Profit Growth in Boom and Bust: 
The Great Recession and the Great Depression 
in Comparative Perspective 
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**Abstract**

The Great Recession of 2007-9 and the Great Depression of the 1930s were triggered by the collapse of asset-price bubbles. However, preexisting structural imbalances in the US economy were the reason why the burst of speculative bubbles induced a general economic collapse. This paper argues that the imbalance created by the combination of stagnant labor earnings and surging corporate profits not only played a leading role in the run-up to the downturns but was chiefly responsible for the slow recoveries. On the one hand, the relative stagnation of labor income represented a key factor behind rising income inequality and a potential drag on consumption which was temporarily alleviated by credit expansion; hence, the rising household debt levels which eventually became unsustainable. On the other hand, rising corporate profits created an overhang of idle money, eager to lend itself to speculative ventures, which played a key role in fueling the stock market bubble of the 1920s and the housing bubble of the 2000s. The paper further argues that despite various superficial and deeper similarities between the circumstances surrounding the Great Recession and the Great Depression, some fundamental differences in the structure of the US economy then and now suggest vastly different future prospects for American capitalism.
Introduction

The panic that started in the US mortgage and securities markets in the summer of 2007 triggered a domestic and global, financial and economic crisis which became widely known as the Great Recession (GR). In more respects than one, the GR was an unusual crisis. What sets this downturn apart from all other crises in post-Depression US history is that the officially announced end of the recession in June 2009 was not followed by anything resembling a typical postwar recovery. While corporate profits quickly returned to and surpassed pre-recession levels, investment and employment have been unusually slow to recover.

The GR has evoked numerous comparisons with the deepest structural crisis of the twentieth century – the Great Depression (GD) of the 1930s. Both downturns were triggered by asset-price bubbles – a stock market bubble in the late 1920s and a housing bubble in the 2000s. However, preexisting structural imbalances in the US economy were the reason why the burst of speculative bubbles induced general economic collapse. This paper examines one of those imbalances arising from the highly unequal growth of property income relative to labor income. My key argument is that the combination of relatively stagnant labor income and surging corporate profits not only played a leading role in the run-up to the downturns but was chiefly responsible for the slow recoveries. This analysis reveals similar dynamics behind the boom and the bubble of the 1920s and the 2000s: sluggish wage growth and falling labor share of national income, deepening inequality with heavy concentration of wealth gains at the top of the income distribution, correspondent mounting indebtedness among lower- and middle-income households, surging corporate profits and a corporate saving glut seeking financial ventures. Thus, two causal mechanisms underlay the structural fragility of the economy then and now. On the one hand, the stagnation of labor earnings represented the key factor behind rising income inequality and a potential drag on consumption which was temporarily alleviated by credit expansion; hence, the
rising household debt levels which eventually became unsustainable. On the other hand, rising corporate profits created an overhang of idle money, eager to lend itself to speculative ventures, which played a key role in the fueling of the stock market bubble of the 1920s and the housing bubble of the 2000s.

This analysis begins with an examination of the asset bubbles that triggered the GD and the GR. It then highlights the similar dynamics behind the bubbles and their burst, and concludes with an attempt to look beyond apparent similarities in order to outline some fundamental differences. Thus, my second key argument is that despite multiple similarities in the factors and circumstances surrounding the GR and the GD, the fundamental differences in the structure of the US economy then and now suggest vastly different future prospects for American capitalism.

This study is centered on the US for reasons that extend beyond the fact that both crises originated there. The critical position of the US in the world economy, based on the relative size of its economy, the ownership of the key international currency, and its dominant role in the global financial markets, not to mention its political and military clout, conveys enormous leverage along with the ability to significantly influence events worldwide. But a no less important part of the reason lies in the fact that over the last 120 years the US has represented a pivotal site of global capitalism where ‘the worldwide frontier of productivity and the standard of living have been carved out’ (Gordon, 2012). As the ultimate purpose of the study of capitalism’s past is to offer a glimpse into its future, what could be more instructive than exploring that singular epicenter of transformation and social change where pioneering production methods and social practices, later to become universally accepted, had first been born?

2. The Boom and the Bubble: Then and Now

Financial crises are often preceded by credit booms that follow a familiar dynamic. At the early
stages of the business cycle, credit offered by private banks and financial markets can significantly contribute to economic expansion by stimulating production and consumption. Traditionally, central banks have been conditioned to react primarily to inflation concerns. Thus, if for whatever reason the price level remains relatively stable, the central bank has little incentive to interfere with the growing ‘prosperity’. But even without a rise in the general price level, credit expansion eventually translates into inflation of asset values. There are different channels through which a credit boom may lead to financial distress depending on what particular asset class becomes the main target of investors and speculators. Housing and securities are typically the most favored targets. The GD and the GR were both preceded by a housing market and a stock market bubble, although in a reversed order.

The ready availability of credit to the US economy played a key role in the economic expansion of the 1920s. The credit boom was particularly pronounced in the second half of the decade reaching its peak in 1928 (Eichengreen & Mitchener, 2004). Credit expansion unfolded in three distinct but mutually reinforcing directions. The first direction was related to an upsurge of mortgage lending particularly boosted by new entrants into the business. Mortgage funding, which had accounted for less than 45 percent of residential construction finance before World War One, reached almost 60 percent at the height of the housing boom in the mid-1920s (White, 2009). The second direction concerned the consumer revolution of the 1920s characterized by a shift to major consumer durables with the automobile playing the most prominent role at the expense of minor consumer durables, nondurables, and savings (Olney, 1991). The key lever of rising spending on consumer durables became installment credit provided mainly by nonbank lenders whose aggressive competition to supply households with credit allowed consumer spending to rise faster than personal income. The third direction of credit expansion concerned the purchase of stocks through the so-called brokers’ loans financed originally mostly by bank credit but after the mid-1920s
increasingly from funds provided by nonbank lenders, such as corporations and wealthy individuals. An often neglected fact that this analysis seeks to highlight is that the credit boom in the late 1920s and in the 2000s came on the top of a profit boom. The resultant glut of loanable funds led and sustained the credit surge and the general economic euphoria.

The Stock Market Bubble of the 1920s

The Wall Street crash of 29 October 1929 has been symbolically associated with the beginning of the GD which lasted an entire decade. Galbraith (2009[1954]) dates the beginning of the stock market bubble as of March 1928. Scores of writers have debated the causes of the spectacular rise in stock prices that took place between the early 1928 and October 1929. A review of this literature should not detain us here. Suffice it to say that opinions roughly fall into the one of two categories: those that argue that rising stock prices were justified by economic fundamentals (Irving Fisher was a famous example at the time), and those that attribute the boom to speculation (e.g. Galbraith 2009[1954]). The view taken here is that the stock market rally can best be explained as having indeed been a bubble. However, I am skeptical of some of the explanations for what caused the bubble offered by the speculation school, such as that margin requirements were too low, along with the related claim that if those requirements had been higher, the bubble would have been avoided.

