International Journal of Political Economy
Vol. 40, No. 3
Fall 2011

Marx and the Crisis

WITH ESSAYS BY
Riccardo Bellofiore
Vladimiro Giacché
Guglielmo Forges Davanzati
Geert Reuten
Fred Moseley
Andrea Micocci

IJPE

M.E.Sharpe

International Journal of Political Economy, vol. 40, no. 3, Fall 2011, pp. 59–71.
© 2011 M.E. Sharpe, Inc. All rights reserved.
ISSN 0891–1916/2011 $9.50 + 0.00.
DOI 10.2753/IJP0891-1916400305

FRED MOSELEY

The U.S. Economic Crisis

Fundamental Causes and Possible Solutions

Abstract: *This paper argues that the fundamental cause of the current economic crisis in the U.S. economy was a significant long-term decline in the rate of profit from the 1950s to the 1970s. Capitalists responded to this profitability crisis by attempting to restore their rate of profit by a variety of strategies, including wages and benefit cuts, inflation, speed-up on the job, and globalization. These strategies have largely restored the rate of profit, but have resulted in stagnant real wages for workers for decades. As a result, household indebtedness has increased to unprecedented levels and must be substantially reduced in order to make a sustainable recovery possible. In addition, increasing indebtedness in the financial sector has greatly increased the instability of the financial system, and this financial indebtedness must also be reduced significantly. In the event of another banking crisis, bankrupt banks should be nationalized and operated in the public interest.*

Key words: *current crisis, debt reduction, falling rate of profit, financial sector indebtedness, household indebtedness*

The U.S. economy recently experienced its worst crisis since the Great Depression. The crisis started in the home mortgage market in 2006, especially the subprime mortgages, and then spread beyond subprime to prime mortgages, commercial real estate, corporate junk bonds, and other forms of debt. As a result, U.S. banks have lost more than a trillion dollars, which has led to a sharp reduction in bank lending, which in turn has caused a severe recession in the U.S. economy.

The federal government responded to this severe recession with extreme policies. Fiscal policy (especially President Barack Obama's $800 billion stimulus package) was the most expansionary since World War II (and more expansionary than that

Fred Moseley is a professor of economics at Mount Holyoke College.

of the New Deal during the Great Depression). The Federal Reserve embarked on unprecedented monetary policies, including lowering the federal funds interest rate to almost 0 percent, emergency loans to investment banks and AIG, and large-scale purchases of long-term Treasury bonds.

After all these expansionary policies, the recovery from the recession so far has been weak and disappointing. The rate of growth has been slower than average (< 3 percent), and the rate of unemployment remains alarmingly high. The official rate of unemployment declined to 9 percent in January 2011 (but only because the official estimates of the labor force declined by half a million workers in the previous two months) and has declined by a million workers since the recession began. Assuming that the actual labor force in the U.S. economy has continued to increase at its normal rate since the recession began (1 percent a year), the real rate of unemployment in the U.S. economy today would be more than 12 percent, and this does not count an additional 5 percent to 6 percent who are working part-time but would prefer to work full-time.

This paper first analyzes the underlying causes of the current crisis, and how the crisis has evolved, and then analyzes what must be done in order to solve the remaining fundamental problems and make possible a lasting recovery. Then the government economic policies adopted so far will be evaluated in order to determine the extent to which these policies address and solve the remaining fundamental problems. The final section is a brief consideration of "what lies ahead." Perhaps the ultimate question of the paper is: Is the crisis over, or is the worst yet to come?

The Decline in the Rate of Profit

To understand the fundamental causes of the current crisis, we have to take a long-run view of the entire post–World War II period. The most important cause of the poor economic performance in the U.S. economy in recent decades was a significant decline in the rate of profit for the economy as a whole. According to Duménil and Lévy (2002), estimates of the rate of profit for the nonfinancial corporate business sector declined approximately 40 percent from the early 1950s to the early 1980s. Other estimates of the rate of profit by Roberts (2010) and Shaikh (2011) show a similar trend.

