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THE FLIP SIDE OF THE U.S. ECONOMIC RECESSION 2007-09

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—Abstract—

This paper is an attempt to translate economic figures and indices into the living conditions of people who are behind the statistics of the U.S. economic recession, which officially began in December 2007 and ended in June 2009. The pathology of the Great Recession began with the financial shock, which resulted from the buildup of financial mischief since the 1980s, and the burst of its real estate bubble by 2007.

A recession is a man-made tragedy with a large human cost. This paper addresses this flip side of the current economic crisis by examining its human consequences on different social classes and groups. A breakdown of various data proves that the working class, the majority in U.S. society, suffers most from the recession, and yet, some amongst them even more than others, depending upon their social status with regard to education, race, and age.

Key Words: *Great Recession, Unemployment rates, Human cost,*

JEL Classification: G01 - Financial Crises

1. INTRODUCTION

The deregulation of the financial markets began in the late 1970s; and as a part of the evolving tendencies towards globalization and free-trade policies, it led to the creation of a fast growing leveraged credit markets through the financialization of capital. Structured finance at expanding scale geared unregulated financial products, such as mortgage-back securities (MBS) and collateralized debt obligations (CDOs), through what later became known as a "shadow banking" system.

It was in 2007 that the growth of debt-hedged funds pushed the financial market to the brink of a free fall. Although the "free fall" was prevented, the collapse of the subprime mortgage industry and its domino effects on the multitrillion dollar markets of credit insurance and mortgage securities led the entire economy to a disastrous meltdown. The irony is, however, that the majority of Americans, the working people, who had little to do with this "meltdown," not only had to bear its heavy burden, but also had to save the system from a "free fall" by bailing out those who were responsible for this "avoidable catastrophe."

2. THE GREAT RECESSION 2007-09

2.1. When regulators vote for deregulation

The closer review of the US financial system provides compelling information in support of the thesis that the recent recession could have been prevented, if not entirely, at least partially, both in depth and length, which stand next to the Great Depression of the 1930s. A glimpse of the deregulation that began in the late 1970s reveals that its goal was to open new marketing opportunities for financial capital in response to the falling rate of industrial profit. (Moseley, 1991: 104) Deregulation by blurring the fine line between commercial banks and investment banks on the one hand, and by promoting financial innovation in the derivatives industry on the other hand, made it possible for financial institutions to make high profits by investing in financial products. Deregulation of the financial market, thus, led financial institutions to explore a new paradigm of profit making through the financialization of capital for the past three decades. The Economist (2008) reports that financial firms, which accounted for about 10 percent of total corporate profits in the early 1980s, saw them increased above 40 percent in 2007.

2.2. Blowing one big asset bubble

After the dotcom crash and its consequent recession of 2001, the Federal Reserve consistently reduced its benchmark interest rate, the Federal Reserve rates, until it fell as low as 1 percent by June 2003. Cheap loans and an increase in loan incentives with easy initial terms in subprime mortgages and adjustable rate mortgages (ARM), along with the economic incentives for the originators of such mortgages, pushed up the demand for real estate and thus, home prices as sharply as over 57 percent between 2001 and 2006. (Policy and Economy Blog)

Influenced by the laissez-faire ideology, the financial regulators contributed to boom in real estate by their weakening of the supervision over the financial system. Such bubble blowing financial activities, some of which were widely exposed to be fraudulent, excited the financial supervisory authorities to the point

that the Chairman of the Federal Reserve exclaimed in a speech: “These increasingly complex financial instruments have contributed, especially over the recent stressful period, to the development of a far more flexible, efficient, and hence resilient financial system than existed just a quarter-century ago.” (Greenspan, 2004) However, it was not only Greenspan who failed to put in context the growing seed of crisis within the womb of the *innovative* financial market, but so was his successor, Ben Bernanke. In his testimony to the Congressional Joint Economic Committee in October 2005, then as chairman of the president’s Council of Economic Advisors, Ben Bernanke referred to the 25 percent increase in home prices as a sign of US economic strength, and what largely would reflect the “strong economic fundamentals.” (Bernanke, 2005)

It is, thus, not surprising to see that the two Fed chairmen, Alan Greenspan for his deregulatory policies and Ben Bernanke, the successor, for his failure of detecting the undergoing housing bubble were targets of a candid criticism in the final report of the majority of panel of the Financial Crisis Inquiry Commission, a bipartisan committee designated by Congress in 2009. A part of this report concludes that the “widespread failures in financial regulation and supervision proved devastating to the stability of the nation’s financial markets. More than 30 years of deregulation and reliance on self-regulation by financial institutions, championed by former Federal Reserve chairman Alan Greenspan and others, supported by successive administrations and Congresses, and actively pushed by the powerful financial industry at every turn, had stripped away key safeguards, which could have helped avoid catastrophe.” (The Financial Inquiry Report, 2011)

Although, the former chairman Greenspan conceded there was a “flaw” in his market ideology (Bloomberg, 2008), his realization came only after the damage had already been done. Such a historical buildup of financial malfeasance had no final result except bringing the financial system to near total collapse and with its spillover to production industries, giving yet a new dimension to its catastrophic human cost.