Despite widely circulated popular perceptions that low margin requirements (i.e. ‘lack of regulation’ in present-day parlance) caused the stock market bubble that peaked in 1929, there is no actual evidence that those requirements were low by historical standards. While this line of reasoning does not discount the notion that the ability to purchase shares on margin has facilitated speculation, it does not see this ability as the underlying cause of the speculative spree that unfolded. In fact, margin requirements before late 1928 were not lower than those prevailing since the early twentieth century or even earlier. Moreover, from around October 1928 margin requirements started rising
towards extraordinarily high levels. Even Galbraith (2009[1954]: 32), a popularizer of the argument that if margin requirements were raised to, say, 75 percent in January 1929 the speculative boom would have ended then, cites actual margins of 45 to 50 percent which, as Irving Fisher noted, were higher than ever before in the history of Wall Street (Smiley and Keehn, 1988). Moreover, due to growing concerns over the stock market rally, by mid-1929 most brokers were raising margin requirements to 50 percent on most stocks and to 60-75 percent on more risky stocks (Rappoport & White, 1994, 274). In light of this evidence, one is tempted to ask, if indeed low margin requirements were the decisive factor in stock market speculation, why did not the bubble occur before late 1928 when said requirements did not exceed 25 percent and were occasionally as low as 10 percent? The view taken here is that two factors made a particular difference in the late 1920s: the spectacular growth of brokers’ loans and the rising share of such loans coming from nonbank sources, such as corporations and wealthy individuals. Wright (1929) traces the origins of this ‘flood of money for the financing of speculation’ to the large post-World War One gold imports propping up the easy money policy of the banks which stimulated business expansion, new capital issues, and refinancing at low rates. The resultant surge of corporate profits created surplus funds which flowed into the call market and fed the stock market boom.

Brokers’ loans were loans made to stockbrokers enabling them to purchase securities for their clients on margin. Consistent reporting of such loans did not exist before 1918. Between that year and 1923, the volume of brokers’ loans at the New York Stock Exchange fluctuated between $1 and 2 billion and started to increase rapidly afterwards. By the end of 1925 brokers’ loans reached $3.5 billion, by the end of 1927 nearly $4.5 billion, and at the peak of 1929, more than 8.5 billion (Snyder, 1930). Brokers’ loans consisted of ‘time loans’, almost exclusively offered by banks, and ‘call loans’, supplied by nonbank sources. The practice of wealthy individuals and corporations lending temporarily idle funds to the brokers for margin purchases existed even before World War
One. But the share of call loans in total brokers’ loans after the war rarely exceeded 30 percent with the exception of a temporary rise in 1920-1. This share started to expand from the mid-1920s on to reach 77.89 percent in October 1929 (Smiley & Keehn, 1988, 136, Table 1). The composition of brokers’ loans from nonbank sources in September 1929 as reported by the six largest member banks in New York City was as follows: corporations – 56 percent; individuals – 20 percent; investment trusts – 14 percent; and foreign – 10 percent (Ibid, 137). The main source of corporate funds flowing into brokers’ loans was retained earnings. The main reason for directing the latter into brokers’ loans was that interest rates on call loans exceeded possible returns on any other type of investment, let alone saving. The peak amount advanced to brokers by corporations ranged from $500,000 to $157,579,000. During 1929, Standard Oil of New Jersey contributed a daily average of $69 million to the call market while Electric Bond and Share averaged over $100 million (Galbraith, 2009[1954]: 31).

In 1928-29, there was a lively debate among academics and policy-makers about the effects of diversion of credit from what was considered legitimate business purposes into speculative stock-market transactions. The Federal Reserve’s (Fed) growing concern over the ‘extraordinary absorption of funds in speculative loans, which has characterized the credit movement during the past year or more’ and the fear of possible ‘detrimental effects on business’ (Federal Reserve Bulletin, 1929) informed its policies over that period. Between January and July 1928, the discount rate was raised from 3.5 to 5 percent. A further increase to 6 percent followed in February 1929. These actions did not seem to make much of a difference to the supply and demand for loans in the call market where interest rates fluctuated between 6 and 20 percent. As these high interest rates made it more profitable for companies and wealthy individuals to lend money on call than to buy commercial paper, a major reallocation of credit in the money and capital markets ensued. Thus, between September 1927 and September 1929 commercial paper outstanding declined from $600
million to $265 million which increased the demand for commercial bank loans, discounts, and Federal Reserve funds. Wright (1929, 124) sums up the overall dynamic as follows: ‘It seems then that the commercial banks and the Reserve banks have indirectly financed the stock-market speculation by financing commerce while the corporations whose production and marketing were being financed by bank credit lent their funds to the stock market.’

The Housing Bubble of the 2000s

In 1992-2006, US residential investment and housing construction experienced the longest sustained boom in postwar history which nurtured the biggest housing bubble since the GD. Housing starts in the 2000s reached levels unseen since the early 1970s. New residential construction exceeded 2 million units in 2005 and peaked at an annual rate of 2.1 million units in the first quarter of 2006. New home sales exceeded 1 million in 2003-2004 and peaked at 1.28 million in 2005. For comparison, new home sales averaged 608,000 in the 1980s and 698,000 in the 1990s. Housing prices also reached unprecedented heights in the 2000s. According to the S&P/Case-Shiller National Index, house prices increased by 11 percent in 2002, 11 percent in 2003, 15 percent in 2004, and 15 percent in 2005. What were the factors that enabled and sustained the spectacular surge in housing values thereby feeding the bubble and, ultimately, leading to its burst? Four different explanations will be addressed here: government policies/regulatory failure, speculation, the low-interest-rate policy of the Fed, and capital inflows resulting from savings glut in developing countries. While these views point to important aspects of the problem, none of them can offer in itself a sufficient or compelling explanation of the origins of the bubble. It is rather by critically interrogating all of them that we arrive at a more plausible explanation of those origins.

The first group of explanations revolve around policies and practices that enabled subprime

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1 If not stated otherwise, data used in this article are drawn from the US Census Bureau, the Bureau of Economic Analysis, the Bureau of Labor Statistics, and the Federal Reserve Board of Governors Flow of Funds.
mortgage lending. Subprime mortgages are extended to borrowers who display a number of high credit risk characteristics including, without being limited to, recent delinquencies, repossession, foreclosure, or even bankruptcy, a relatively high default probability as evidenced by a credit score of 660 or below, and debt service-to-income ratio of 50 percent or higher. Accounts of the crisis emphasizing its subprime origins have a conservative and a liberal strain. Both see the crisis as a result of policy mistakes and institutional failure but while conservative analysts tend to attribute the subprime crisis to government policies aiming at extending homeownership to previously excluded constituencies, such as lower-income groups and racial minorities, liberals blame government institutions for failing to provide adequate regulation and supervision of the financial sector as well as for the inability or unwillingness to take decisive action in curbing predatory lending practices.

