of how we view the operation of the economy are at the center of a lasting solution to the problems of our economic lives. Moreover, these are changes that build a more democratic society. Taken together, they can generate a wider sharing of political authority, giving greater substance to the essential forms of democracy (elections and civil liberties). So, if we are able to change income and wealth distribution, power, and ideology, we can get two good things: better economic lives and a more democratic society.

But how are such changes to be accomplished?

Unfortunately, we have no magic pills that will bring a quick cure. We do, however, have some ideas. We think that our analysis of the economic crisis suggests some ways to begin to bring about positive change. As we will argue, an important cause of greater inequality, greater power for the wealthy, and greater reliance on the myth of the market has been the weakening of labor unions. In significant part, this weakening of unions has been a political phenomenon, and we believe unions can in turn be strengthened by political action. We will also argue that social policies—such as universal, single-payer health care, universal child care, environmental protection and repair, full-employment programs, and extensive housing support—not only provide direct benefits to the recipients, but also contribute to greater economic equality and a more democratic distribution of power. They also tend to bring about a shift in ideology.

We do not pretend that it is easy to strengthen labor unions or establish more extensive social programs. After all, a large part of the reason for the weakness of unions and the inadequacy of social policies is the unequal distribution of power in our society. So one might ask how we propose to strengthen the role of unions or improve social policy while the structure of power is not altered. Our answer is that these changes provide particular places to start altering the structure of power. As we have said, inequality, power, and ideology form a vicious circle, each reinforcing the other. The problem is finding openings where we can break into this circle, transforming it to a virtuous circle of change. We think this is possible, but it is not easy.

Furthermore, and especially important, the current economic crisis and the economic structures out of which it developed are international—or, to use the in-vogue term, global. Just as the crisis is global, so are the conditions that led to the crisis. Issues of income distribution, power, and ideology operate around the world, not just in the United States. And the global nature of economic relations has had a major role in shaping social, political, and economic relations in the United States. For example, one of the reasons labor unions have been weakened in recent decades is that U.S. workers have been placed in direct competition with much more poorly paid workers elsewhere in the world. We think there are ways that political action in the United States, when focused on conditions and policy within the country, can bring about positive changes in the structure of international economic relations. Still, it will be hard to increase the power of U.S. labor unions or to greatly improve the distribution of income and wealth in the United States without also achieving the much needed improvement in the conditions of workers elsewhere in the world.

All this sounds like a Herculean task—if not an impossible task! And we would probably see it as impossible if we believed it to be an all-or-nothing proposition—that is, if we believed that without a complete, all-or-nothing change in our economic conditions and structures of power there could be no progress. Yet we think that experience shows something quite different: that progress can be made short of a complete solution. After all, the U.S. and world economies have not always been in crisis or on the brink of crisis, income and wealth distribution has not always been as unequal as it is now, power has not always been so badly distributed, and the myth of the market has not always been so dominant. So we are optimistic.

Where We Are Going

In Chapter 2, we are going to do a few more things to set the stage for the discussion and analysis in the rest of the book. We first provide a description of some of the central aspects of economic conditions existing at the time of this writing. We make no pretense of being able to forecast the immediate course of the U.S. and world economies—if the worst has passed, how long the doldrums will continue, or if another setback is in the near offing. Other economists have sufficiently embarrassed themselves through that pretense, and we do not wish to join their ranks. Some brief description of how things have been moving, however, will help to establish a basis for the analysis and arguments we want to present in later chapters.

We then explain just what we mean by the term "economic crisis," and in doing so we intend to make clear why the economic downturn that began in 2007 has been different than other downturns. A crisis is not simply an exceptionally bad recession. It is that, but it is something more. A crisis is a disruption not only of output and employment, but also of both the basic organizational structures of the economy and the way people think about their economic lives. Thus, when a crisis develops, it opens up opportunities for substantial changes. The changes are by no means automatic, and they can be of very different sorts. There is no guarantee that something good will emerge from a period of crisis. Things can revert to the pre-crisis situation or even lead to something much worse (as the European experience of the 1930s demonstrated). But at least there are possibilities for positive change. The problem is how to make the most of those possibilities.

The Core of Our Analysis

In Parts II and III we present the core of our analysis of the development of the economic crisis within the United States. First, in Part II, we examine the changes in recent decades of the inequality-power-ideology nexus, and then, in Part III, we explain how those changes led into the current economic disarray.