This significant decline in the rate of profit was the main cause of both of the "twin evils" of higher unemployment and higher inflation and, hence, also of the lower real wages of recent decades. As in periods of depression in the past, the decline in the rate of profit reduced business investment, which in turn has resulted in slower growth and higher rates of unemployment. An important new factor in the postwar period is that many governments in the 1970s responded to the higher unemployment by adopting expansionary fiscal and monetary policies (more government spending, lower taxes, and lower interest rates) in attempts to reduce unemployment. However, these government policies to reduce unemployment generally resulted in higher rates of inflation, as capitalist firms responded to the

government stimulation of demand by raising their prices at a faster rate in order to restore the rate of profit, rather than by increasing output and employment.

In the 1980s, financial capitalists revolted against these higher rates of inflation and generally forced governments to adopt restrictive policies, especially tight monetary policy (higher interest rates). The result was less inflation but also higher unemployment. Therefore, government policies have affected the particular combination of unemployment and inflation at a particular time, but the fundamental cause of both of these "twin evils" is the decline in the rate of profit.

Strategies to Restore the Rate of Profit

Capitalists have responded to the decline in the rate of profit by attempting to restore the rate of profit in a variety of ways. In the past three decades, the U.S. economy has been characterized above all else by attempts by capitalists to raise the rate of profit up to its earlier, higher levels.

I have already mentioned the strategy of inflation, that is, of increasing prices at a faster rate, which reduced real wages or at least avoided increases in real wages, so that all the benefits of increasing productivity in recent decades have gone to higher profits. More recently, more and more companies have actually reduced money wages for the first time since the Great Depression. Many workers have been faced with the choice of either accepting lower wages or losing their jobs. As a result of these strategies, the average real wage in the United States has hardly increased since the mid-1970s (Rasmus 2004).

Another widespread strategy has been to cut back on health insurance and retirement pension benefits. Workers have to pay higher and higher premiums for health insurance, and many workers who thought that they would have a comfortable retirement are receiving a rude awakening and probably will have to work longer, leaving fewer jobs for younger workers. In fact, an article published not long ago in the *New York Times Magazine* was titled "The End of Pensions" (Lowenstein 2005).

Another common strategy for increasing the rate of profit is to make workers work harder and faster on the job; in other words, to make them "speed up." Such a "speed-up" in the intensity of labor increases the value produced by workers and therefore increases profit and the rate of profit. The higher unemployment in recent decades contributed to a "speed-up," as workers were forced to work harder to compete with one another for fewer available jobs. Yet another common business strategy is "downsizing," that is, laying off 10–20 percent of a firm's employees and requiring the remaining workers to do the work of the laid-off workers. This method also generally increases the intensity of labor even before the workers are laid off, as all workers work harder to avoid being among those who are laid off.

A more recent strategy has been to use *bankruptcy* as a way to cut wages and benefits drastically. Companies declare Chapter 11 bankruptcy, which allows them to continue to operate and renegotiate their debts, and most importantly to declare

their union contracts null and void. This strategy was pioneered by the steel industry in the 1990s, and has spread to the airlines industry in recent years. Half the airline companies in the United States have been in Chapter 11 bankruptcy, and they have made very steep cuts in wages and benefits (25 percent or more).

The most drastic example of this strategy is Delphi Auto Parts, the largest auto parts manufacturer in the United States, which was owned by General Motors until 1999. Delphi declared Chapter 11 bankruptcy in October 2006 and announced that it would cut wages by approximately two-thirds (from roughly $30 per hour to about $10 per hour), and would reduce benefits correspondingly. The Delphi chief executive (who used to work in the steel industry) has publicly urged the automobile companies to follow the same strategy. This strategy could spread to the unionized companies in the rest of the manufacturing sector of the economy in the years ahead.