The view taken here is that the origins of the crisis go deeper than institutional failures and can be fully understood only when considered within broader socio-economic and historical contexts. These origins hark back to the confluence of two factors: the saturation of the US housing market that became apparent by the 1970s, and the opportunity offered by the demands of the civil rights movement to dismantle discriminatory lending practices, thereby expanding the size of that market. The contribution of housing to the postwar economic miracle in the US is difficult to exaggerate. Housing affects the economy through several main channels. First, investment in residential construction directly contributes to GDP growth. Second, the purchase of housing stimulates the demand for consumer durables and housing-related services including home improvement, cleaning, gardening, etc. Third, a host of industries offering legal, financial and insurance services depend critically on housing transaction volumes. Finally, the so-called wealth effect resulting from the appreciation of housing values boosts total spending in the economy.

By the late 1970s/early 1980s, the potential of homeownership as a key driver of growth in the American economy seemed largely exhausted as the overwhelming majority of eligible
homeowner candidates had been housed. The homeownership rate, which stood at 43.6 percent in 1940, reached a periodic peak of almost 65 percent in the mid-1970s. Population growth was far from sufficient to keep the housing machine going at its previous pace; besides, it was strongly skewed toward minority groups where homeownership rates were lagging behind. Thus, a feasible course of action was to extend homeownership to previously excluded segments of society, such as African Americans, other minorities, women, and the poor. This, in turn, meant the abolishment of discriminatory lending practices known as ‘redlining’ which effectively prohibited lending in certain areas, typically populated by minorities, because of the general characteristics of the neighborhood rather than of the specific property to be mortgaged. Subprime lending was further enabled by the deregulation of the mortgage markets that began in the 1980s with several key pieces of legislation which led to the massive growth of securitization and the vertical disintegration of the lending industry epitomized in the transition from the traditional ‘originate-and-hold’ to ‘originate-and-distribute’ model of lending (Ivanova, 2011a).

Did policies aimed at extending homeownership to low-income groups, such as the Community Reinvestment Act (CRA) of 1977 and the affordable-housing mission of the Government-Sponsored Enterprises (GSEs), popularly known as Fannie and Freddie, paved the road to the subprime crisis? Yes and No. On the one hand, the CRA applied only to bank lenders, while two-thirds of all mortgage lenders in the USA, including the major subprime lenders such as Ameriquest, New Century Financial Corporation, and Countrywide, until 2008, were nonbank lenders and not subject to the CRA. Quite a significant share of subprime lending took place in the private, non-agency market, dominated by nonbank lenders. While the conforming markets peaked in 2003, non-agency markets continued to expand. In 2005-6, non-agency origination and issuance (including subprime, alt-A, and jumbo mortgages) significantly exceeded the volumes realized in the prime (agency) market. For example, in 2001, banks originated $1.433 trillion in conforming
mortgage loans and issued $1.087 trillion in agency securities, while the non-agency sector originated $680 billion in mortgages and issued $240 billion of mortgage-backed securities (MBSs). By 2006, non-agency origination of $1.48 trillion was 45 percent larger than agency origination, while non-agency issuance exceeded agency issuance by 14 percent (Ashcraft & Schuermann, 2008: 2). On the other hand, the purchases of private-label MBSs by the GSEs significantly boosted the demand for such securities, and, in turn, subprime lending. The GSEs purchased respectively 42 and 49 percent of all newly issued subprime mortgage securities (almost all at adjustable interest rates) retained on investors’ balance sheets during 2003 and 2004, which was more than five times their estimated share in 2002 (Greenspan, 2010: 206).

Nonbank lenders that were very active in supplying subprime mortgages were not subject to the regulations that applied to traditional banks and thrifts. Furthermore, the infrastructure of securitization offered various ways for traditional bank lenders to circumvent existing regulation. Certainly, some of the worst excesses and outright predatory practices could have been avoided under stricter lending requirements. But, arguably, more extensive regulation altogether prohibiting the innovative mortgage products sold to customers who often could not afford to service them would have defeated the purpose of the entire enterprise. That purpose, commonly embraced by government and business, was to expand the size of the housing market by allowing access of new entrants. These new entrants could only come from previously underserved constituencies that were disproportionately poor and riskier (i.e. subprime). The way to turn such candidates into homeowners was to change the underwriting standards and the structure of mortgages.

Another group of explanations of the origins of the recent housing bubble emphasize the role of speculation. Asset-price bubbles have been a recurring event throughout history and speculation represents the oldest and most common explanation of their origins. Shiller (2008: 3) seems to confirm the popular dictum that the only lesson from history is that nobody learns from it,
by blaming the housing bubble on the general lack of intelligence about how to handle bubbles: ‘the housing bubble that created the subprime crisis ultimately grew as big as it did because we as a society do not understand, or know how to deal with, speculative bubbles’. He sees ‘an epidemic of irrational public enthusiasm for housing investment [as] the core of the problem’ and concludes that ‘the ultimate cause of the global financial crisis is the psychology of the real estate bubble (with contributions from the stock market bubble before that)’ (Shiller, 2008: 3). Speculation and irrational behavior play a part in many explanations of bubbles but rarely have they been assigned such a central role. Even more questionable is the assertion that ‘the psychology of the real estate bubble’ was ‘the ultimate cause of the global financial crisis’. Bubbles occur with relative frequency but they do not always bring about an economic implosion. Arguably, it takes something more than ‘irrational exuberance’ and momentum trading to produce an economic collapse of the magnitude of the GR. As this analysis strives to emphasize, it is the combination of financial and structural factors that allows irrational exuberance to power and sustain a bubble whose burst can induce economy-wide collapse.

