The Roller Coaster Economy: Financial Crisis, Great Recession, and the Public Option

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When Alice was in Wonderland, it was a topsy-turvy place that Alice found very confusing. The present capitalist market economy, much like Alice’s Wonderland, often seems topsy-turvy and confusing to most people, perhaps never more so than today.

Right now, as this book is written in 2009, millions of Americans have lost their jobs and go without a secure income. More than 1 million U.S. homeowners are facing foreclosure and the loss of their homes. Thousands of businesses are going bankrupt, mostly small businesses, but also some very large ones.

You might think from these facts that the economy produced too much, hired too many workers, and created too many companies. But millions of people in the United States need more to eat, more clothes, and more shelter. In 2007, more than 37 million people, some 12.5 percent of the U.S. population, lived in poverty without enough money to get by on. Those numbers go up every day as the economy spirals downward.

If so many people urgently need so many things, why does the economy act like it has produced too much? Why do unsold clothes pile up on store shelves, cars sit in showrooms, and houses stand empty, when so many go without?
These same topsy-turvy contradictions appear in the global economy. Economies across the globe—not just the U.S. economy, but also the European, Japanese, and even the red-hot Chinese and Indian economies—are cutting back production. European finance employees, Japanese electronics employees, Chinese garment workers, and Indian software employees are losing their jobs as their economies slow and the world export market dries up.

But there is great need for more production. In 2005, 1.4 billion people, about one-quarter of the population of the developing world, lived in extreme poverty, making do on less than US$1.25 a day. Half the population of sub-Saharan Africa, 380 million people, continues to live in extreme poverty. The poverty-stricken and many others need more food, more clothing, and more shelter.

The world economy has enormous capacity to produce. Instead of producing more, however, economies across the globe are producing less. They are firing their employees.

It is this strange, contradictory, topsy-turvy state of affairs that reminds us of Alice’s adventures in Wonderland (Carroll 1901). Alice would find that the economic system reduces production when many people urgently need more goods and services. She would think this is strange and mysterious, and perhaps as topsy-turvy as Wonderland.

**Resolving the Mystery**

The first step in solving this mystery is to recognize that the economy has not produced more than people need. The economic output is only more than people have the money to buy at a price that yields a profit.
Today’s housing and mortgage crisis makes that clear. In the fall of 2008, homelessness reached record levels all across the United States. In Massachusetts in September 2008, for example, 2,000 families lived in shelters. Another 574 families could not find shelter space and were temporarily housed elsewhere. At the same time, 18.6 million housing units in the United States stood empty. U.S. housing prices were down nearly 20 percent from their peak in late 2005. Sales of new homes had just about dried up. And housing starts, the building of new homes, reached their lowest level since record keeping began in 1947. Only in a topsy-turvy world could Massachusetts and every other state scramble to provide shelter to a record number of homeless families while millions of homes lie empty.

For some people, these contradictions are not so bothersome. Take Wall Street Journal columnist Holman Jenkins. How would he “shake off the mortgage mess”? That is easy: demolish unoccupied houses. Unsold houses, figures Jenkins, “go rancid on the shelf, souring the values of the nation’s entire housing stock,” pulling down its price. Destroying unsold houses would, he argues, reduce the supply of housing and drive up housing prices (Jenkins 2008). Jenkins’s reasoning is the quintessential example of the market economy’s upside-down logic. Jenkins is more obsessed with driving the price of houses back up than with the plight of the homeless. How else could he advocate destroying unoccupied houses to make those that remain on the market more expensive, while many families go without a home?

Unemployment is another example of the topsy-turvy nature of the economy. Employees lose their jobs because the commodities they produce go unsold. But without a job or income, they too will lack the money they need to purchase the goods they badly need. And then yet more employees will lose their jobs. The number of unemployed climbs by millions as the economy produces less and less, and employs fewer and fewer workers and professionals. All the
while, the millions of people without jobs would be happy to work to produce the goods that they so desperately need.

How can this strange mystery be solved? This question is of vital importance to people all over the world. This book seeks to unravel the mystery of how vast numbers of people are unemployed while millions of people urgently need more food, clothing, and shelter. This book was written both to explain the mystery and to discuss ways to change this topsy-turvy economy for the better.

