The Economy Does Not Look Good

by Martin Melkonian

I will start off with the good news. If we measure recession as economists do by the level of gross domestic product, we see that in the quarter that ended in September 2009, the GDP rose by about 2.8 percent, which is a fairly substantial rise. Historically this rise is slightly below average, however it certainly was a great improvement over the downswing that began in the tail end of 2007 and continued into the second quarter of 2009.

Many economic commentators think this signaled that the United States and the global economies were headed back to “normal,” whatever that means. They believe the stimulus program, where the federal government pumped $787 billion into the economy and various other programs helped to stabilize the banking industry and had a major impact on ending the formal recession.

While there have been some new shocks to the system, most of the leading indicators that economists watch have been pointing upward. In particular, there was a very strong increase in productivity. Productivity means the ability to produce more with any given work force. Paradoxically, a lot of the productivity improvement was because of layoffs. Employers did not hire new people to take the place of the people that left, so the remaining people had to work harder. Corporate profits went up because if you get rid of a major expense such as the cost of workers, the bottom line is going to show improvement. With the increase in corporate profits, there was also a dramatic rebound in the stock market. However, that does not mean I personally would jump back into the market.

Good Economic Signs

Other good economic signs included a slight uptick in housing starts and a higher personal savings rate. The U.S. savings rate had fallen to zero percent for a couple of years. Americans just were not saving. There were even months in which the U.S. had a negative savings rate; people were borrowing in order to sustain their consumption. However, Americans are now saving about 5 percent of their income, which is both good news and bad news. The good news is that people feel somewhat more comfortable with a little bit of savings put away for the future. The bad news is that when Americans save they are not spending, which contributes to the overall weakness of the economy.

The trade deficit is the difference between what the U.S. sells abroad and what Americans buy from other countries. There have been huge, huge deficits for many years. But in 2009 it actually began to shrink a bit because of the deep recession. Americans were buying fewer goods from China and other countries, including fewer imported cars. Energy consumption was also down. Because of the recession, Americans are actually using less imported fuel than in previous years. How sustainable this drop in the trade deficit will be is certainly questionable. The U.S. had been running a $800 billion a year trade deficit. In 2009 it declined to approximately $500 billion. It is a substantial improvement brought about by a sharp reduction in consumer spending.
Unfortunately, the bad news outweighs the good news. The U.S. lost about 8 million jobs between 2007 and 2009, bringing the official number of unemployed to 15 million workers. The official unemployment rate has fluctuated around 9 to 10 percent, but it has been much higher in some localities and among some ethnic and racial groups. According to economists and policy makers, there is always going to be some unemployment due to people switching jobs and because of structural problems. But the situation now is that people are actually leaving the workforce because they cannot find work and their unemployment benefits are expiring.

The government tallies the unemployment rate as the number of people who are officially unemployed divided by the work force. If the work force shrinks, as it has been doing, the official unemployment rate goes down even though fewer people are employed. People who have given up looking for work are called discouraged workers.

Another group that does not get tallied are involuntary entrepreneurs. These are people who were formally unemployed but have now started their own businesses or are acting as consultants. It includes people who are trying to maintain their dignity by having a business card and saying they are consultants who are working, but they are really largely unemployed. Nor do official unemployment statistics include the growing number of involuntary employed part-time workers who might best be described as underemployed. If you include the workers who are not included in the official unemployment rate, unemployment in the United States is really somewhere between 15 and 20 percent.

Average numbers hide areas and groups that are more severely affected by the economic downturn. The official rate of unemployment for Black teenagers who were in the workforce in November 2009 was 49.4 percent. In June 2010 the Pacific states had the highest official unemployment rate at 11.4% In Nevada; the official unemployment rate was 14.2%, the highest for any state in the nation. The states with the next highest rates were Michigan, 13.2 percent; California, 12.3 percent; and Rhode Island, 12.0 percent. In New York State the official unemployment rate was 8.2%.