Another increasingly important strategy by capitalists to reduce wage costs has been to move their production operations to low-wage areas around the world. This has been the main driving force behind the globalization of recent decades: a worldwide search for lower wages in order to increase the rate of profit. This is the essence of globalization. This strategy also puts more downward pressure on wages in the United States, because of the much greater threat of outsourcing jobs to other countries. The North American Free Trade Agreement (NAFTA) and the Central America Free Trade Agreement (CAFTA) are, of course, very important parts of this overall globalization strategy to reduce wages and increase the rate of profit.

Therefore, we can see that the strategies of capitalist enterprises to increase their rate of profit in recent decades have in general caused great suffering for many workers: higher unemployment and higher inflation, stagnant real wages, and increased insecurity and stress and exhaustion on the job. Marx's "general law of capitalist accumulation," namely that the accumulation of wealth by capitalists is accompanied by the accumulation of misery for workers, has been all too true in recent decades in the U.S. economy (and of course in most of the rest of the world). Most American workers today work harder and longer for less pay and lower benefits than they did several decades ago. It appears to be the end of an era in which blue-collar workers in the United States could be part of the middle class.

It appears that this all-out campaign by capitalists to increase the rate of profit in all these ways has been modestly successful in achieving this objective. It has taken a long time, but the rate of profit has recovered most of the previous decline. The usual estimates of the rate of profit do not include the profits of U.S. companies from their production abroad, only from domestic production. These estimates also do not include the multi-million dollar salaries of top corporate executives. But these estimates do include a large and increasing percentage of financial sector profits (approximately one-third of total profit in recent years has been financial profit), much of which will probably turn out to be fictitious (i.e., anticipated future earnings that are "booked" in the current year, but will probably never materialize because

of the crisis). All in all, I conclude that there has been a substantial (although not complete) recovery of the rate of profit in the United States.

As seen above, this recovery of the rate of profit of U.S. companies has been accomplished at the expense of American workers. It has also been accomplished without a major depression in the U.S. economy. I think this would have surprised Marx, who argued that just cutting wages would generally not be enough by itself to fully restore the rate of profit, and that what would usually be required in addition is a deep depression characterized by widespread bankruptcies, which would result in a significant devaluation of capital. That has not yet happened in the U.S. economy, and yet the rate of profit appears to be mostly restored. But I don't think that Marx envisioned reducing wages by as much as 90 percent, which has been made possible by "globalization" and the doubling of the global industrial reserve army.

Increase of Household Debt

Surprisingly and disappointingly, the recovery of the rate of profit has not resulted in a substantial increase in business investment, and thus has not led to an increase of employment as would normally be expected. Business investment as a percentage of the gross domestic product (GDP) has remained at low levels in spite of the recovery of the rate of profit. Instead of investing in business expansion, owners and executives have chosen to spend their higher profits in other ways besides. They have: (1) paid out higher dividends to stockholders (i.e. to themselves); (2) "bought back" shares of their own company, which has increased the prices of their stock and increased their executive compensation; (3) loaned the money (e.g., for mortgages), thereby contributing to the financial speculative bubble in recent years; and (4) invested their profit in low-wage areas of the world rather than in the United States ("globalization," as discussed above). Therefore, workers have not even benefited through the "trickle down" effect of more investment leading to more jobs. Instead, capitalists have spent their increased profits on luxury consumption (e.g., airplanes, expensive automobiles, multiple vacation homes), and unemployment has remained high.