**Recession and Depression**

In economic expansions, American production rises while unemployment falls. Every expansion in American history, however, has been followed by an economic contraction. If the contraction is relatively mild by historical standards, it is called a recession. If it is more severe, it is called a depression. The difference can best be explained by a joke first made by President Harry Truman: If your friend loses her job, he said, it is a recession; if you lose your job, it is a depression. When the contraction lasted ten years and official unemployment went up to 25 percent in the 1930s, it was called the Great Depression.

The term “depression” was commonly used before World War II to refer to any economic contraction. From 1948 to 2001, there were ten minor contractions. Conservatives did not like the term “depression” because it reminded everyone of the horrors of the Great Depression which they would rather forget, while denying that the economy had any basic problem. So conservatives invented the term “recession” to convey the idea that the problem was mild and temporary. Eventually the term “recession” was widely used.
Now, in 2009, America is in the most violent contraction since 1929. It is even larger than the recession of 1982, which had been the biggest one since the 1930s. Conservatives want to call it a recession. But that word is not strong enough for most people. Paul Volcker, a past chair of the Federal Reserve System, has called it a “Great Recession” (Volcker 2009, p. 1).

A “Great Recession” reflects actuality a lot better than just the term “recession.” The Great Recession of 2007 to 2009 reflected new economic structures that have arisen in the last thirty years and have born a bitter fruit. More people have lost their jobs than in any other contraction since the Great Depression. Although it is not in the same class with the Great Depression, this Great Recession is bigger than any of the previous recessions in many ways. Americans have witnessed a deep contraction with an entirely different quality. An elephant is not just a bigger horse; it is qualitatively different.

Moreover, this contraction represented dramatic changes in the economic structure. The structure of the economy means the building blocks of which it is built and how they fit together. No contraction since the Great Depression has caused such a strong financial crisis. No other recession has seen millions of foreclosures that meant the end of the American dream of owning a house. No other recession has had so many large corporations teetering close to bankruptcy.

But there was also a financial crisis in the middle of the Great Recession. This crisis has been building for decades as the whole economic structure slowly changed. So the most accurate description of the 2007 to 2009 situation would be a Great Recession with a Financial Crisis. That is too big a mouthful, so the book will use the term “Great Recession” for the period 2007 to 2009. The expansion that preceded the Great Recession should be called the expansion of 2001 to 2001 during the Bush administration, but it will be called the Bush expansion for short.
Part II of this book will discuss the extent to which the Bush administration influenced the major variables.

Three questions will be explored in this book. First, why did the most recent expansion turn into a Great Recession? Second, what were the structural changes that led to the crisis of 2008? Third, in the last chapter, the question is what to do about it; that is, what changes have to be made in the structure of the U.S. economy to stop this sort of thing from happening ever again?

The Curse of Unemployment

In the first half of 2009, unemployment in the United States rose by half a million every month. The auto industry has been especially hard-hit. Of the big three, General Motors (GM) sold the lowest number of vehicles in forty-nine years in 2008. Both GM and Chrysler, the third largest auto company, went bankrupt in 2009. Despite these massive job losses, some politicians and economists in the United States blamed unemployment on the people, rather than the businesses that fired them. Former senator Phil Gramm, a politician with a PhD in economics, said in July 2008 that the Unites States had “become a nation of whiners” and dismissed the downturn as nothing more than a “mental recession” (see Cooper 2008). Conservative economic think tanks, such as the Heritage Foundation, insisted that the rising unemployment was not attributable to corporations firing employees. Rather, corporations were creating fewer new jobs because of high taxes. For them, the important way to cure the problem of unemployment was cutting business taxes. There was no need to extend unemployment benefits (see Sherk 2009).
This pro-corporate apology and dismissal of recessions is not new. “Absolutely sound” was President Calvin Coolidge’s assessment of the economy and the stock market in 1929. In the fall of 1929, Hoover’s secretary of the Treasury, Andrew Mellon, reassured one and all that “there is no cause to worry. The high tide of prosperity will continue.” Finally, in mid-October 1929, no less than Irving Fishing, the preeminent U.S. economist of his day, proclaimed that “stock prices have reached what looks like a permanently high plateau” (see Galbraith 1988, pp. 15, 26, 41, and 70).

A few days later the stock market crashed, and the U.S. economy sank into a depression that was to last a decade. By 1933, at least 25 percent of the labor force was unemployed and another 25 percent were on involuntary part-time work or were so discouraged that they gave up looking for jobs. The homeless, the hungry, and the desperate were never fully counted. The most famous pictures of the era showed long lines of people waiting for free bread or a bowl of soup. These breadlines, as they were called, would sometimes extend for blocks from the entrance of a soup kitchen.