Another serious problem has been declining real wages (adjusted for inflation) for the past three decades. Family income, prior to the recession, had been maintained because Americans were working longer hours and more family members were working. But real wages, what we get per hour, was slipping. Over the past decade Americans lost about $2,000 dollars in purchasing power per person.

How Companies Do Business

Much of this is because of the way American companies are doing business. They find outsourcing production and services overseas more profitable than hiring American workers and producing goods and services at home. Jack Welch, the former president of GE, has long championed the idea that multinational corporations should go to the cheapest source of supply, wherever that is, and whatever its impact is on domestic workers. Right now the cheapest workforce is in China, but it may be shifting to Vietnam and Bangladesh. Corporate greed has generated a kind of a race to the bottom. In the meantime, while American workers are losing jobs, corporations earn record profits.

One thing that concerns me as an economist is the GDP gap. The GDP gap is the difference between what a nation is capable of producing at something close to full employment (an official unemployment rate of 5%), and what is actually being produced. In periods of full employment there tends to be a zero GDP gap. In
the third quarter of 2009, the GDP gap grew to about 6%, meaning the U.S. was producing 6% less than it would have been producing in a full employment economy. That amounts to a huge economic loss for our society. Unemployment also has repercussions on government finances. When people are not working, they are not paying taxes. At the same time, various levels of government must provide unemployment insurance and other social benefits.

In the early 1930s, the United States did not have automatic benefits for the unemployed and their families. When people were unemployed it meant they lost their purchasing power and were completely dependent upon friends, relatives, and charity. The overall demand dropped precipitously and the economy remained depressed for over a decade. To some degree this prolonged decline was avoided because of the stimulus package and other measures initiated by the Obama administrations, although economists such as Paul Krugman and Joseph Stiglitz have criticized these measures as inadequate. Others are angry that taxpayers gave trillions of dollars to bailout banks and brokerages that acted irresponsibly. The public received nothing in return while the top officers of these corporations received multi-million dollar bonuses. Investment banks, in particular Goldman Sacks, showed huge profits and were able to pay their executives these enormous bonuses because they are able to borrow taxpayer money from the Federal Reserve at between zero and one-quarter percent interest.

They were able to use this money to speculate around the world. In some cases, they were able to earn 5, 6, or even 20 percent return by continuing the same trading practices that brought the U.S. and global economies into such difficult straits. Hundreds of billions of dollars of this borrowed money has been invested in U.S. government bonds. Essentially they are borrowing money from the government at almost no interest and lending it back at three percent. This is how the big banks were rescued.

Goldman Sacks and Morgan Stanley, because they were investment banks, were ineligible to the federal bailout. They got around legal restrictions by buying up some small commercial banks. Suddenly they were transformed into commercial banks, which give them access to the Federal Reserve’s money stock.

The housing industry was one of the hardest hit by the recession. Record foreclosures meant that by December 2009 two million houses had been taken over by banks and mortgage brokers. Another 5.2 million homes were in the process of foreclosure despite government efforts to prevent it. Approximately 20% of the homeowners in the United States, one out of every five, were “underwater,” which means the value of their homes was less than their mortgage liability. Because of this, there is a real possibility that many more people will fall into default on mortgage payments and banks will foreclose on the property. Many conservative politicians and some economists blamed individuals for making bad decisions. But this ignores the role of banks and mortgage agencies that lured people into loans they could not afford through exorbitant promises. It also ignores that consumers were forced to borrow just to maintain their lifestyles because of declining real wages.

The collapse of the housing market meant a dramatic 8 trillion dollar loss in the aggregate wealth of American families. Household debt remains...
enormously high and it is one of the constraints upon current spending by consumers and governments that is essential to end the economic crisis.

A major problem facing the nation today is that many state and local governments face bankruptcy. (In 2009, only one state, North Dakota, was not in deficit). To cover budget deficits they can either raise taxes to increase revenue or they can sharply cut social services. Raising taxes when people are already hurting and face losing their homes is politically untenable. New York State faced a thirteen billion dollar deficit in fiscal year 2009-2010 and the next year the state legislature was virtually paralyzed as it struggled for months to pass a budget.