An important further consequence of the higher profits and the continued weakness of business investment is that banks had lots of money to lend, but non-financial corporations did not have much need to borrow. Therefore, banks searched for new borrowers. Meanwhile, workers were strapped with stagnant wages for decades and were all too eager to borrow money to buy a house or a new car, and sometimes even basic necessities. Therefore, banks increasingly focused on *workers* as their borrower-customers, especially for home mortgages over the last decade or so. The percentage of total bank lending going to households increased from 30 percent in 1970 to 50 percent in 2006. The total value of home mortgages *tripled* between 1998 and 2006, and the ratio of household debt to GDP more than doubled, from 45 percent in 1970 to 95 percent in 2007. This was an extraordinary increase of

household debt, unprecedented in U.S. history (the ratio of household debt to GDP in 1929 was 25 percent). In this way, the profitability crisis for firms has evolved into an overindebtedness crisis for households.

Banks even increased lending to low-income workers, especially with "subprime" mortgages that required little or no down payment and little or no documentation of the borrower's income. Subprime mortgages as a share of total mortgages increased from 7 percent in 2000 to 20 percent in 2006. However, after two to three years, the interest rates on these subprime mortgages had to be adjusted upward and the monthly payments increased significantly, making them unaffordable for many low-income borrowers. The strategy was that by the time the interest rates had to be adjusted upward, the value of their homes would have increased enough (it was universally assumed that housing prices would continue to increase forever) for a new mortgage to be taken out (with a higher level of debt) and the old mortgage paid off. This strategy ceased to work in 2006, when housing prices stopped rising and have declined an average of 25–30 percent since then. Old mortgages could no longer be refinanced, borrowers were stuck with higher reset mortgage rates they could not afford, and the default and foreclosure rates started to soar.

Since the housing crisis began, about 5 million houses have been foreclosed on, and it is estimated that at least another 5–7 million will be foreclosed in the years ahead (depending mainly on how long unemployment remains high). This would be a total of 20–25 percent of all mortgages in the United States, which rivals the Great Depression. The American dream of owning your own home is turning into an American nightmare for millions of families.

Increase of Financial Sector Debt

Another important aspect of the current crisis is that there has been a fundamental change in the source of funds for U.S. banks in recent decades. Banks used to depend primarily on *deposits* as their main source of funds to loan out. However, in recent decades, banks have relied increasingly on *debt* (i.e., on money borrowed from insurance companies, pension funds, money market funds, etc.) as a major source of funds to loan out (as much as 50 percent of total funds for some of the largest banks). Debt financing enables banks to "leverage up" their equity and thus earn a higher rate of return on their equity. A 2 percent rate of return on a loan, with a 20:1 leverage ratio, becomes a 40 percent rate of return on the bank's equity.

However, this increasing dependence of banks on debt financing also makes the banking system *more* unstable and more vulnerable to crises. That is why we are experiencing such a serious banking crisis today—because the big banks themselves are so heavily in debt. As a result of this new debt financing strategy, banks' losses quickly wipe out their small amount of equity and threaten losses for the banks' creditors. Since bank debt is not guaranteed by the government (only bank deposits are so guaranteed), the short-term creditors of banks that are suffering losses will want their money back as soon as possible. This results in a modern-day "run on the banks," but these modern runs are not by depositors (as in the old days) but by the banks' *creditors* (especially short-term creditors). This is a completely new phenomenon. It was not present in the Great Depression or nineteenth-century depressions, and it greatly adds to the instability of our banking system.

Another new source of the U.S. financial system's instability is the rapid growth of the "shadow banking system," such as hedge funds and private equity funds, which were not regulated at all and which borrow almost all the money they invest. These new financial institutions often have leverage ratios of 50:1 or higher, and are therefore even riskier and more unstable.

As a result of the financial sector's increasing reliance on debt as a major source of funds, the ratio of financial sector debt to GDP has increased enormously, from about 20 percent in 1980 to 120 percent in 2008![1] Financial sector debt was almost nonexistent in 1929.

In sum, I argue that the main problem in the U.S. economy at the present time is *too much debt* in relation to income, especially household debt and financial sector debt. Such debt is far beyond previous record levels and makes the economy more unstable and more vulnerable to a crisis because in a downturn, heavily indebted debtors are not able to keep up with their debt payments. In recent decades, the U.S. economy has gone from suffering a "falling rate of profit" crisis to suffering from an "overindebtedness" crisis. The strategies used to restore the rate of profit have resulted in unprecedented and very dangerous overindebtedness.

