

## SHORT BIOGRAPHY FOR DAVID KOTZ

### Contact Information

**Address:** Economics Department, Thompson Hall, University of Massachusetts, Amherst, MA 01003, USA.

**Telephone:** 413-545-0739 (office), 413-584-2547 (home office)

**Fax:** 413-545-2921

**Email Address:** dmkotz@econs.umass.edu.

David Kotz is Professor of Economics at the University of Massachusetts Amherst and Research Associate at the Political Economy Research Institute. He is currently working on a book *Russia's Path from Gorbachev to Putin: The Demise of the Soviet System and the New Russia*, coauthored with Fred Weir, Routledge, forthcoming 2007. His recent work has been on the evolution of formerly centrally planned economies, accumulation and crisis in the U.S. economy, the analysis of neoliberal economic policies and institutions, and models of participatory socialism. His articles have appeared in *Monthly Review*, *Science and Society*, *The Review of Radical Political Economics*, *Rethinking Marxism*, and in several Russian and Chinese journals.

# **Contradictions of Economic Growth in the Neoliberal Era: Accumulation and Crisis in the Contemporary U.S. Economy**

**David M. Kotz**

## **1. Introduction**

Capitalism has assumed distinct institutional forms in particular times and places.

Each stage, or institutional form, of capitalism appears to have a particular main contradiction in the capital accumulation process which causes the periodic crises or recessions.

In the regulated capitalism in the USA in the post-WWII decades, the typical cause of recessions was a real wage squeeze on profits.

That is, in an expansion, real wages tended to rise faster than real output per worker, which reduced profits.

This results from the relatively strong bargaining position of labor under regulated capitalism.

Short-run crisis, or recession, tends to resolve the profit squeeze.

Crisis □ increased unemployment □ reduced worker bargaining power □ eliminates wage squeeze on profits.

Problem: in the regulated capitalist era, over time short-run crises lost the ability to resolve the profit squeeze within the existing institutional structure of capitalism.

More effective state intervention to limit the severity of recessions, plus an expanding welfare state, meant that recessions did not undermine workers' bargaining power as effectively.

After mid 1960s, crises no longer disciplined the working class effectively, and the result was a worsening inflation-unemployment tradeoff.

In 1970s this produced spiraling inflation that contributed to the dissolution of regulated capitalism.

Was replaced by the neoliberal form of capitalism after 1980.

Neoliberal capitalism does not tend to encounter a problem of a real wage squeeze on profits.

The working class has relatively little bargaining power.

Instead, the typical main contradiction of accumulation in neoliberal capitalism is overproduction.

With a tendency for profits to rise rapidly while real wages rise slowly if at all, eventually a crisis of overproduction emerges.

How does an expansion happen in neoliberal capitalism, with stagnating wages?

A neoliberal expansion tends to be accompanied by

a rising profit rate

an atmosphere of euphoria (great optimism) among capitalists

the emergence of asset bubbles

the rapid expansion of various forms of debt.

Those developments can promote growing investment demand and consumer demand for a time, despite the stagnation of wages.

However, the above processes eventually reach limits, leading to a recession.

In an earlier paper (2003) I examined the long US economic expansion of the 1990s, which lasted until 2000.

Showed the key roles of a rising profit rate, a stock market bubble, and growing household debt in postponing a crisis of overproduction for a time.

This paper examines the 2001 recession in the US, which followed the 2000 peak of the 1990s expansion, and the current US economic expansion since 2002.

Then we will compare this recent experience to the US economy in the earlier part of the neoliberal era.

We find the following:

- 1) The expansion since 2002, like that of the 1990s, has been driven by a rising profit rate, an asset bubble, and debt-fueled consumer spending.
- 2) Since 1980 there has been a long-term worsening of a key imbalance in the neoliberal structure:

Long-run growth in debt resulting from the means used to moderate and overcome short-run crises.

The above long-term trend suggests that the neoliberal structure may be approaching a limit to its ability to promote capital accumulation.

If this is so, then we may be entering a period of crisis of the neoliberal model.