In Part II (Chapters 3 and 4) we trace the evolution of economic relations from the structures that came out of the Great Depression and World War II to a significantly different set of structures in the new millennium. In the earlier years, the focus of Chapter 3, there was substantial income and wealth inequality in the United States, but less than had existed before the 1930s. Power, too, was disproportionately in the hands of the wealthy, but the dramatic political and social changes of the 1930s and war years had shifted the balance of power a bit in favor of the labor movement in particular and popular forces in general. A complex of factors in this period created, for example, the basis for the advance of the civil rights and the women's movements. The ideology that guided economic affairs, shaped very much by the experience of the Great Depression, was more accepting of government intervention than it had been in an earlier era and than it would become in subsequent decades. The War on Poverty, in spite of its shortcomings, seemed to establish the principle that the government had a responsibility to improve the conditions of those people economically worst off. And both economists and politicians generally accepted the idea that the government could and should use fiscal policy as well as monetary policy in an active manner to avoid recessions or severe inflation. Employing an active fiscal policy came to be known as Keynesian economics, after the British economist John Maynard Keynes whose writings explained and justified this approach. At the end of 1965, *Time* magazine titled a major article on the economy "The Economy: We Are All Keynesians Now," and at the beginning of the 1970s, the conservative Republican president Richard Nixon would declare, "I am now a Keynesian in economics."[1]

Beginning in the mid-1970s, it became apparent that things were changing. The economic relations of the post–World War II era had broken down, and economic life was severely disrupted in those years. The changes that emerged out of this period are examined in Chapter 4. In response to the economic problems that were emerging, large firms and wealthy individuals set out to establish a new set of economic relations. They engaged in what we might call a "power grab." In the ensuing years, through the 1980s, 1990s, and the first decade of the new millennium, the success of this power grab was most evident in the changes in taxation—not only at the federal level, but also at the state and local levels. Indeed, perhaps the first noteworthy success of these changes was the passage in 1978 of Proposition 13 in California, an amendment to the state's constitution that greatly limited both local property taxes and the state government's ability to increase taxes. The attack on taxation reached its high point—or, from our perspective, its low point—with the substantial reduction of taxes on the wealthy during the early years of George W. Bush's administration.

Yet while tax issues were perhaps the most apparent feature of the power grab, it had equally important manifestations in deregulation of business (especially financial business), major changes in social welfare legislation, and steps that weakened the role of labor unions. Republicans took the lead in these changes, and it was during the reign of Ronald Reagan in the 1980s that the process gained full momentum. However, Democrats also played a large role, with crucial deregulation of the financial sector and major alteration of social welfare programs ("the end of welfare as we know it") during the Clinton administration (though the years of Democratic control of the White House seem to have been somewhat better, or less bad, for labor unions).

The power changes of these years were accompanied, both as cause and effect, by ideological changes and rising inequality. Not only was there an onslaught against taxes, with tax rates for the rich being cut most substantially, but conservative forces succeeded in establishing the dominance of a full-blown anti-tax ideology. Virtually nowhere in the country could a politician succeed without declaring her or his commitment to "no new taxes." George H.W. Bush underscored the approach with his famous 1988 campaign statement, "Read my lips: no new taxes." Then, after implementing some tax increases during his administration, he lost his bid for re-election in 1992.

Antitax rhetoric was closely linked to a more general antigovernment ideology. Conservatives portrayed government as bureaucratic, inept, corrupt, and just plain bad. In economic affairs, they avowed, it was best just to "leave things to the market." Unfettered, unregulated market activity was virtually deified as providing the basis for innovation, economic growth, and the spread of good times for everyone. The prevailing ideology was summed up in the old aphorism, "That government is best which governs least." While the ideology was not always expressed in these simplistic terms, it was in fact often reduced to such slogans. Moreover, the U.S. government and its allies were able to spread this ideology into—or perhaps it is better to say that they were able to impose it on—international economic affairs.

The facts on the ground, however, didn't quite fit with claims of this free-market ideology. In particular, it did not spread good times for everyone—far from it. From the mid-1970s on, income and wealth in the United States became more and more unequally distributed. Wages stagnated and most families were able to achieve some increase in their overall incomes only by sending more family members into the paid workforce, working longer hours, or both. At the same time, the incomes (and the wealth) of the very rich soared. Those at the very top, the richest one percent of families, took the lion's share of income increases, and those near the top also did pretty well. But for most people, improvement was very limited if it took place at all. The numbers, which we will present as we tell the story, are shocking.

In Part III (Chapters 5 and 6), we explain how the economic crisis emerged out of these structures of inequality, elite power, and perverse ideology. The stage was set for crisis by the great changes that took place in the financial industry, changes that had begun in the 1970s. The power of business leaders and the wealthy, expressed in the antigovernment ideology, was the basis for the reduction of government controls on economic activity (i.e., deregulation) that, especially in the financial sector, was so important in generating the crisis.

Unregulated bankers are dangerous. Failing to regulate them is a bit like failing to regulate automobile drivers in that they put the rest of us at risk. Competition leads unregulated banks to take on greater and greater risks.