As commonly acknowledged, asset-price bubbles are unlikely to arise without easy access to credit; that is, a general surge in liquidity is required for a boom to become a bubble (Kindleberger, 2005). The policy of the central bank plays an essential role in the shaping of credit conditions. However, as the experience of the 1920s and the 2000s teaches us, any analysis of the impact of monetary policy should take into account that the general availability of loanable funds is significantly influenced by nonmonetary factors, such as corporate profitability and the distribution of income. The aggressive expansionary policy of the Fed under Alan Greenspan pursuant to the dot-com crash is often credited with having created the housing bubble. Indeed, in the course of 2001, the Fed drastically reduced its target for the federal funds rate and the discount rate. In the twelve months beginning in July 2003, these rates stood, respectively, at 1 and 2 percent before the
Fed started raising them. While this policy may have been part of the reason why the housing boom turned into a bubble, it is important to emphasize that substantial increases in housing prices preceded the monetary expansion. Thus, while according to the Case-Shiller National Index housing prices were quite stable in the early 1990s (there was an increase of only 2.6 percent in 1990-4), in 1995-2000 they increased 27.5 percent, followed by a 42-percent increase between the first quarter of 2001 and the housing peak in the second quarter of 2006. Notably, the initial increase started when the short-term interest rates were still relatively high: In the period 1995-2000 both the federal funds rate and the discount rate averaged over 5 percent and never fell below 4.5 percent. The embattled former Fed Chairman has frequently emphasized this fact in order to argue that it ‘was long-term interest rates that galvanized home asset prices, not the overnight rates of central banks, as has become the seeming conventional wisdom’ (Greenspan, 2010: 235). Greenspan further argues that the decline in the interest rates on fixed-rate long-term mortgage loans, relative to their mid-2000 peak, began 6 months before the Fed started easing the federal funds rate in January 2001. In the meantime, a growing body of research has found evidence that foreign investors’ demand for US government bonds has played a role in the suppression of the long-term interest rates (e.g. Warnock & Warnock, 2009; Goda et al., 2011; Goda & Lisandrou, 2014).

In 2005, the soon-to-be Chairman of the Federal Reserve Board Ben Bernanke coined the notion of a global saving glut in an attempt to explain the steep upward trajectory of the US current account deficit (CAD) and the low level of long-term interest rates (Bernanke, 2005). In the early stages of the GR, this account figured among the official versions of the driving forces behind the crisis as demonstrated, for example, by the 2009 Economic Report of the Present which states that ‘[t]he roots of the global financial crisis can be traced back to before the beginning of this decade and were, in part, caused by a rise in saving by developing economies’ (Council of Economic Advisors, 2009: 63). What was titled ‘global saving glut’ pointed to a very real problem of the (real)
global economy which, however, had little to do with a generalized surge in saving or the mythical propensity of citizens of developing countries to save. During the period 1996-2003, which Bernanke was referring to in his famous speech, there was no evidence of any increase in the aggregate world saving as share of world GDP. In fact, in 2002, the share of gross world saving was at its lowest level since 1984 (Figure 1). What changed in the early 2000s was the distribution of world saving characterized by a significant increase in saving in two world regions: Developing Asia and the Middle East, which was matched by declining saving in advanced economies, particularly in the US. As shown in Figures 2 and 3, while gross saving and investment as shares of advanced economies’ GDP have declined since around 1990, both have surged as a percentage of emerging market and developing economies’ (EMDEs) GDP after 2000. Moreover, in that year for the first time in two decades the share of gross saving exceeded the share of investment in EMDEs’ GDP. The gap between the shares of saving and investment continued to increase in the following years. It systematically exceeded 3.45 percent in 2005-8 peaking at 4.79 percent in 2006. What were the origins of this ‘saving glut’?

National saving has three components: government saving, corporate saving of the financial and nonfinancial sector, and household saving. Chinese households, the poster child of thrift in the global economy, have allegedly been saving too much and consuming too little; the result is an imbalanced economy that could be rebalanced, so the popular wisdom goes, by a reduction in household saving and an increase in consumption. However, a growing body of research has challenged the view that rising household saving is the key factor behind rising total saving in China while finding instead that the high national saving rate can be attributed to the growing shares of both government and corporate savings (e.g. Anderson, 2009; He & Cao, 2007; Yang & Jianfeng, 2009). Furthermore, the low level of domestic consumption does not seem to have been driven by the households’ propensity to save, which has actually trended downwards, but by the persistent
decrease in the households’ share of national disposable income (Luo & Zhang, 2010; Yang & Jianfeng, 2009).

The corporate saving glut, directly linked to the changing balance between profits and wages in national income, is not a phenomenon peculiar to China, or to ‘developing countries’, but represents a secular trend which manifests itself globally. Comparing corporate saving rates across countries on the basis of firm level data, Bayoumi et al. (2010) find that Chinese firms do not have a significantly higher saving rate (relative to total assets) than the global average. In fact, since the early 2000s, the magnitude of the increase of corporate saving in industrialized countries has been far greater than the corresponding rise of total saving in emerging economies. From 2000 to 2004, net corporate saving in the G6 countries (France, Germany, Italy, Japan, the UK and the US) increased by $1.09 trillion while the increase in net total saving of all emerging economies including Asia in the same period was only $208 billion (JPMorgan Research, 2005, Table 1, Chart 1; see also IMF, 2006; OECD, 2007). As shown in Figure 4, the difference between gross saving and investment in EMDEs peaked at $663 billion in 2008. In the same year, US net corporate profits hit the recession trough of $976 billion. Except for the period 2006-08, US corporate saving has systematically exceeded the EMDEs’ saving glut. To put the numbers into further perspective, the total investable wealth of the so-called high-net-worth individuals increased from $30.8 trillion in 2003 to $40.7 trillion in 2007 and $46.2 trillion in 2012 (World Wealth Report, 2005, 2008, 2013). In 2005, the combined assets of pensions, insurance and mutual funds totaled $46 trillion (BIS, 2007). While excess savings in EMDEs undoubtedly contributed to the global demand for safe and not-so-safe US assets, its share in the sizeable pool of global investable funds seems relatively modest. Moreover, in the meantime excess saving in EMDEs has significantly declined. By contrast, growth in other key sources of global liquidity seems unlikely to subside in near future.

The rising share of total saving originating from the corporate sector has been part and
parcel of the decline in the labor share of national income. While analysts have offered different explanations for the causes of this phenomenon, they all point to a global trend dating back to the mid-1980s (Ellis & Smith, 2007; Karabarbounis & Neiman, 2014; Kristal, 2010; Rodriguez & Jayadev, 2010; Stockhammer, 2013). The related tendencies of lagging labor and growing corporate share along with a surge in corporate saving despite high dividend payments have strongly characterized the US economy both in the 1920s and in the 2000s.

3. Key Elements of Fundamental Fragility in the US Economy Then and Now

As Galbraith (2009[1954]) remarks, it is easier to explain the 1929 stock market crash than the Depression that followed. Why does the burst of one bubble trigger economy-wide and global collapse while the effects of another remain limited? The 1987 US stock market bubble had minimal effects on the overall economy. Similarly, the collapse of the dot-com bubble was followed by one of the mildest recessions in postwar history in terms of real GDP (although, admittedly not in terms of employment) while the financial sector remained largely unaffected. As this paper argues, neither the outbreak nor the severity of the GD and the GR can be fully understood by focusing on the particular features of the stock market or the housing bubble. Rather, the structural fragility of the economy that manifested itself in these bubbles was the underlying reason for the economy-wide collapse that followed.