Without new tax revenue, we are looking at 12-15% cuts in state and local spending. This means the elimination of entire programs and the loss of thousands of jobs, which can spur on a downward spiral and make economic conditions even worse. The federal deficit was 1.4 trillion dollars in 2009, but this is just the tip of the iceberg. If we add up all of the annual deficits, we have something called the national debt. The national debt in 2009 was about 12 trillion dollars and it was heading much higher as deficits continued.

Other problems facing the economy are equally serious. Military spending is out of control because the U.S. is in a perpetual state of war. Total military spending approaches one trillion dollars a year. The trade deficit has been growing because of the attraction of lower cost high quality foreign made goods and the outsourcing that has been championed by American companies trying to increase their profits. Global warming is an economic problem because our economy is heavily dependent on fossil fuels. There has been a lot of talk about alternative forms of energy, especially after the BP blowout in the Gulf of Mexico, but there has been very little concrete progress. The BP blowout also illustrates the general problem of environmental degradation.

There is also a growing gap between wealth controlled by the rich and the resources available to the rest of us. From the 1930s to about 1970 there was a great compression of incomes as the middle class expanded and the percentage of wealthy and poor contracted. Since then, there has been a dramatic move in the opposite direction. As the rich get richer, poverty is headed back upward. About 13% of the population, more than 1 in 8 Americans, lives below the official poverty line, which is about $22,000 a year for a family of four. Child poverty is at record levels with a lot of kids going around hungry in this rich country.

People going hungry in this country, people without jobs, an ecological crisis, a growing wealth gap, a housing crisis, and corporate influence over government point to an economy in trouble. These are all things students need to examine in a high school economics curriculum.
A. By most measures, Harley-Davidson has been having a rough ride. Motorcycle sales are falling in 2010, as they have for each of the last three years. The company does not expect a turnaround anytime soon. But despite that drought, Harley’s profits are rising — soaring, in fact. Last week, Harley reported a $71 million profit in the second quarter, more than triple what it earned a year ago. This seeming contradiction — falling sales and rising profits — is one reason the mood on Wall Street is so much more buoyant than in households, where pessimism runs deep and joblessness shows few signs of easing.

B. Many companies are focusing on cost-cutting to keep profits growing, but the benefits are mostly going to shareholders instead of the broader economy, as management conserves cash rather than bolstering hiring and production. Harley, for example, has announced plans to cut 1,400 to 1,600 more jobs by the end of next year. That is on top of 2,000 job cuts last year — more than a fifth of its workforce.

As companies this month report earnings for the second quarter, news of healthy profits has helped the stock market — the Standard & Poor’s 500-stock index is up 7 percent for July — but the source of those gains raises deep questions about the sustainability of the growth, as well as the fate of more than 14 million unemployed workers hoping to rejoin the work force as the economy recovers.

C. The trend is hardly limited to Harley. Giants like General Electric and JPMorgan Chase, as well as smaller companies like Hasbro, the toymaker, all improved their bottom lines despite slowing sales in the second quarter. Among the S.& P. 500 companies that have reported second-quarter results, more than one in 10 had higher profits on lower sales, nearly twice the number in a typical quarter before the recession, according to Thomson Reuters.

D. Harley has warned union employees at its Milwaukee factory that it would move production elsewhere in the United States if they did not agree to more flexible work rules and tens of millions in cost-saving measures.

Even if sales do improve, a surge in hiring is unlikely. “The last thing we’re worried about is when are we going to have to add more capacity, because what we’re really doing is reconfiguring our entire
operational system for greater flexibility,” Keith Wandell, the company’s chief executive, said on a conference call with analysts last week.

E. At Ford, revenue in its North American operations is down by $20 billion since 2005, but instead of a loss like it had that year, the unit is expected to earn more than $5 billion in 2010. In large part, that is because Ford has shrunk its North American work force by nearly 50 percent over the last five years.