Some modern economists still argue that the high wages of employees prevented a normal economic recovery during the Great Depression. As they see it, New Deal policies increased the bargaining power of employees and allowed them to push up their wages and salaries. Those high labor costs kept employers from hiring back employees in the long depression (see Cole and Ohanian 2004, pp. 813–815; see also Spirer, Spirer, and Jaffe 1998, p. 139).

This widespread belief that employees themselves, not the economic system, should shoulder the blame for the Great Depression reduced sympathy for the unemployed. This belief only reinforced the corroding effect that unemployment had on the sense of self-worth of the
millions who lost their jobs in the Great Depression. In *Hard Times* (1970), a riveting oral history of the Great Depression, Studs Terkel recorded hundreds of people’s recollections of their hard times. Terkel captures the courageous spirit of his subjects. Some of the more articulate and the political rebels attributed their suffering to outside economic forces and worked to change the economy. They did this through hunger marches and protests.

Among the millions of unemployed, however, “the great many were wounded, in one manner or another,” writes Terkel. “The suddenly-idle hands blamed themselves, rather than society. Millions experienced a private kind of shame when the pink slip came. No matter that others suffered the same fate, the inner voice whispered, ‘I’m a failure’” (Terkel 1970, p. 5). The notion that employees have no one to blame but themselves when they lose their job persists today. Most of the unemployed still bitterly reproach themselves as failures. Most politicians and economists perpetuate this view. When asked about black unemployment in the severe recession of 1982, President Ronald Reagan famously pointed to the help-wanted ads in the *Washington Post*. “I made it a point to count the pages of help-wanted ads,” he replied. “In this time of great unemployment, there were 24 full pages of classified ads of employers looking for employees. What we need is to make more people qualified to go and apply for those jobs” (Reagan 1982).

Actually there were twenty-six pages of ads, but most were devoted to job openings for professionals, such as engineers, unlikely to be filled by the unemployed. But even at that, there were only 3,500 jobs advertised, while 85,000 people were unemployed in the metropolitan Washington area at the time (see Spirer, Spirer, and Jaffe 1998, p. 139).

Equally tenacious is the belief that the economy itself is inherently stable and could not be the root cause of an economic collapse. That was Republican presidential candidate John McCain’s reaction when the U.S. financial market froze in the fall of 2008. During the Great
Recession year of 2008, Senator McCain took to the stump to assure the American people that “the fundamentals of our economy are strong,” sounding chillingly like Calvin Coolidge and Herbert Hoover on the eve of the Great Depression. The same day as Senator McCain made his statement, Lehman Brothers, the giant investment bank, declared bankruptcy (Stein 2008).

In spite of recessions and depressions, some conservative economists and politicians still argue that anyone who really tries can get a job, so all unemployment is purely voluntary. Is it true that unemployment is voluntary and the unemployed are personal failures? All the evidence says otherwise. Unemployment is due to the usual way that the institutions of the present capitalist economy operate. The main types of evidence are the following.

First, the reality reported every few days in all U.S. newspapers in 2008 and 2009 was that many firms, not just automobile makers, were firing thousands of people at a time. Citigroup, the giant banking conglomerate, decided to fire 53,000 employees. Alcoa, the aluminum maker, decided to cut 15,000 employees, 13 percent of its worldwide workforce. DHL, the express shipper, decided to get rid of 9,500 employees, 73 percent of its U.S workforce. Dell computers announced it would fire 8,900 employees, one-tenth of its workforce. Circuit City, the failing electronics retailer, announced it would let go of 8,000 employees, one-fifth of its workforce (this is before it went out of business). And many, many more companies could be added to this list.

When corporations fire thousands of employees, from guards to engineers, they do not blame employees for their individual shortcomings. They simply fire them.

Second, in every economic downturn, people look every day at the help-wanted advertisements in the newspapers. At the peak of the cycle in 2007, job ads ran day after day, sometimes with no takers. In a downturn, however, the number of job ads drop precipitously.
Third, the change in employment is systemic, reflecting changes in the aggregate economy. American employees lost jobs each and every month of 2008. All told, 2.6 million Americans lost their jobs in 2008, the highest number in one year since 1945 at the end of World War II.