## **2. The Recession of 2001**

My paper analyzes the causes of the recession of 2001, which ended the long 1990s expansion.

I will not present this analysis in my talk.

The basic points:

- 1) Rate of profit fell sharply from 1997-2000, mainly due to problem of overproduction, which reduced profit margins.
- 2) Bursting of stock market bubble in 2000, partly due to falling profit rate, ended what had been main stimulus to growing consumer spending and investment spending.

The 2001 recession was mild, with nonfinancial corporate business sector output falling only 2.7% over 5 quarters.

Yet the behavior of business investment in 2001 seemed to indicate a severe recession would take place.

Why was the recession relatively mild and short?

As table 4 (slide 13) shows, nonresidential fixed investment fell by 4.2% in 2001 and another 9.2% in 2002.

Severe recession avoided in 2001 by an unusual continuing growth in consumer spending.

Consumer spending is approximately two-thirds of GDP, so that its movements have a large impact on GDP.

Economists have traditionally portrayed consumer spending as a relatively passive factor in economic growth.

In most past recessions, consumer spending either fell or stagnated (table 6, slide 15).

Consumer durable goods spending, which is considered the part of consumer

spending that is easiest to postpone in hard times, declined in each of the previous four recessions.

The 2001 recession showed different behavior of consumer spending:

Consumer spending grew by 2.5% in the recession year of 2001.

Consumer durable spending grew by 4.3% that year.

Yet disposable personal income grew that year by only 1.9%.

Consumer spending can rise faster than disposable personal income by households going deeper into debt.

Figure 2 (slides 5 & 6) shows three different measure of household debt:

1) household debt as a percentage of disposable personal income

2) household debt as a percentage of household assets

3) the household debt service ratio (DSR)

#3 is debt servicing payments as a percentage of disposable income.

#3, the DSR, indicates how burdensome the debt is for households.

#1, debt over disposable personal income, shows the potential burden without regard to the current interest rate and repayment terms, which can change over time.

#2, debt over assets, shows the extent to which households are leveraging their assets by adding debt.

Figure 2 shows a change in the cyclical behavior of household debt in the 2001 recession.

All three measures of household debt fell during, or right after, the three-year long depressed period 1980-82 and the recession of 1991.

That is, past recessions in the neoliberal era reduced debt ratios.

However, in 2001 all three measures of household debt jumped significantly rather than falling.

In 2001 all 3 measures reached their highest levels to date in the neoliberal era.

Why did households go deeper into debt to increase their spending amidst a recession?

The Fed (Federal Reserve) engineered rapidly falling interest rates that year.

As figure 3 (slide 7) shows, interest rates fell sharply in 2001.

While the fall in interest rates did nothing to stem the accelerating decline in nonresidential fixed investment, it apparently encouraged households to take on additional debt to raise their spending.

As a result of falling interest rates, the DSR rose by much less in 2001 than the other two measures of household debt (figure 2).

That is, the rise in the burden of repayment was moderated by the decline in rates. Rising consumer spending, fueled by debt, added 1.74 percentage points of GDP growth that year.

This was double the actual growth in GDP of 0.8%!

As a result, the current expansion began with the highest level of household debt since 1980.

### **3. The Expansion of 2002-2005**

The expansion during 2002-05 can be divided into 2 phases (see table 4, slide 13):

1) Phase 1, a slow growth period, with GDP growing at 1.6% in 2002 and 2.7% in 2003.

Average GDP growth rate was 2.1% in phase 1.

2) Phase 2, a rapid growth period, with GDP growth 4.2% in 2004 & 3.7% in 2005.

Average GDP growth rate was 3.9% in phase 2, almost double that of phase 1.

In addition, the main factors promoting growth differed in the 2 phases.

#### **A. Phase 1:**

In every previous business cycle expansion since 1962, the expansion began with a rapid increase in nonresidential fixed investment.

However, in phase 1 of this business cycles expansion, nonresidential fixed investment was declining or barely growing (table 4, slide 13).

Nonresidential fixed investment fell by 9.2% in 2002 and rose by only 1.3% in 2003.