The ‘roaring’ twenties and the ‘exuberant’ 2000s have entered official history as times of growing ‘prosperity’. In the recent period, however, it is difficult to challenge the notion that this prosperity failed to deliver rising labor incomes in light of the evidence that real wage growth for the majority of the populace has been modest to non-existent. By contrast, while workers in the 1920s experienced some real wage growth, its relative magnitude has often been exaggerated. In actuality, a closer look at the evidence then and now reveals a deepening structural imbalance between labor
and capital which manifests itself through two main channels: the rising share of corporate profits and falling wage share of national income, and the spectacular growth of top incomes along with rising household indebtedness in the lower ranks of the income distribution.

Wages and Labor Share

Since the mid-1970s, real wage gains for the majority of American workers have been weak to nonexistent. As shown in Figure 5, real average weekly earnings in the private nonfarm sector declined significantly between the late 1970s and the early 1990s, increased moderately in the late 1990s and were almost flat in 2002-2008. The general stagnation of labor income has gone along with deepening wage inequality which in the 1990s superficially manifested itself as increasing returns to skills and education (Ivanova, 2015). Between 1975 and 1998, the annual earnings ratios between college-educated and high-school-educated workers increased from 1.5 to 1.92 for male workers and from 1.45 to 1.76 for female workers. In particular, the earnings of men with a bachelor’s degree increased by 17 percent and those of men with an advanced degree (master’s or higher) grew by 25 percent, while the earnings of men who did not graduate college plummeted by 15 percent (Wolff, 2000). Overall, the much debated rising return to skills in the 1990s was to a significant extent due to the declining real earnings of less educated workers.

The earnings performance changed temporarily in the late 1990s when workers in all educational categories saw real wage growth. However, after 2000, all these groups of workers experienced declines in real earnings, such that for the entire period 1991–2010 period average real income grew less than 10 percent for all educational categories. The overall poor real earnings performance improves only slightly when we factor in the roughly 18 percent of total labor compensation accounted for by various nonmonetary benefits ranging from health insurance to stock options (Haskel et al., 2012).
The general stagnation of labor income underlies the decline of the labor share of national income from the postwar high of 0.59 in 1970 to 0.5 in 2006 falling further to just under 0.5 in 2012-14 (Figure 6). There are different ways to measure the labor share depending on the choice of the numerator which could be wages and salaries, total employee compensation, and aggregate labor income. My preferred one is the wage share which measures the share of wages and salaries in national income. The total compensation share, also presented in Figure 6, further includes various supplements to wages and salaries along with employer contributions to Social Security, pensions and insurance funds. The aggregate labor share includes, in addition to total compensation, an estimate of the labor component of proprietors’ income. I have chosen to ignore the last measure because of the technical and theoretical problems involved in the separation of the labor and capital income earned by entrepreneurs, sole proprietors, and unincorporated businesses. The decline of the US labor share after the 1970s, regardless of the measure used, has been documented by a substantial and growing body of literature (e.g. Jacobson & Occhino, 2012; Kristal, 2013).

Do we observe similar tendencies in the 1920s? Because of the lack of consistent national records before 1929, reliable economic data are somewhat difficult to obtain and, to the extent that such are available, they are typically estimates. As manufacturing was the most dynamic sector of the economy at that time, it is not unreasonable to take manufacturing wages as a benchmark. According to Douglas (1929), real wages of manufacturing workers increased 28 percent between 1914 and 1927 (it should be noted that 1914 was a recession year and choosing it as a base inflates the result). There was nothing spectacular about wage growth during the roaring twenties. The only year of significant change was 1928 when real wages of manufacturing workers grew by 6 percent which Douglas (1929) decomposes into a five-percent increase in average money earnings and one-percent decrease in living costs. Brissenden’s (1929) estimate of real annual earnings per capita in manufacturing industries also shows about 28 percent increase between 1914 and 1927. As shown in
Figure 7, the trendline between 1899 and 1914 was flat; real annual earnings in 1914 were slightly below the level achieved in 1899.

Despite the real wage gains during the boom decade of the 1920s, wage growth was lagging behind the growth of capital income which led to a decline of the wage share. The latter, measured as percent of value added for all manufacturing industries, peaked at 45 percent in 1921 (a recession year) and after a continuous decline reached 36.9 percent in 1929 without starting to recover until 1935 (Steindl, 1952, 76, Table 9). It is important to note that first, Steindl’s very detailed calculations show significant variations in wage shares across industries, and second, his measure of the wage share does not include salaries which he considers a part of overhead cost. He estimates that the ratio of salaries to value added between 1923 and 1929 actually increased from 12.1 percent to 13.6 percent.

The Top-Heavy Income Distribution

The fall in the labor share of national income over the last three decades has been accompanied by rising income inequality. The fact that labor earnings have largely stagnated since the late 1970s, except for the second half of the 1990s, should not be taken to imply that there has been no income growth at all. Labor earnings, comprising wages, salaries, and self-employment income, represent only one, albeit the largest, component of money income as defined by the US Census Bureau. Additional components include interest, dividend and rent payments, government transfers, pensions, etc. A comparison of total income changes by quintile in 1978-2008 relative to the previous 30-year period reveals an overall significant slowdown in income growth for the bottom 80 percent of the income distribution (Table 1). Income growth has been particularly weak in the bottom three quintiles and most pronounced at the very top of the income distribution. According
to Piketty & Saez (2015), during the long 1993-2000 expansion of the Clinton administration and the shorter 2002-7 one of the Bush administration, the incomes of the top 1 percent increased, respectively, by spectacular 98.7 and 61.8 percent. In contrast, the incomes of the bottom 99 percent grew 20.3 percent in 1993-2000 and 6.8 percent in 2002-7. Thus, in the second period, the top 1 percent captured two thirds of income growth. At the height of the boom in 2007, the median household income was $57,357 and thus slightly below the 1999 peak of $57,843. In 2014, the median household income was $53,657 which was 6.5 percent below the 2007 level and 7.2 percent lower than the income peak that occurred in 1999 (US Census Bureau, 2015).

The evolution of the top incomes over the last century has been U-shaped. The share of total income accruing to the top 10 percent was 46.09 percent in 1928 (and reached almost 50 percent if capital gains were counted), declined sharply during the Depression, remained below 35 percent in the postwar decades and started to increase again in the early 1980s. It crossed the 45-percent mark in 2006 and exceeded 50.6 percent including capital gains in 2012 – the highest level since the beginning of the series in 1917 (World Wealth and Income Database).