When jobs disappear month after month and unemployment rises across the country, the fault is not with those who lost their jobs. Rather, the economic system is clearly at fault. When the economy collapses, corporations curtail their demand for labor. They do not hire new employees, they fire them. Employees do not lose their jobs because they become too lazy to work or in order to look for a new job. On the contrary, they lose their jobs because those jobs no longer exist. If 2.6 million employees lost their jobs because of individual failures, they would not all have lost them during 2008. Moreover, if the blame was individual, thousands of employees at one corporation would not lose their jobs at the same time.

In fact, the pattern of the expansion and decline of employment and output in the whole economy is remarkably stable; it reproduces itself business cycle after business cycle. The recession may be faster or slower, shallower or deeper, but, as will be seen in this book, the general patterns of employment and output over the cycle persist. The consistency of these cyclical patterns also is evidence against the view that unemployment is a personal failure and not a failure of the economic system.

If the cycle of boom and bust of the roller coaster economy endlessly repeats itself, what is the cause? This book will reveal that the basic cause is the institutions of capitalism. Briefly, capitalism is a system of private ownership of enterprises, with profit as its goal. The owners employ material equipment and human beings, who are called employees. The process of
production and delivery of goods and services yields a profit to the owners of capital, who are called capitalists.

Production takes place only when capitalists expect to make a profit. When profit declines, capitalists no longer invest. Instead, they curtail production. This loss of production costs employees their jobs. This scourge of unemployment is inflicted on employees in every recession or depression.

Chapter 3 will show that the amount of unemployment goes down in every capitalist expansion, but goes up again in every capitalist recession. The workings of the economic system with its roller coaster movements cause large-scale unemployment. How the economic system creates unemployment will be explored later in this book.

Unused Employees: A Closer Look at Unemployment

Let us begin by looking at exactly how the unemployment rate behaves over the roller coaster of the business cycle. The unemployment rate is the percentage of people without jobs compared to the total labor force. The Bureau of Labor Statistics of the U.S. Department of Labor (www.bls.gov) calculates the unemployment rate by means of a survey that is seasonally adjusted. The official rate of unemployment averaged over the last five business cycles fell by 42 percent in expansions as more employees were hired. The unemployment rate rose an average of 42 percent in the last five recessions as more employees were fired.

The total output and rate of employment of the economy always rise during expansions and fall during recessions. Both series move pro-cyclically, or with the business cycle. But the unemployment rate moves in the opposite direction to employment. The unemployment rate falls
during expansion, but rises in recessions. Its movements are countercyclical, or opposite to the business cycle.

During every expansion, the economy adds more and more production. To produce more, corporations hire more employees, adding to the number of employees in the labor force. As a result, the unemployment rate falls in the expansion. On the other hand, in a contraction more and more employees are fired, so the unemployment rate must rise.

**The Official Unemployment Rate and Its Shortcomings**

In May 2009, the official unemployment rate stood at 9.4 percent, meaning 14 million people were unemployed. That is a lot of unemployed people, but the number was still rising rapidly.

The Labor Department’s official unemployment rate, however, dramatically understates the extent of unemployment. First, the Bureau of Labor Statistics (BLS) does not count as unemployed any man or woman without a job unless they are still actively looking for work. If a person has become so discouraged that she did not actively look for a job in the previous four weeks, then she is not counted as unemployed. In fact, she is said to have dropped out of the labor force.

Second, the BLS leaves out part-time employees from the count of unemployed persons. Any employee whose hours are involuntarily reduced to fewer than forty hours is defined as a part-time worker. In every recession or depression, the number of people who can find only part-time jobs and those who are too discouraged to look for work rises rapidly. These categories of unemployed people have risen considerably so far in the Great Recession. The BLS calculates alternative unemployment rates that include these categories and therefore go a long way toward
correcting the shortcomings of the official unemployment rate. The broadest alternative measure of unemployment, called U-6, corrects for discouraged workers by counting as unemployed any person who currently wants a job, is available to work, and has looked for work in the last year. The U-6 unemployment rate also counts anyone involuntarily employed as unemployed.

Making those adjustments for May 2009, the unemployment rate soars to 16.4 percent. That was the highest rate since the BLS began calculating the U-6 rate in 1994 (for historical comparisons with earlier unemployment rates, see Bregger and Haugen 1995).

