The Economic Crisis: No, this will not be a Normal Cyclical Recovery

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The Congress, at the behest of corporate lobbyists, wrote into legislation the rules that permitted companies to offshore jobs, reduce real wages, and permit risky financial practices. Therein lies the root cause of this crisis.

Philip Tetlock, a professor at the University of California, Berkeley, spent two decades tracking 82,000 predictions made by 284 experts. His findings, reported in his book, "Expert Political Judgment," are that, on average, the expert's predictions were only bit better than random guessing would have been. He writes, "It made virtually no difference whether participants had doctorates, whether they were economists, political scientists, journalists or historians, whether they had policy experience or access to classified information, or whether they had logged many or few years of experience."

The only consistent attribute was fame, and the relationship was inverse. The more famous experts made worse predictions than the unknown forecasters did. Dean Baker [http://www.prospect.org/csnc/blogs/beat_the_press] has often pointed out that the media, when reporting on a forecast made by a prominent economist, should (but never does) quality the prediction with a list of previous predictions made by the expert that were wrong. But economists, even when their predictions are right, have a way of basing their predictions on sheer nonsense.

For instance, Roger Altman [http://www.ft.com/cms/s/0/3d89a930-220d-11de-8380-00144feabdc0.html?nclick_check=1] predicts that this will not be a normal cyclical recovery. Although it is likely that this is correct, his article is a mishmash of nonsense.

Altman writes that,

"we saw a housing and credit market collapse that caused enormous losses among households and banks. The result was a steep drop in discretionary consumer spending and a halt to lending. To see why recovery will be slow, we can look at the balance sheet damage. For households, net worth peaked in mid-2007 at $64,400bn (€47,750, £43,449bn) but fell to $51,500bn at the end of 2008, a swift 20 per cent fall. With average family income at $50,000, and falling in real terms since 2000, a 20 per cent drop in net worth is big – especially when household debt reached 130 per cent of income in 2008.

This debt derived from Americans spending more than their income, reflecting the positive wealth effect. Households felt wealthier, despite pressure on incomes, because home and financial asset values were rising. Now that wealth effect has reversed with a vengeance, the crisis and unemployment have frightened households into raising savings rates for the first time in years. They had been stagnant at 1-2 per cent of income but have surged to nearly 5 per cent. With reduced incomes, only cutting discretionary spending can produce higher savings. This explains why personal consumption expenditures fell at record rates at the end of 2008."

Where and when Altman and other economists acquired the ability to read the minds of people is unknown.

Sometime in the past, apparently, some charlatan sold the economic profession a boxcar bull of crystal balls. So instead of asking people why they spent more than they earned, these economists peer into a reflective glass and see only themselves.

Even my anecdotal experience contradicts Altman. Throughout the past decade, in conversations with fellow workers, neighbors, friends, and relatives, not one single time have I heard anyone boast about his/her increased feelings of wealth. They did, however, complain about the increased costs of essential products and services and the lowering of the real-dollar value of their incomes. They did not borrow because they felt wealthier; they borrowed to supplement their declining incomes in an inflationary economy. And bankers enabled them, encouraged them, to do it by offering easy loans with low payments without ever revealing the true costs of those loans. Consumers borrowed not because they felt wealthier, they borrowed because they needed the money. And when the Ponzi bankers' schemes brought down the economy, repaying the loans became impossible, job losses eliminated incomes, and consumer purchasing declined. Unless jobs are generated that provide sufficient income to regenerate a consuming economy, this will not be a normal cyclical recovery.

It, however, is not obvious that such jobs will materialize. Over the last quarter century, American business has moved myriad higher paying jobs to foreign countries which depend upon American consumers to purchase the products produced for the American companies that moved their manufacturing overseas. Even Obama says that these jobs are not coming back. The infrastructure to recreate these jobs no longer exists in America. The businesses that still provide such jobs are asking, in some cases requiring, workers to work for lower wages. The lost jobs and lowered wages mean lower consumption for the unforeseeable future. When the big three automobile companies reduce their workforces and pay lower wages, they are, in reality, reducing the market not only for automobiles but also for products and services of all kinds. So how can bankers be expected to increase lending? Who will the credit worthy borrowers be? Certainly not the people without jobs or with reduced incomes or with reduced credit scores because of recent defaults. Certainly not businesses with fewer sales and lower profits. The lending will not materialize no matter how the failing banks are recapitalized. Furthermore, the number of jobs that need to be created for a recovery is a multiple of the number lost if the wages paid by the new jobs is less than those paid by the lost jobs. So no, this will not be a normal cyclical recovery.

Some economists have begun to speak of another "jobless recovery." I can't even imagine what that could mean? About three quarters of the American economy was driven by consumption. Without a regeneration of the levels of consumption needed to drive this portion of the economy, nothing that can truly be called a recovery can happen. The way out of this crisis is not to recapitalize the banks, but rather to recapitalize consumers. Given the political ideologies active in the United States of America, I doubt that that will ever happen. After all, the business of America is business, not the welfare of its people.

Economists and politicians are blaming this crisis on faulty practices carried out by the financial industry. And no one has pointed how retirement investment plans such as 401Ks regularly pumped money into the stock market and contributed to the bubble. These practices may have precipitated the crisis, but given the assault on the wages of working class Americans and the shifting of higher-paying jobs to foreign countries, an economic collapse, sooner or later, was inevitable. Anyone who can perform simple arithmetical calculations should have known it.

When a nation consigns its people to working for meager wages, its prosperity is doomed. The Congress, at the behest of corporate lobbyists, wrote into legislation the rules that permitted companies to offshore jobs, reduce real wages, and permit risky financial practices. Therein lies the root cause of this crisis. People merely do what the law allows. Without a prosperous people, America cannot be a prosperous nation. So welcome America to the third-world.

John Kozy is a retired professor of philosophy and logic who blogs on social, political, and economic issues. After serving in the U.S. Army during the Korean War, he spent 20 years as a university professor and another 20 years working as a writer. He has published a textbook in formal logic commercially, in academic journals and a small number of commercial magazines, and has written a number of guest editorials for newspapers. His on-line pieces can be found on *http://www.jkozy.com/ and he can be emailed from that site's homepage.*

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