Changes in the Gini index also confirm the U-shaped evolution of income inequality over the last century. The Gini index for family income including capital gains increased from 0.359 in 1919 to 0.483 in 1929 (Smiley, 2000). Inequality declined during the Depression and after the War until the mid-1950s; for the following two decades the trendline was flat. Income inequality has been continuously on the rise since the mid-1970s. The Gini index for families reached 0.445-2 in 2013-4 versus the postwar low of 0.348 in 1968. The Gini index for households, calculated by the US Census Bureau since 1967, was 0.48 in 2014 up from 0.386 in 1968. The estimate of the

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2 Piketty and Saez base their analysis on the Internal Revenue Service tax tables which show the number of tax filers, their incomes, and various income sources. By focusing on ‘market income’, their estimates leave out various government transfer payments which were minimal in the 1920s but constitute a significant part of the income at present, particularly for lower-income households. Other factors which render the task of comparing levels of inequality on the basis of tax returns more difficult include differences in income tax coverage over time, different definitions of income, and the effect of changes in the top marginal rate on reported personal incomes.
Congressional Budget Office of the 2011 Gini index based on pre-tax income (market income plus government transfers) is 0.47. When capital gains are included, the 2011 Gini index reaches 0.59.

The Growth of Borrowing and Rising Indebtedness

The exorbitant income gains at the top have gone along with stagnant to modestly rising incomes at the bottom. Notably, consumption growth exceeded income growth as the housing and consumption booms of the 1920s and the 2000s were fueled and sustained by growing household indebtedness along with the luxury spending of upper-income households (Barba & Pivetti, 2009; Brennan, 2014). The debt burden of low- and middle income households has risen disproportionately to their income. In 1989, there was no significant difference between the debt-to-income ratios of families in the lowest quintile and all families (0.89 compared to 0.88). In 1995, the ratio for the bottom 20 percent was 1.85 compared to 1.09 overall. By 2004, this ratio has risen to 2.37 percent. In 1989-2004, mean debt-to-income ratios for all families increased from 0.88 to 1.47 but the increase was particularly pronounced for the bottom 90 percent and barely noticeable at the top (Brown, 2008, 10). Between 1983 and 2007, the debt-to-income ratio of the bottom 95 percent of the income distribution more than doubled reaching close to 140 percent, while the debt-to-income ratio of the richest 5 percent of the US population has remained constant at around 70 percent (Kumhof & Rancière, 2010).

Between 2000 and the peak year 2007, residential mortgage debt outstanding for one-to-four family houses and multifamily properties almost doubled from $6.1 trillion to $11.96 trillion. Total mortgage debt outstanding for residential, farm, and commercial properties increased in the same period from $6.75 trillion to $14.66 trillion or 117 percent. The growth of mortgage debt in the 1920s was even more spectacular (although from much lower levels in absolute terms). According to Persons’ (1930, 104) estimate, from 1920 to 1929 total residential mortgages outstanding increased
from $11.1 billion to $27.1 billion or 140 percent. A look at the trajectory of consumer credit is also instructive. Largely due to the widespread use of installment credit for the purchase of consumer durables, consumer debt as a percentage of household income doubled from 4.68 percent in 1920 to 9.34 percent in 1929 (Olney, 1991, 87-90, Table 4.1). Between 2000 and the peak year 2008, outstanding consumer credit (revolving and nonrevolving) rose from $1.74 trillion to $2.55 trillion or about 46 percent. Total household debt (residential mortgage debt and consumer credit) peaked at over 130 percent of disposable personal income in 2007.

The Saving Imbalance

The combination of stagnant wages and rising indebtedness has led to a decline in the personal saving rate. Between the mid-1960s and mid-1980s personal saving as a share of disposable income fluctuated between 8.2 and 10.9 percent. It has continuously declined since then to reach 1.5 percent in 2005 while averaging 2.8 percent in 2000-7. The decline has not been uniform as high-income households tend to save more than low- and middle-income households both in absolute and relative terms. Table 2 displays saving rates by income quintile calculated by deducting the mean expenditure for every quintile from after-tax-income and expressing the difference as percentage of income. Negative saving rates mean that household consumption exceeded income and the difference was financed either from savings from previous years or, most likely, borrowing. The significantly negative saving rates for the lowest two quintiles are, at least partially, due to income underreporting (see Rogers & Gray, 1994). Since 1989, the saving rates for the upper two income quintiles have trended upward, but the difference has been most pronounced in the top quintile whose saving as a share of income has risen from 22 percent in 1989 to 37.1 percent in 2012.

Rising income inequality in the 1920s was also reflected in differential saving rates. Analyzing the effects of income distribution on the percentage of total income saved, *America’s Capacity to*
Consume (ACC), an influential volume, co-authored by Moulton, Leven, and Warburton and published by the Brookings Institution in 1934, arrived at two conclusions. First, the savings of the majority of the population constituted a negligible portion of total savings. Moulton (1935, 136-7) estimates that in 1929, 91 percent of families including all those with income under $5,000 saved about $4 billion or slightly above 25 percent of total savings, while the savings of 2.3 percent of families with income over $10,000 amounted to over two-thirds of the total. Moulton’s estimates of total savings included capital gains. If those, amounting to $7.5 billion, were deducted from his original estimate of $20 billion of savings in 1929, one arrives at around $12.5 billion (Villard, 1937). Correspondingly, the above share of 91 percent of families in total savings should be about one third which does not significantly alter the situation. Second, in the period 1914-29, the proportion of national income received by those with incomes of $5,000 and above showed a marked upward trend while the proportion received by the group below the $5,000 income level showed a corresponding downward trend (Lewis, 1935, 533). ACC concluded that rising incomes in the upper-income brackets ($5,000 and above) resulted in higher saving rates and growth in total savings: ‘the fact that there has been a greater increase in incomes received by the upper than by the lower income classes has tended automatically to increase the aggregate volume of savings. The tendency has been especially marked during the last decade [1920-9]’ (Moulton et al, 1934, 111).

The overall upward trend of aggregate saving along with the rising rates of both personal and corporate saving in the 1920s constitutes a significant difference between then and now. The fall in personal saving in the 2000s was paralleled by an increase in corporate saving which was not only sustained but accelerated further in the aftermath of the GR. In 2005 corporate saving as percentage of gross saving exceeded the share of personal saving for the first time in the postwar period (Figure 8). In that year, personal saving amounted to $242.7 billion while corporate saving (retained earnings) reached $660.4 billion. Overall, gross saving as percentage of gross national income (GNI)
declined from 23.2 percent in 1981 to 14.3 percent in 2009 and increased to 18.3 percent in 2014 largely as a result of the sustained growth of corporate saving and the decline in the government deficit. Net saving, which was negative in 2008-11, reached 2.9 percent of GNI in 2014.