Possible Solutions to "Overindebtedness"

It follows from the above analysis that a necessary condition for a lasting solution to this crisis is a significant reduction in the ratio of debt to GDP, or debt to income, especially in the household and financial sectors. In general, there are three ways to accomplish the necessary reduction in the debt-to-GDP ratio. These three ways can be illustrated by the following simple equation, which decomposes GDP in the denominator of this ratio into the product of the price level (P) times the quantity of real output produced (Q):

$$D/GDP = D/(PQ).$$

This ratio can be reduced in three general ways .

1. *Real growth.* The preferred way to reduce the debt-to-GDP ratio is for GDP in the denominator to grow faster than the debt in the numerator, as a result of real growth in the econom (↑Q), without a corresponding increase of debt (↑D) (that is, "grow our way out of overindebtedness"). Unfortunately, that preferred solution is not very likely to happen in the U.S. economy in the years ahead. In the U.S. economy today, faster growth is possible only as a result of increased debt. But increasing growth and GDP by means of increasing debt does not solve the fundamental problem of too much debt in relation to GDP. The numerator debt increases almost as much as (or more than) the denominator GDP.

2. *Inflation.* A less preferred way to reduce the debt-to-GDP ratio is to increase GDP in the denominator by means of inflation (↑P) (that is, "inflate our way out of overindebtedness"). However, inflation would have to be very high for many years in order to be an effective solution to over-indebtedness. Assuming that the debt level remains constant, it would take four to five years of a 10–15 percent rate of inflation to return the overall private debt-to-GDP ratio to its 1980 level (and its level in 1929, which was 150 percent). But if debt remained constant over this period, then there would probably be little or no growth and hence increasing unemployment. So we would have the worst of both worlds, both double-digit inflation and double-digit unemployment. In other words, we would have a return to "stagflation"—but worse than in the 1970s and 1980s, when the word was coined. So that is not a good solution.

3. *Debt reduction.* There are two main ways to reduce debt in the numerator of the debt-to-GDP ratio: reduce the amount of debt owed through some process of bankruptcy or quasi-bankruptcy, or pay off part of the debt out of current income ("deleveraging").

3a. *Bankruptcy.* The classic way to reduce the debt of businesses (both nonfinancial and financial) throughout the history of capitalism has been through the *bankruptcy* of insolvent firms. There are two types of business bankruptcies. In *liquidation bankruptcies,* the assets of the bankrupt company are sold off and the proceeds used to pay the creditors of the bankrupt company a fraction of the money owed to them (usually a small fraction). The rest of the debt is "wiped out." In temporary bankruptcies (called Chapter 11 bankruptcies in the United States), the bankrupt company continues to operate and the creditors either accept a significant writedown of the debt (a haircut, as it is called in the industry), or agree to convert a portion of their debt into equity in the newly reorganized company, or some combination of the two, both of which reduce the outstanding debt of the reorganized company.

But of course bankruptcies of businesses are usually very painful and result in further disruptions of the economy and a deeper depression, especially in the case of liquidation bankruptcies. But in the past these bankruptcies did at least succeed in significantly reducing the overall debt level in the economy, which laid the foundation for a lasting recovery from a crisis.

A similar process of temporary bankruptcies also applies to households (obviously households are not "liquidated"). Personal bankruptcies also wipe out a part of the debt owed to creditors and the households get a "fresh start" (although with damaged credit ratings), with less disruption of the economy than in business bankruptcies.