This suggests that the overcapacity created during the previous expansion took some time to work off.

The capacity utilization rate in industry fell from 82.0% at the peak in 2000 to 75.3%

in 2002 and 75.5% in 2003, the lowest levels since the severely depressed early 1980s.

Leading factor in phase 1 exp: Consumer spending.

In 2002 consumer spending grew by 2.7%, much faster than the 1.6% growth in GDP.

In 2003 consumer spending grew by 2.9%, slightly faster than the 2.7% growth of GDP.

How can we account for the leading role of consumer spending in phase 1?

Answer: Two factors:

1) Bush tax cuts boosted disposable personal income in 2002 despite slow growth in personal income (table 7, slide 16).

Despite fact that cuts mainly benefitted the rich, some aid was provided to middle income households.

2) Households took on large amount of additional debt.

In 2003 consumer spending increased 2.9% while disposable personal income increased only 2.4% (table 7, slide 16).

Evidence on Household Debt Expansion in Phase 1:

Two measures of household debt, debt/disposable personal income and debt/assets, rose substantially.

The 3<sup>rd</sup> measure, DSR, rose only slightly.

Reason: Rapidly falling interest rates limited the increase in burden of debt

The falling interest rates encouraged debt increase.

Additional growth factor in Phase 1: Rising government purchases, especially federal military (table 5 slide 14).

B. Phase 2

GDP growth accelerated to 3.9% in 2004 and 2005.

Consumer spending growth rate increased, but now not faster than GDP growth.

Leading factors:

1) Nonresidential fixed investment grew 9.4% in 2004 and 8.9% in 2005.

2) Residential investment grew at 10.3% in 04 and 7.7% in 05 (smaller total

than nonresidential fixed investment).

Residential investment grew due to very low interest rates B and also housing bubble (to be discussed).

Why did nonresidential fixed investment grow rapidly in phase 2:

Does not appear was shortage of capacity:

Capacity utilization in industry recovered only marginally in 2004 to 78%, well below the 2000 level of 82.0%.

Apparent Reason: a rapid recovery of rate of profit after 2001 (figure 1, slide 4).

The after-tax rate of profit in the nonfinancial corporate business sector rose by 86.1% from 2001 to 2004.

Why rate of profit rose after 2001:

1) Main reason was very slow growth in real wages (1.1% per year), much slower than output per worker (3.4% per year).

The neoliberal model kept workers bargaining strength very low despite economic expansion, which repressed real wage growth.

2) Secondly, falling interest rates also contributed to rise in rate of profit.

Consumer Spending:

Despite repressed wage growth, consumer spending rose rapidly during phase 2 of the expansion.

Although consumer spending rose slightly more slowly than GDP in phase 2, the large size of consumer spending resulted in that component of GDP contributing 65% of GDP growth in 2004 and 70% in 2005.

Disposable personal income in 2004 and 2005 rose significantly more slowly than GDP, yet consumer spending did not.

In 2005 consumer spending rose by 3.7% while disposable personal income rose by only 1.1% (table 7, slide 16).

In 2005 the personal saving rate turned negative, at -0.4% of disposable personal income.

Why the rapid rise in consumer spending in phase 2 despite slow disposable personal income growth: Continuing rise in household debt.

The entire expansion from 2002-05 has been supported by rising levels of household debt.

Compared to the previous business cycle peak in 2000 (figure 2, slide 5 & 6):

- 1) Debt/disposable personal income rose from 91.0% to 111.9%.
- 2) Debt/Assets rose from 13.3% to 16.4%.
- 3) DSR rose from 12.6% to 13.2% (rise moderated by falling interest rates).

These are the highest levels in the neoliberal era.

Note: The stabilization of DSR shows that falling interest rates and easing repayment terms have allowed households to rapidly increase their debt without increasing the repayment burden since 2001.

Thus, the Fed's very easy monetary policy facilitated household debt expansion.

However, as interest rates rise, the burden of this debt will rise with them.

Q: How have households been able to borrow so much?