The Preponderance of Property Income over Labor Income and the Corporate Saving Glut

A key similarity between the 1920s and 2000s concerns the impressive growth of property income relative to labor income. While total labor income increased 29 percent between 1922 and 1929, interest and dividend payments more than doubled from $6.5 billion to $13.28 billion (Kreps, 1935, 565, Table 1). The net profits of the 135 leading industrial corporations increased about 150 percent from $840.2 million in 1922 to over $2 billion in 1929 while their retained earnings in 1929 were $732.2 million compared to 297.2 million in 1922 (Sloan, 1936, 41). Total cash holdings of all corporations increased $5.6 billion between 1925 and 1929 (Moulton et al, 1934, 153).

The Depression led to a disproportionate decline of labor earnings relative to property income. Total compensation declined from $51.4 billion in 1929 to $29.8 billion in 1933. In March 1933, the total number of persons employed in all manufacturing establishments was 55 percent of what it had been in 1926, while the total amount disbursed in wages was only one-third of the 1926 amount (Lauck, 1934, 784-5). Kreps (1935, 564) estimates that by 1933 labor income had fallen to 65 percent of the 1923-25 average while dividends and interest payments still amounted to 93 percent of the 1923-25 average. By 1931 corporate profits had entered negative territory but the collapse was not at all uniform. In fact, some of the biggest corporations weathered the storm tolerably well. As Sloan (1936, 40) documents about the fortunes of the leading 135 industrial corporations,

*At the end of the cycle, despite the enormous losses which had been sustained, and despite the fact that during the three years 1931-1933 security owners received cash disbursement of over a billion dollars in excess of the net available for the common [dividends] in those three years – despite these facts, our 135 corporations had 710 millions more cash in their coffers at the end of the cycle [1933] than at the beginning [1922]. And at the end of*
the period cash was down from the peak figure by less than 400 million.

And yet, net investment was 0 in 1931, negative in 1932-4, and sluggish afterwards. It only took off from 1941 on when the war effort began in earnest.

The developments discussed above have their counterparts in the period before and after the GR, although in a greatly magnified form. The upward trend of corporate profits since the second half of the 1990s was briefly interrupted by the GR, only to accelerate further in its aftermath. Between 2000 and the peak year 2006, net corporate profits more than doubled from $516 billion to $1.17 trillion. In 2014, they reached $1.6 trillion. While corporate profits tripled in 2000-14, wages and salaries increased by about 55 percent. Between 2000 and 2013, the wage share of national income declined 5 percent while the share of corporate profits increased by 5.3 percent.

The balance sheets of US corporations have undergone significant changes over the last three decades. While the nonfinancial corporate sector was a net debtor in the 1970s and 1980s borrowing between 15 and 20 percent of the value of its tangible assets, it became a net lender in the 2000s (Armenter & Hnatkovska, 2011; Bates et al. 2006). Since the 1980s, total corporate cash holdings of financial and nonfinancial corporations, defined to include cash and short-term securities transferable to cash, have risen at an annual growth rate of 7 percent in 1980-95 and 10 percent in 1995-2010. Cash holdings increased from $453 billion to $1.22 trillion in 1980-95 and reached $4.97 trillion in 2010. A closer look at the cash holdings of nonfinancial corporations reveals the following dynamic: they increased very rapidly between 2002 and 2004 growing at an annual rate of 19 percent (from $822 billion to $1.17 trillion). After a brief pause in 2006-08, they started growing again at an annual rate of 11 percent to reach $1.62 trillion in 2011 (Sánchez & Yurdagul, 2013). Corporate cash holdings of nonfinancial corporations reached $1.8 trillion in 2013 and $1.76 trillion in 2014. Despite impressive profit margins and cash holdings at an all-time high, domestic investment has remained sluggish. In 2014, more than five years after the official end of the GR, real
net private domestic investment was only $625.3 billion or 3.9 percent of GDP versus $951.2 or 6.7 percent of GDP in 2005. Net fixed nonresidential investment was only 2.7 percent of GDP in 2014 versus 3.2 percent in 2007 and 4.2 percent in 2000. The huge gap between profit margins and investment despite the lack of evidence of declining profit rates (or rates of return on invested capital) has puzzled many observers (e.g. Smithers, 2013).

In this context, finding rational or plausible explanations for the growing corporate cash holdings has become increasingly difficult. Standard explanations, such as precautionary motives and transfer taxes, ring increasingly hollow considering the magnitude and persistence of the problem. While a detailed investigation of this matter is beyond the scope of the present analysis, one of its most relevant aspects needs to be highlighted: the connection between the offshore outsourcing of production, the growth of corporate cash holdings, and the slowdown of capital accumulation in the US. The upward trend of corporate cash holdings dates back to the 1980s and can be plausibly linked to the marked increase of the share of overseas profits in total US profits which reached 20 percent for the first time in 1982 and 25 percent in 1986 (average per year shares per decade are presented in Table 3). Offshoring and offshore outsourcing emerged as strategies for reducing input costs and maximizing profits in response to the 1970s profitability crisis of the Fordist industrial model. The domestic counterpart of this process has been a trend towards less capital investment and alternative uses of retained earnings. The offshore outsourcing of production has gone along with the repatriation of profits which has contributed to the so-called financialization of the US economy in terms of an increased offering of financial services by nonfinancial firms, higher dividend payments, and the growing acquisitions of financial assets including the purchase of companies’ own shares for the purpose of raising stock prices (Medlen, 2010; Milberg & Winkler, 2010; Orhangazi, 2008). In fact, the accumulation of abnormally high cash holdings has been driven by US multinational corporations (MNCs). In the late 1990s, the cash holdings of the latter were not
larger than those of purely domestic firms. This situation changed over the 2000s and by 2010, US MNCs held over 3 percent more assets in cash than comparable domestic firms or foreign MNCs (Pinkowitz et al., 2012).

The build-up of corporate surplus funds added to the global pool of idle funds that fueled the housing bubble by raising the demand for various forms of financial ‘investments’. Thus, the US money and securities markets in the 2000s bear a remarkable resemblance to the call market of the late 1920s. While in the late 1920s surplus capital went into the call market to finance brokers’ loans thereby fueling the stock market bubble, in the recent period, idle funds from all over the world fostered the US housing bubble by flooding financial markets with liquidity.

**Instead of a Conclusion: The Great Recession Is Different**

The GD and the GR were triggered by the burst of a stock market and a housing bubble but to trigger something does not mean to cause it. This analysis has highlighted the unfolding of similar dynamics in the US economy then and now: surging corporate profits, relative stagnation of labor income, rising inequality, growing debt burden for the lower classes, overaccumulation of savings by the upper classes, credits booms, asset bubbles, and crashes that depressed the entire economy for years to come. I would like to conclude with a warning that the acknowledgment of those similarities could be gravely misleading if they were used to justify claims that the policies enacted to bring the economy out of the Depression can work again in some modified form to rid us of the consequences of the GR. For the American economy then and now is fundamentally different.