3b. *Deleveraging.* The second way to reduce debt in the numerator is for debtors to pay down part of the debt out of their current income, and not renew that borrowing. This method is less painful than bankruptcies in the short run, but takes much longer. Paying off debt with current income reduces spending on current output. For example, there is less investment by firms, less consumption by households, and less lending by banks, all of which result in slower growth. And since the total debt level now is so high (260 percent), it would probably take years (roughly a decade) to reduce the overall debt-to-GDP ratio to its 1980 level (120 percent) by this means of deleveraging.

This "deleveraging with slow growth" appears to be the most likely scenario for the U.S. economy in the years ahead. But many years of slow growth would also mean many years of very high unemployment, which in turn would cause more defaults on home mortgages and more losses for banks, which would probably precipitate another serious banking crisis eventually and an even more severe recession, which would make the bankruptcy scenario more likely.

Government Policies

This section briefly discusses the effects of the extraordinary government economic policies adopted in recent years by the administrations of George W. Bush and Barack Obama and the Federal Reserve (the Fed) in order to try to contain the crisis and stimulate a recovery, with special attention to the effects of these policies on the debt-to-GDP ratios of the different private sectors of the economy discussed above. The key question is: do these government policies lead to a significant reduction in these debt ratios? Fiscal and monetary policies are examined first, then the home mortgage modification programs and the bank bailouts.

Fiscal and Monetary Policies

With respect to debt reduction, the aim of the very expansionary fiscal and monetary policies adopted is precisely to *avoid bankruptcies* and the disruptions and deeper depression that they cause. Therefore, these policies obviously do not reduce the private debt ratios.

With respect to growth, these policies almost certainly resulted in somewhat faster growth than would have otherwise been the case. However, growth has so far been slow, and is likely to remain slow in the years ahead (due in part to deleveraging). If there is faster growth, it would be due mainly to the increase of debt created by the Fed. As discussed above, increasing growth and income by means of increasing debt does not reduce the debt-to-GDP ratio. Therefore, it is not likely that policy-induced growth will reduce the private debt ratios in the years ahead.

With respect to inflation, it is possible that the combination of very expansionary fiscal and monetary policies might result in a higher rate of inflation, and thus could land us in serious stagflation, as discussed above. And again, because the increase of income is the result of an increase of debt, the debt-to-GDP ratio would not be significantly reduced. Inflation in the years ahead is the main worry of some mainstream economists. The Fed is saying that it has an "exit strategy" that will avoid higher inflation. But if the Fed is successful in avoiding higher inflation, then the debt to income ratio would not be reduced by this means.

In addition, as a result of the very expansionary fiscal policy, the federal budget deficit more than tripled in two years, from $450 billion in 2008 to $1.5 trillion 2010 (that is, from 3 percent to 10 percent of GDP). The 2010 deficit declined slightly, but the 2011 deficit is forecast to increase again to $1.65 trillion, due mainly to the extension for at least two more years of tax cuts for the rich instituted under the Bush administration. As a result, the government debt-to-GDP ratio will likely increase from around 40 percent to around 100 percent by the middle of the decade. Ultimately, the government debt has to be paid out of income generated in the private sector. Therefore, adding more government debt is only a short-term solution (at best), and is not likely to provide a long-term solution for too much private debt in relation to private income.

Finally, the Fed's extraordinary lending policies obviously do not reduce the amount of private debt. If anything, these policies increase debt, especially of financial institutions and also of households. To a large extent, the increased Fed lending has offset reduced private lending, with a net result of little or no increase of total debt. But certainly there has been no reduction of debt as a result of the Fed's extraordinary lending policies. It is hard to see how an overindebtedness crisis could be solved by still more debt, especially in the financial sector, which is the most overindebted sector.

Joseph Stiglitz (a Nobel Prize–winning economist) has recently stated that the Fed's policies simply perpetuate the bubble and are a variation of the same policies that created the debt bubble in the first place. Stiglitz had in mind the very expansionary monetary policy of Fed chairman Alan Greenspan, especially as implemented during the 2001–2 recession, when the target interest rate was reduced to 1 percent (for the first time since the end of World War II) to avoid a more serious recession. But avoiding a more serious recession then has led to an even more serious crisis now. And I fear that the Fed's current, significantly more expansionary monetary policy in this recession will lead to an even greater crisis in the future. The Fed's policies buy some time, but they do not solve the fundamental problem of too much debt. If anything, they make the fundamental problem worse.

