US recession declared over but economic problems deepen

By Nick Beams
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Last week the National Bureau of Economic Research announced that the recession which began in March 2001 had ended in November of that year. But the fact that it took the NBER’s Business Cycle Dating Committee 20 months to conclude the recession was over indicates that the supposed “recovery” of the US economy is quite unlike anything seen in the post-war period.

As the NBER team noted: “In determining that a trough occurred in November 2001, the committee did not conclude that economic conditions since that month have been favourable or that the economy has returned to operating at normal capacity.”

In making its decision the NBER committee based itself on gross domestic product statistics which show increasing economic output since the fourth quarter of 2001. But this growth has been far below the level needed to maintain employment.

Last month, the US unemployment rate hit a nine-year high of 6.4 percent, amid indications that it will rise still further in coming months as cuts in expenditure by the states begin to take effect.

The overall trend is also clear from a comparison between present conditions and the end of the previous recession in the early 1990s. According to the NBER, the previous recession went from July 1990 to March 1991 and a year after it had ended employment levels began to increase. On this occasion, however, 20 months after the recession is supposed to have ended, job numbers are still falling.

From March to November 2001, employment dropped by almost 1.7 million. Since then it has fallen by another 938,000. According to economist Barry Bluestone, writing in the American Prospect, this is not a “jobless” but rather a “jobloss” recovery. For the past 24 months, Bluestone noted, employment has been lower than it was one year before with the US experiencing “the longest private-sector employment slump since the Great Depression.”

The reasons why the US economy has failed to undergo a recovery—despite the predictions of economic pundits over the past two years—are to be found in the nature of the recession itself. Unlike previous downturns, it was not the result of a fall in consumption spending but was set off by a downturn in business investment in the wake of the collapse of the share market bubble and the inflated, and often bogus, profit expectations of the late 1990s.

In a “normal” recession recovery begins as cuts in interest rates induce increased consumption spending, leading in turn to increased production to meet demand and eventually to increased capital spending.

On this occasion, however, consumption spending has not fallen, having been sustained by the cuts in interest rates carried out by the Federal Reserve Board over the past two years. But because this increased consumption demand is not the result of increased income but has been financed by rising debt, much of it emanating from home mortgage refinancing, there are limits on how much longer it can continue to sustain the US economy, much less provide the impetus for a recovery.

The only real basis for a recovery is an increase in business capital spending and it is here that some of the intractable problems of the US economy are most clearly seen. Interest rate cuts have little or no impact here because the major problem confronting business is not lack of credit but lack of profitable opportunities.

This can be seen in figures published by Morgan Stanley chief economist Stephen Roach. Pre-tax profits as a share of business product for the non-financial corporate sector rose to 8.7 percent in the first quarter
of 2003 as against the low of 7.2 percent in the first quarter of 2001. This rise, however, was still well below the peak of 12.8 percent reached in the third quarter of 1997 and almost 1.5 percentage points below the post-1970 10.1 percent average.

Moreover, it had taken eight quarters for the profit share to rise just 1.5 percentage points from its lowest level. In the seven previous business cycles, the gain over the equivalent period was 2.9 percentage points, almost double. “In other words,” Roach commented, “... corporate profitability is lacking in its normal vigour and has not improved nearly enough to repair the damage that was done in the last recession.”

The economic problems generated by lower profit rates are compounded by the fact that lower interest rates and higher budget deficits—both of which tend to stimulate economic growth—are having increasingly less impact.

In an analysis published last week, US financial commentator Kurt Richebacher noted that while increased indebtedness had so far prevented a longer and deeper recession, the US economy needed more and more debt creation just to sustain marginal growth in GDP.

“Between 2000 and 2002,” he pointed out, “the federal budget has swung from a surplus of $295 billion into a deficit of $257 billion, heading for a $400-500 billion deficit in 2003. During the same two years, total non-financial credit zoomed $2,520 billion and financial credit by another $1,879 billion, both adding up to $4.4 trillion.” The “extremely poor economic effects” of these fiscal and monetary stimuli was highlighted by the fact that real GDP grew by only $248 billion in the same period.

According to Richebacher, US economists seem undeterred by data that “overwhelmingly point to the enduring weakness of the economy” as they stick to their forecast of its “imminent, strong recovery”, although there is “no trace” of the “generally predicted postwar snapback”.

In fact, rather than a “snapback”, the Fed’s lower interest rate regime, while preventing a deeper recession in the short-term, may be creating conditions for an economic crisis in the longer term. Since the collapse of the share market bubble, the essence of the Fed’s policy has been to finance consumption spending by means of a real estate bubble enabling large mortgage refinancing. But the millions of working class and middle class families, who have taken on additional debt, could find themselves financially stretched if interest rates start to rise, leading to sharp falls in consumption spending that would send the economy into recession.

While Fed chairman Alan Greenspan has pledged to maintain the low interest rate regime until there is “a return to satisfactory economic performance” there are powerful objective factors pushing in the other direction.

The White House has announced a record deficit of $455 billion this year and $475 billion next year. As the Los Angeles Times commented acridly in a recent editorial, this was not as bad as it seems, but worse. This was because the deficit, some $375 billion of which had been created by the administration’s tax cuts, did not include the costs of the US occupation of Iraq—estimated at around $4 billion a month—or the costs to be incurred in Afghanistan. Overall, the editorial pointed out, the Bush administration was likely to create a debt of $4.1 trillion over the next 10 years and high government debt would at some point impact on financial markets.

The other major factor which could push interest rates up is the worsening US balance of payments deficit, now running at around $500 billion. If for any reason investment inflows into the US falter, then interest rates will be forced up, possibly setting off a deep-going recession in the US and global economy.

Compared to other post-war recessions, the downturn of 2001 is one of the shallowest on record. But viewed within the wider context of the deep-going structural imbalances within the US economy, it may well turn out to be the opening phase of a major crisis.

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