The stabilization of debt/assets after 2002 suggests the answer to that question.

The development of a bubble in the housing sector enabled households to borrow against their appreciating home values.

See figures 4 slide 8 (Housing Price index/Owner=s Equivalent Rent).

In 2001 recession, this index rose instead of falling.

By second quarter of 2005, Housing Price index/Owner=s Equivalent Rent had reached 25% above highest previous level of neoliberal era.

Data suggest an accelerating housing bubble in recent years.

The housing bubble enabled households to gain access to growing credit to finance rising consumer spending, keeping the expansion going at a relatively rapid rate.

#### **4. Concluding Comments**

Now have all the pieces needed to assess the expansion of 2002-2005 and to draw some implications from it.

Key factors driving the expansion (in order of importance):

- 1) Growing consumer spending driven by growing debt, which in turn has been driven by easy monetary policy and a housing bubble.

- 2) Growing nonresidential fixed investment driven by a rising rate of profit which, in turn, has been due primarily to real wages growing more slowly than output per worker;
- 3) Growing residential investment driven by easy monetary policy and probably also by the housing bubble.
- 4) Growing federal purchases, mainly rising military purchases, that directly contributed to GDP growth, and tax reductions that indirectly contributed to GDP growth.

This was financed by a rapid increase in the federal budget deficit, which went from a surplus in \$189 billion surplus in 2000 to a deficit of \$453 in 2004.

Thus, the main contradiction of economic growth in a neoliberal structure, between favorable conditions for creation of surplus value and problematic conditions for its realization, have been temporarily resolved during 2002-05 by

- 1) growing household and government debt
- 2) large reductions in interest rates
- 3) a housing bubble.

Note: Asset bubbles tend to emerge in a neoliberal structure.

Have been bubbles in every neoliberal expansion in the US economy.

Reason: shift in income toward profits and wealthy households □ rapidly growing volume of funds seeking investment while potential final demand growth is limited.

Hence, surplus funds tend to find their way into speculation in some asset.

Economic expansions within a neoliberal structure appear to depend on the emergence of such bubbles as well as the expansion of debt.

2006 vs. 2001:

It seems likely that the current expansion will soon end in a crisis of overproduction:

- 1) When the housing bubble bursts, as all bubbles must, households will find it difficult to obtain further credit based on home values.
- 2) Interest rates have been rising since 2004, which raises the burden of the record level of household debt.

This suggests that the process of increases in consumer spending beyond increases in disposable personal income may soon reach its limit.

In 2001 crisis of overproduction, conditions were favorable for limiting the crisis:

- 1) interest rates were relatively high, leaving ample room for lowering them.
- 2) the federal budget was in surplus, leaving ample room for expansionary fiscal policy.

However, the means for moderating the recession of 2001 and for stimulating the subsequent expansion had the following effects:

- 1) pushed household debt to previously unseen levels
- 2) drove government debt to very high levels
- 3) brought interest rates to historically low levels.

When the next crisis emerges, it will be difficult for the government to take effective steps to moderate the crisis:

- 1) It is unlikely that the Fed can lower interest rates which are still relatively low, in the near future due to high energy prices and the huge US trade and current account deficits.
- 2) The Federal Government has little room to pursue further expansionary fiscal policy measures, in light of the very large federal deficit.

Furthermore, it seems unlikely that a way can be found to further increase debt-based consumer spending.

Hence, the next crisis of overproduction may become a severe one, as consumer spending stagnates or declines and nonresidential fixed investment declines.

A stagflation could possibly emerge under these conditions:

- 1) Declining consumer spending and investment demand reduce GDP,
- 2) The huge current account deficit requires high interest rates and causes a falling dollar, bringing rising inflation.

The foregoing analysis suggests that the U.S. economy' neoliberal structure may be reaching a limit in its ability to promote economic expansion and avert severe economic crises.

If so, we may be entering a period of crisis of the neoliberal model itself, analogous to

the crisis of regulated capitalism that emerged in the 1970s.

If this occurs, the neoliberal institutional structure may not survive such a crisis.