

Talking Economic Blues

By Ron Tabor
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The recent volatility in the US stock market and in financial markets abroad has raised the question of the health of the US and global economies. As is their wont, a slew of economists and financial professionals have reassured us that economic “fundamentals are sound.” And yes, according to a variety of measures, the US economy appears to be very healthy, while the international economy, for the first time in some years, is expanding. Official unemployment in the United States is at a record low of 4.1%. (It was only a few years ago that 5% unemployment was considered “full employment.”) Consumer spending is robust. Inflation is modest (although there are signs that it is increasing, which was the likely cause of the plunge in stock prices). Corporate earnings are strong. And the stock market, even after the recent sell-offs, is at or near historic highs.



Yet, somehow, we are not quite reassured. It's hard to dismiss the drop in the stock indices as a mere "correction," let alone a "salutary" one. In addition, some may remember that in the run-up to the Great Recession of 2008-09, then-President George W. Bush also insisted that the "fundamentals are sound," while during the prelude to the collapse of the dot.com bubble and recession of 2000, after the longest economic expansion in the post-World War II period, we were told that things couldn't be better.



A closer look at the current US economy reveals some troubling questions. While official unemployment is way down, the labor participation rate – that is, the percentage of the potential workforce that is either working or looking for work – is also at a record low: 62.7%. This means that whatever the government may say, real unemployment is much, much higher than the official statistics indicate. To put this more graphically, in various parts of the country - among them, Appalachia and other rural areas, parts of the Rust Belt, and the inner cities outside the Rust Belt – a great many people are without jobs, without hope of finding one (either unwilling or unable to move to where the jobs are or lacking the skills to do them), and very likely to be addicted to opioids and/or other mind-altering substances. And this is not to mention those who are struggling to make ends meet on one, two, or even three poor-paying, part-time jobs. At the same time, several sectors of industry are complaining about a shortage of semi-skilled and skilled workers. Beyond all this, the growth in labor productivity has been worryingly slow, the rate of business investment has been tepid, and the "wealth-gap" between the rich and everybody else is continuing to grow. Finally, it's worth noting that while consumers are currently spending at robust levels, the savings rate is

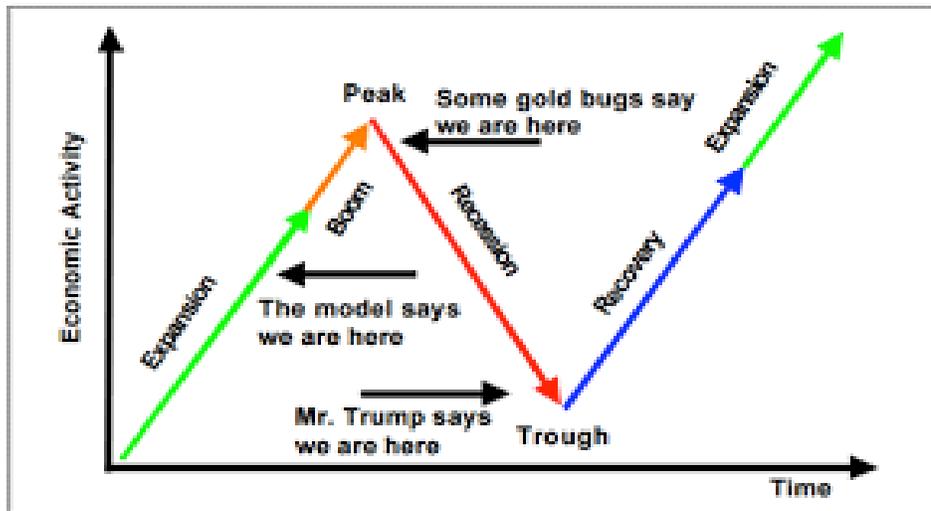
extremely low. In other words, people are spending everything they earn (and even borrowing to finance their purchases) and are not putting any money away for a rainy day. If/when the currently optimistic economic picture starts to get cloudy, let alone becomes downright dark, people are likely to curtail their spending very rapidly.



Despite the economists' confident prognostications, the reality is that nobody really knows what causes the ups and downs in the economy (the so-called "business cycle"), let alone is able to predict precisely when economic upturns and downturns will occur. There are a myriad of competing theories out there, none of which has ever been empirically confirmed, while detailed analyses of economic crises over the years (even over the centuries) reveal that no two business cycles have ever been the same.

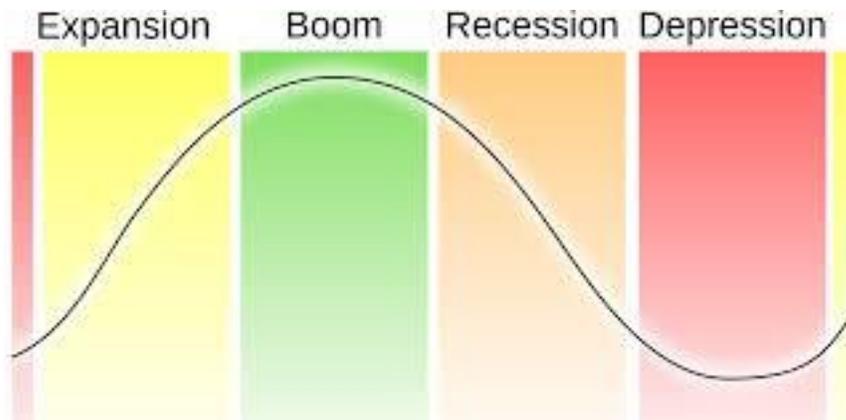
In fact, at the highest, most abstract level of economic theory, the business cycle is not supposed to happen at all. In this realm, the fundamental assumption is that when markets are free, that is, operate without monopolies, oligopolies, and other obstructions, they are fully transparent - that is, at any given time, prices give complete and accurate information about economic conditions - and all participants in the market - businesspeople big and small, workers, consumers, bankers, investors, etc. - act on the basis of full and accurate knowledge and in a rational manner. In such a situation, the market and the economy as a whole will always be in "equilibrium," and no such thing as a "business cycle" will ever occur. The absurdity of this conception, as well as its complete irrelevance to the real world, should be obvious (except to those whose minds have been completely addled by political ideologies