3. THE HUMAN COST OF THE GREAT CRISIS

3.1. A glimpse of the vulnerability of the labor force

The majority of American people are working class (Zweig, 2000: 7), accounting “for over 60 percent of the labor force.” (Zweig, 2000: 3) With regard to their place in production, the working class people are those who do not own means of production (capital) and consequently have hardly any control or power over their work and employment. It is, thus, the workers along with their children and other

dependents that will always be the main victims of any economic crisis. The economic burden of the crisis for the majority of working people is even life threatening as their healthcare benefits, among others, are tied to their employment. In addition, the crisis begins by reducing employment in the least protected segments of labor force, where workers are making a subsistence living and coping with their vulnerability in terms of color, education, and age.

As the income of most Americans is fundamentally labor income, high unemployment translates into terrifying news for the majority of Americans who live on labor, and the provision of social benefits for them is the weakest among all advanced countries. Thus, the ever-growing income gap in the US, also adds tremendously to the insecurity and stress of this majority, even if they *conservatively* try "to live within their means." Just as an example, the "C.B.O. study found that between 1979 and 1997, the after-tax incomes of the top 1 percent of families rose 157 percent, compared with only a 10 percent gain for families near the middle of the income distribution." (Krugman, 2002)

3.2. The soaring unemployment rate

As the finance sector is a key to the functioning of the real economy, its crisis, particularly when it is not "mild," does not remain within the financial market; it rather spills over to the entire economy resulting in social misery and despair. However, the share of this burden has never been uniform across all classes of society; not to mention it has never been the case with the share of the fruits of its prosperous times either.

The unemployment rate is one of the main indicators of the state of economy and its labor force situation. During the recent recession, which officially began in the December of 2007, the unemployment rate soared from 5 percent reaching 9.7 percent in 2009. However, the *real* unemployment rate was by far higher than those official rates as they did not include by definition "discouraged and marginally attached workers" (those who have given up looking for jobs), involuntary part-time workers (those who are not able to find full-time job), and those who work, but at jobs that underutilize their skills.

Figure-1: Number of Unemployed by Different Measures

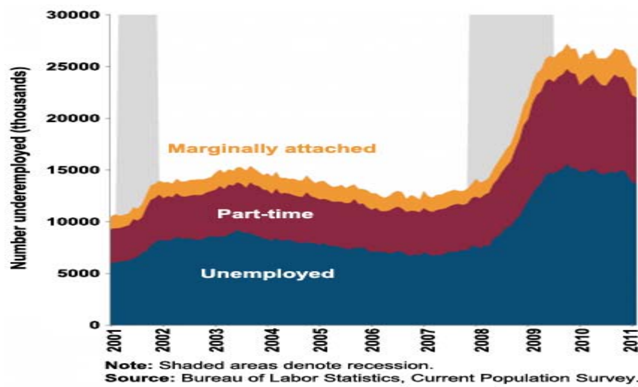


Figure (1) measures the number of unemployed people in different categories; it shows at the peak of the recession in 2009 there were *actually* more than 25 million unemployed against the official number of less than 15 million.

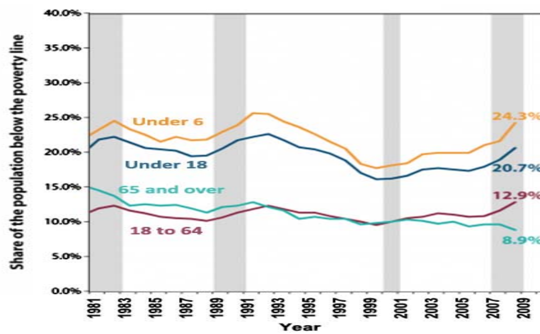
3.3. The break-down of unemployment rate

A closer examination of the unemployment data of the recession reveals facts about the degree of the range of job losses in the economy by hitting the poorest first. For example, the interactive graphs provided by The New York Times (November 6, 2009) would show that for those who did not have a high school degree (ages 15-24), or in other words, those in terms of their income were at the bottom of labor force, the unemployment rate reached 26.6 percent by September 2009, a rate three times higher compared to college-degree holders (8.4 percent). And still, the case was much worse for black men in the same category: it was as high as 48.5 percent for the same period.