Mortgage Modifications

Here, the government had a real chance to get to the root of the problem by requiring a reduction of the amount of mortgage debt owed by homeowners to banks and other creditors. Many economists have suggested that the mortgage debt should be reduced to the current value of the house. On average, this would require a reduction of about 20 percent in the amount owed. Such a writedown of mortgage debt would go a long way toward a reduction of household debt, which is necessary to provide the foundation for a sustainable recovery. Household debt levels would still be high but less so, and therefore more manageable.

But, of course, the banks and other mortgage investors have strongly opposed mandatory "writedown" policies because they would mean recognizing their losses. Both the Bush and the Obama administrations have given in to the banks and thus have missed this key chance to force a reduction of household debt and thereby help solve the overindebtedness crisis. Both the Bush and the Obama mortgage modification programs have been voluntary on the part of the banks, and so far very few banks have "volunteered."

I suggest that it would be much better for the government to simply mandate that whatever the market value of the house is now, that is the amount the homeowner owes to the banks. This would force the banks to pay for their own losses, which is the way it should be, rather than taxpayers paying for the banks' losses. Although the household debt-to-GDP ratio has declined slightly, from 95 percent to 90 percent, it is still twice as high as its 1980 level—45 percent.

Bank Bailouts

Here was another opportunity for the government to help solve the overindebtedness crisis by forcing a reduction of the debt owed by banks that were insolvent.[2] However, both the Bush and the Obama administrations have missed this opportunity as well. In general, the bank bailouts have channeled money, in one way or another, now or in the future, from taxpayers to banks and their creditors. Instead of debt reduction, the creditors are being paid in full—with taxpayer money—and the problem of the overindebtedness of the financial sector remains.

Bank bailouts have come in three main versions : (1) purchasing the banks' toxic assets at inflated prices to help restore the banks to solvency and enable them to pay off their creditors; (2) investing capital in the banks to provide a cushion against future losses and, again, enable them to pay off their creditors (this was the main policy); and (3) providing insurance for the banks' toxic assets at inflated values and with insufficiently low premiums (specifically in the bailouts of Citigroup and Bank of America), which makes it likely that the government will have to pay for future claims of default on these toxic assets. This latter policy is deceptive. Little or no government money has to be spent now, but will probably have to be spent in future years, and by then it will be too late to stop the payments of taxpayer money to the banks because the government insurance guarantees will have already been given by these bailouts.

Banks also benefited from other government policies implemented by the Fed and the Federal Deposit Insurance Corporation (FDIC), as well as the government takeover of Fannie Mae and Freddie Mac. The main Fed policy that benefited the banks was its zero-interest-rate policy, which enabled the banks to borrow from the Fed at zero interest and buy Treasury bonds at 3 percent or lend at 5 percent. Banks also benefited from the FDIC policy of guaranteeing all new debt issued by the banks—in unlimited amounts (the Temporary Lending Guarantee Program). This has made it possible for the banks to borrow money at a lower rate of interest

than they could without this guarantee (0.5–0.75 of a percentage point lower). In addition, Fannie Mae and Freddie Mac have purchased almost 100 percent of the new mortgages issued since the crisis began. Without this support, the mortgage market would have completely collapsed, and with it the value of the banks' mortgages and mortgage-backed securities.

As a result of this massive government support, the banking system avoided a collapse and the financial condition of banks, especially the larger banks, has improved. The Congressional Budget Office (2011) estimates that all the capital invested in banks will be repaid, and the government will even make a small profit. These estimates do not count the hundreds of billions of dollars of direct or indirect subsidies for the banks due to the government policies discussed in the previous paragraph.