and mind-numbing abstractions). Most obviously, markets are not always free, people do not always act on the basis of complete knowledge of market conditions, and they do not (duh!!!) always act rationally.



“Neo-classical” economists have modified this view in some ways but have retained its essence. Thus, the “monetarists,” such as Milton Friedman and other members of the “University of Chicago School” of economic theorists, insist that economic crises and the business cycle as a whole are purely monetary phenomena, caused by there being either too much or too little money in circulation. In their view, if the central banking authorities – in the US, the Federal Reserve Board – were to ensure a slow and steady increase in the supply of money, economic growth would occur smoothly and uninterruptedly, and no crises would occur. One of the fallacies of this view is that, in the real world, the central bankers do not at all times have accurate knowledge either of the amount of money in circulation or of its “velocity” (how fast it changes hands). With the massive expansion and intricate elaboration of the credit/financial markets that are characteristic of the modern capitalist economy, no such knowledge is possible. Beyond this, the conception is completely tautological. When an economic crisis does occur, this is deemed to be because the monetary authorities did not perform their task competently. (It’s like the New Age belief that you can do whatever you want as long as you truly believe you can. Thus, when you jump out of a window and, instead of flying, break your neck, this is because you didn’t really believe you could fly.)

To their credit, the Keynesians recognize that economic cycles and crises are endemic to the system, but their view of the cause of such crises – that as people become wealthier as the economy expands, they tend to spend proportionally less of their incomes – is too vague to be of much use in explaining, let alone predicting, the economic cycle (although it has led them to understand that when crises do occur, the government needs to act quickly to stimulate “effective demand”).



Marxists also understand that economic crises are a fundamental characteristic of capitalism, but Marx himself never developed a unified and consistent theory of the business cycle, and to this day, there is no more agreement among Marxists than among mainstream economists on what actually causes such cycles and their concomitant crises. The simplest and most basic of these explanations is that the capitalist economy, because it results from the spontaneous and disconnected activities of large numbers of people (that is, is unplanned), is intrinsically characterized by what Marx called the “anarchy of production.” Over the course of a given economic cycle, the different sectors of the economy do not develop at precisely the same rate. The result is the build-up of “disproportionalities,” which sooner or later cause the economy to crash. To put this in more modern terms, the equilibrium among the various facets of the economy that is necessary to sustain the economy’s smooth and continuous expansion is a fragile one; it is easily disrupted and cannot be sustained indefinitely. Over time and in various ways, the economy gets further and further removed from this optimum. Eventually, this causes the economy to abruptly slow down (“crash”) and enter into a recession or worse.

As an aside, it is worth noting that some economists who have studied the business cycle in detail, such as Joseph Schumpeter, claimed to have discerned as many as four distinct cycles or "waves", ranging from 3-4 to 50+ years, whose complex interactions lie behind and explain the oscillations of the economy.

Of these, the cycle/wave I believe is most relevant today is the one that appears to occur over roughly eight-to-ten years. (This was the focus of Marx's theorizing.) The expansions (and the recessions that followed them) of the 1960s, 1980s, 1990s, and 2000s reveal such a cycle fairly clearly, whatever its precise causes. Each expansion was characterized by an explosion of credit, which financed the over-development of certain economic sectors relative to the others. Eventually, in each case, the credit bubble burst and the economy entered a recession.

If this pattern holds, we can reasonably expect a downturn to occur within the next year or so. As I see it, the main "disproportionalities" that have come to characterize the current economic upturn are three: (1) the massive increase in stock prices, with "price-earnings ratios" (one measure of the relative values of stocks) at close to historic highs; (2) the more recent burst in consumer spending, in part motivated by the run-up in stock prices and the euphoria this has created, financed to a great degree by borrowing; (3) the bottleneck in the labor market (millions of people not working combined with shortages of qualified workers), which may soon lead to a spike in wages in key sectors of the economy. (Some or all of these, along with a significant increase in interest rates as the Federal Reserve acts to contain inflation, may well be the triggers that cause the next downturn.)

Precisely how long the current expansion will continue and when the next recession will begin is anyone's guess. The expansion is already the second longest of any since World War II. Since it was, for a variety of reasons, very slow to pick up momentum, it may well continue for some time. However, given the short-term "disproportionalities" mentioned above and the more fundamental "structural" problems of the economy (among them, the failure of our educational system to prepare the poorer layers of the working class to find work in the contemporary economy, the wide and increasing gap between the 20% at the top of our society and everybody else, and the decay of the country's infrastructure), I

don't see how a recession can be avoided in the relatively near future.

By way of conclusion, let me say that, in my view, integrally involved in attempting to analyze economic fluctuations is the question of human psychology, including our tendencies to think linearly, to run with the herd, to value economic losses at a higher level than gains, and to panic when things don't go as we expect them to. This accounts, to a great degree, for the ultimately unpredictable nature of economic developments.