3.4. Different effects of the recession

The breakdown of unemployment into different economic and social categories revealed that the recession took away the incomes of the lowest paid in the economy at a much higher pace than those in any other groups.

Figure-2: US below Poverty Rate by Age



Source: U.S. Census Bureau, Historical Poverty Tables

The majority of these people born into poverty, and then grew up in a social environment, which could hardly promise them opportunities of a life better than what they already had. The figure (2) shows nearly one out of every four under the age of 6, and one out of every five until the college age of 18 remains *hopelessly* poor, under the poverty line.

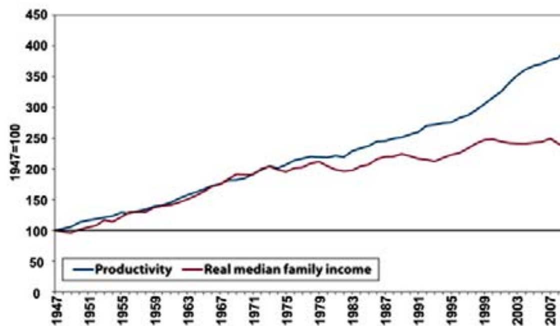
There are also less general, but by no means less tragic socio-economic effects of recession. For example, depending on their asset portfolio, the elderly people about to retire lost at different scales a significant part of their retirement savings. "The stock market lost 47 percent of its value between September 30, 2007, and December 2, 2008, a decline of about $11 trillion." (Soto, 2008) Although, elderly workers save less in stocks, nevertheless almost half of the retirement savings of 50 and older are in equity, and the "plummeting value of retirement assets could force adults to delay retirement and remain at work. (Soto, 2008) Another example is about the psychological stress of recession due to unemployment, which let down millions of homeless parents to seek a place to live with their children or relatives, not to mention the extreme unfortunate cases that ended in suicides. Study shows that "unemployed have two to four times the suicide rate of employed adults." (USA Today, January 11, 2009)

3.5. The recession may be over, but for whom?

The great recession was officially over in June 2009, and after a consecutive 18-month decline in output, the economy geared towards recovery. In its general economic sense, however, *recovery* is actually an elusive term. By definition, it is an economic upturn in terms of total production (GDP), which does not necessarily mean a decrease in the unemployment rate. As a matter of fact, the

unemployment rate kept on increasing after the recovery until October 2009, when it hit its highest rate at 10.2 percent. In other words, recovery from the Great Recession actually meant recovering the growth in production with a lesser labor cost, or simply recovering the lost profits at the cost of lower wage and salary incomes. The New York Times (November 24, 2010) reports that “American business earned profits on an annual rate of $1.659 trillion in the third quarter (of 2010) according to Commerce Department report released Tuesday (November 23).” The same report points out that this figure is the highest recorded since the government began keeping track over 60 years ago, which breaks the record of the highest corporate profits earned in the third quarter of 2006. The report, thus, proves that when the unemployment rate in the recovery period was, on average, as high as double before the recession in the same period, the corporations managed to make even higher profits. The yawning gap between labor productivity and the real median family income since the middle of recession in 2008 (Figure 3) is the major reason for having a recovery by means of “making more with less.”

Figure-3: Productivity vs. Real median family income



Source: EPI analysis of U.S. Census Bureau, Historical Income Tables

Conclusion

The recession of 2007-09 was both the deepest and longest of recessions since the Great Depression of 1930’s. The ultimate cause of such an unprecedented recession is to be found in the free market-oriented views of the fiscal and monetary regulators, rather than simply the “greed” of financiers which is nothing more than an expected outcome of such views in a practical world. Financialization, as reflection of a deregulated financial system, drove the financial markets towards the expansion of derivatives in search of higher profits

beginning in the last years of the 1970s. Since then, money capital increasingly shifted from production industries to financial markets for investment in producing "exotic" financial products.

Three decades passed and the *freedom* of the free market allowed the "greed" of financiers to pursue increasingly adventurous forms of investment ending with a maniacal interest in real estate. The financial meltdown and its spillover into the rest of the economy caused soaring unemployment for more than 18 months, and consequently unprecedented social misery and despair. As millions lost their homes, medical insurance, equity savings, retirement savings, there are still millions more, who continue to live in chilling fear of adding to these grim statistics.

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