From the perspective of this paper, the crucial point about the bank bailouts is that they have not led to a sufficient reduction in the debt-to-GDP ratio in the financial sector. This ratio has declined some (from 120 percent to 100 percent), but still remains far above its 1980 level of 20 percent. An amendment was proposed to the Dodd-Frank Wall Street Reform and Consumer Protection Act that would have limited the debt-to-equity ratio of banks to 15:1, but this amendment was not included in the final act.

What Lies Ahead?

As stated above, I think the most likely scenario for the U.S. economy over the medium term is continued slow growth and very high rates of unemployment. Long-term unemployment will become an increasingly serious problem for millions of Americans. As a result, there will probably be more defaults on home mortgages, which in turn will cause more losses on mortgages for banks. At some point, there will likely be another serious banking crisis, and an even deeper recession or depression.

If another banking crisis does occur, the government should *definitely not* bail out the failing banks, but should instead *nationalize* any large bank that is failing, and operate these banks as public banks. Such nationalization of failing banks should also involve the reduction of their debt to a level consistent with the value of their assets, which would reduce the overall financial sector debt-to-GDP ratio.[3]

However, even the nationalization of failing banks might not be enough to reduce the currently very high debt-to-GDP ratios to sustainable levels, and the economy could still eventually fall into a deeper depression. In that case, the only way to avoid a deep and prolonged depression would be to fundamentally change the economic system from a profit-making capitalist economy to a democratic socialist economy, the main goal of which would be to produce what people need rather than profit for a minority elite. I hope there will be a broad social movement to accomplish that fundamental change in the U.S. economy, and I urge readers to participate in building that movement.

Notes

1. These estimates do not include the debt of the "shadow banking system" (hedge funds, private equity funds, etc.), and thus *understate* the true level of financial sector debt.
2. See Moseley (forthcoming) for further discussion of the bank bailouts.
3. See Lapavitsas (2009) for an extensive discussion of the further benefits of the nationalization of banks.

References

Duménil, Gérard, and Dominique Lévy. 2002. "The Profit Rate: Where and How Much Did It Fall? Did It Recover?" *Review of Radical Political Economics* 34, no. 4: 437–61.

Lapavitsas, Costas. 2009. "Systematic Failure of Private Banking: A Case for Public Banks." www.researchonmoneyandfinance.org/media/papers/RMF-13-Lapavitsas.pdf, accessed June 18, 2010.

Lowenstein, Roger. 2005. "The End of Pensions." *New York Times Magazine* (October 30), www.nytimes.com/2005/10/30/magazine/30pensions.html?pagewanted=all/, accessed October 30, 2005.

Moseley, Fred. 1997. "The Rate of Profit and the Future of Capitalism." *Review of Radical Political Economics* 29, no. 4: 23–41.

———. forthcoming. "The Bailout of the 'Too Big to Fail' Banks: Never Again." In *Handbook on the Political Economy of Financial Crises*, ed. G. Epstein and M. Wolfson. New York: Oxford University Press.

Rasmus, Jack. 2004. *The War at Home: The Corporate Offensive from Ronald Reagan to George W. Bush*. San Ramon, CA: Kyklos Productions.

Roberts, Michael. 2010. *The Great Recession: Profit, Cycles, Economic Crisis: A Marxist View*. www.archive.org/details/TheGreatRecession.ProfitCyclesEconomicCrisisAMarxistView/, accessed January 8, 2011.

Shaikh, Anwar. 2011. "The First Great Depression of the 21st Century." *Socialist Register* 47: 44–63.

United States Congressional Budget Office. 2011. *Report on the Troubled Asset Relief Program–March 2011*. www.cbo.gov/ftpdocs/121xx/doc12118/03–29-TARP.pdf, accessed April 11, 2011.

To order reprints, call 1-800-352-2210; outside the United States, call 717-632-3535.