**The Misery and Waste of Unemployment**

The human misery of unemployment repeats itself with every downturn of the roller coaster economy. Unemployment even continues, if to a much lesser degree, when the economy expands. With each contraction of the economy, the social costs of this seemingly irrational economic system mount.

**Losses to Society**

Society suffers many types of losses from the contractions during business cycles. As the Great Recession has continued, thousands of factories have stood idle and millions of employees were unemployed, so society lost an enormous amount of potential output that could have been consumed. Society also lost potential production because very few new plants and very little new equipment were produced. This meant there was very little, if any, growth of productive potential for future expansion during the Great Recession. For that reason, every recession or depression lowers the long-run rate of growth. Society also has lost the new inventions that were
not discovered because there was less money for research and development. Society lost because millions of people were unable to work and to create to the best of their potential. Society lost because millions of people were frustrated and unhappy, and the social atmosphere was poisoned.

**Losses to Employees**

The greatest misery of the business cycle, however, is caused by the involuntary unemployment of millions of people. Every one of these individuals suffers the disruption of a useful life. Heads of families may not be able to maintain the standard of living to which their family is accustomed. Unemployed workers feel useless, believing their job loss is a personal failure. There is a measurable increase in mental and physical illness among the unemployed and their families. Increased unemployment is associated with increases in alcoholism, divorce, child abuse, crime, and even suicide. According to a grim, startling study published by the Joint Economic Committee of Congress (Brenner 1976), a sustained 1 percent increase in unemployment is associated with the following statistically significant percentage increases:

- suicide: 4.1 percent
- state mental hospital admissions: 3.4 percent
- state prison admissions: 4.0 percent
- homicide: 5.7 percent
- deaths from cirrhosis of the liver: 1.9 percent
- deaths from cardiovascular diseases: 1.9 percent
Social Problems Caused By Unemployment

The unemployed begin to feel isolated from society and alienated from others. They feel weak, unable to change their lives, and certainly unable to change society. Rather than combining with other people to protest, they often even stop voting in elections. They do not demand to know how a political candidate intends to reduce unemployment. Many simply withdraw from any action and feel helpless. They often lapse into mental depression. As shown above, the percentage of people with mental sickness rises in every area with heavy unemployment.

Unemployment often leads to unhappy marriages, especially if a spouse is convinced that a partner’s unemployment is due to that partner’s own laziness or stupidity. The data also show a close relationship between the percentage of unemployed people and the percentage of couples that get divorces. Every time the marriage of a couple with children is terminated, the children are harmed. After a divorce, some children withdraw into themselves. Other children become unruly. There are many minor symptoms of the unhappiness of children of divorced parents—for example, a rise in the number of children who stutter.

Another social problem worsened by unemployment is crime. In those communities in which many young adults have no jobs, they first sit around and talk about how bad things are. Then they are easy targets for gangs to recruit them to become criminals. People who ordinarily would not stoop to crime may see it as the only option to feed their family.

Crime rises in each city in very close relationship to the amount of unemployment. How is it possible to get rid of crime? People are willing to risk a jail sentence if they need to feed themselves or their family. But as soon as jobs open up, there are thousands of unemployed who
show up to compete for just a few jobs. In a recession or depression, the newspapers carry many photographs of these long lines.

These facts tell us the easiest way to reduce crime rapidly: just increase employment. People who have good jobs seldom go out to rob the corner grocery store. People who have no jobs just get more and more desperate.

**The Hunt for Clues Begins**

Americans can begin to solve the mystery by recognizing the following.

First, the business cycle is not a myth but a hard fact. The economy does not follow a path of steady growth, nor does it quickly return to it from any dislocation. Rather, there is a systematic pattern of expansions and contractions. In every expansion, production across the economy increases, while it falls in every contraction.

Second, the unemployment rate falls in every expansion, but rises in every contraction. The unemployment in a contraction, whether it is a small recession or a vast depression, is involuntary. This is shown by two undeniable facts. Millions of people are fired at the same time, with no choice. And advertisements for new jobs drop to a very small number.

Third, capitalism suffers from the curse of crises and recessions or depressions at the end of every period of prosperity. The result is periods of mass unemployment. Mass unemployment leads to feelings of isolation, weakness, and hopelessness for millions of individuals. For many of these people, the end result is loss of hope and dignity, loss of a spouse, mental illness, physical illness, and, in rare cases, suicide.
In the Great Recession, those costs are being visited upon Americans more than ever before since the Great Depression.