Despite the possible presence of structural and superficial similarities, no two crises are fully alike. In the analysis of crises, it is important to distinguish between general factors pertaining to the nature of capitalism as a production and monetary system (those are the factors that account for possible similarities) and specific ones related to the concrete level of development of this system.
within particular socio-historical frameworks and circumstances (those are the factors that account for the differences). The accumulation of surplus capital as a result of surging corporate profits was among the leading causes of the GD and the GR. But in the first case, the surplus of capital led to overinvestment relative to effective demand. In the second case, there is surplus of capital relative to profitable investment opportunities in the domestic economy in addition to the looming prospects of actual and potential weak demand.

The origins of the GD lay in overinvestment relative to consumer demand against the backdrop of labor abundance and low wages that ultimately drove the economy into an underconsumption trap; hence the depth, length, and severity of the slump (Devine, 1983; 1994). Consumption in highly unequal societies depends critically on the combination of continuous borrowing by low- and middle-income households and the luxury spending of the rich. In time, the relative importance of the latter is bound to increase as rising debt-to-income ratios impede further borrowing. As summed up by Gjerstad & Smith (2009: 289), ‘[t]he crash of October 1929 resulted from a sudden recognition that the credit system had been stretched to its limit: New houses and consumer durables could be produced, but creditworthy borrowers were scarce’.

The effects of the stock market crash were almost immediately felt in the consumer goods market as collapsing fortunes of rich individuals led to declining orders for dispensable luxury goods. Producers reacted to falling demand and investment was curtailed (Moulton, 1935). These dynamics may seem superficially similar to those underlying the run-up to the GR but that is not all there is to it.

The US economic and military success in the postwar age of high mass consumption was based on the dramatic expansion of potential output during the Depression years due to the combination of continued growth of manufacturing productivity and the spillover effects in transportation and distribution resulting from the extension of public infrastructure (Field, 2011). Despite the overall slowdown of investment and productivity growth in the 1930s, corporations
continued to invest in research and development and to enhance their innovative capabilities. These developments underlay the extraordinary level of profitability reached during and immediately after World War Two which significantly overshot both the pre-Depression and postwar trends. This ‘leap forward’ was attributable to a strong wave of technological change manifest in a 40-percent increase in multifactor productivity and associated with an ‘autonomous’ substitution of equipment for structures in the capital stock (Duménil et al., 1993).

The GR was preceded by a massive wave of overinvestment in construction which should not be confused with a general investment boom. The housing bubble was sustained by the combination of strong institutional support for the ideology and practice of homeownership which gave rise to the lowest mortgage lending standards in history, low interest rates, a financial industry eager to innovate, and a massive demand for, preferably, safe and, preferably, high-yield assets by institutional investors, corporations, wealthy individuals, governments, sovereign wealth funds, etc.; that is, multiple trillions of idle money in the global economy were looking for a safe haven. The GR started in the US but had global origins, and not merely global impact. It was, in fact, the first crisis of capitalism as a system of globalized production characterized by the geographical separation between the production of value and the distribution of value along with the persistent imbalances this spatial configuration generates (Ivanova, 2011c, 2013). And yet, many accounts of the crisis tend to ignore the profound ways in which the globalization of production has transformed the structure and underpinnings of domestic demand and profitability.

Unsurprisingly, many analysts have found it difficult to frame the GR as either a demand-side or a supply-side crisis which has resulted in the frequent invocation of the specter of financialization as the main culprit. Financialization is a notion used to describe a range of issues from the preponderance of shareholder value, to the rising share of the financial sector’s profits, and the growing importance of financial markets and institutions. The majority of the existing accounts
of financialization presume a clear-cut separation between production, seen as socially beneficial, and finance, perceived as potentially or actually parasitic due to its tendency to pursue speculative profits at the expense of productive investment (Ivanova, 2015). The notion of an antagonistic relation between production and finance harks back to Keynes’ (1997 [1936], 376) distinction between the productive (functioning) capitalist and the rentier as the ‘function-less investor’ who profits from interest and rent ‘without sacrifice’. This opposition has little basis in contemporary capitalism. During the early stages of industrialization, the role of the industrial capitalist seemed opposed to that of the rentier because of his direct participation in the production process. With the advent of the business corporation, the provision of capital (ownership) was separated from the running of the enterprise (management). This separation deepened in the subsequent evolution of the corporate form. Once the organization of production is entrusted to hired management, the difference between the ‘productive’ capitalist and the rentier starts to blur along with the difference between profit of enterprise, interest, and rent. The origins of present-day financialization hark as far back as the emergence of the ‘modern corporation’ in the late nineteenth century. From its very inception as the joint-stock company to its present-day giant multinational form, the corporation has embodied and reproduced the dialectic of production and finance. The term ‘absentee ownership’, introduced by Veblen (1997[1923]), refers not merely, as popularly understood, to the separation of ownership and management/control but to the peculiar form of ‘ownership’ epitomized in the corporate form. The corporation itself is the (absentee) owner of all business assets. The shareholders do not own real assets but shares – pieces of paper conferring legal rights, such as the right to receive dividends or vote for directors. They are functionless investors regardless of what the corporation does. The corporation – national or multinational – is a financial enterprise that may also be involved in the business of actual production. It is, by its very essence, ‘a pecuniary institution, not an industrial appliance’ (Veblen, 1997[1923], 83). The enormous productive capacity
of the modern corporation, and of the type of capitalism based on it, lies at the core of the host of issues associated with profitability, underconsumption, overinvestment, and financialization crises.

Financial bubbles are temporary occurrences that neither create nor alter long-term development trends. The housing bubble of the 2000s was no exception. The sluggish investment underlying the present weak recovery follows a long-run trend of a relative slowdown of capital accumulation in the US since the 1970s. This relative slowdown of domestic accumulation has been paralleled by surging capital exports over the last three decades as evidenced, among other things, by the sustained increase in the stock of outward foreign direct investment from about 5.5 percent of US GDP in the mid-1980s to 20.7 percent in 2007 and 28.3 percent in 2014. The GR may have opened the door to a different world but did not create it. It exposed tendencies that have been lurking in the background for decades. This newly uncovered world seems to display the structural features of both demand-side and supply-side inadequacies. Not all of these features are full-blown, some are still latent.

Structural inadequacy of aggregate demand was one of the factors underlying the GR. The overextension of credit was among the key reasons why effective demand appeared healthy before the crisis. The curtailment of credit through tightening of lending standards, prompted by rising debt burdens and insolvency of borrowers, accounted to a significant extend for the drop in consumer demand after the crisis started. The full effects of rising debt levels on the American economy have not yet been felt but are bound to be. The demographic profile of debt distribution is characterized by a growing debt burden on younger generations which is likely to alter the whole dynamics of consumer spending in the future. Furthermore, the structure of US consumer spending is characterized by a heavy orientation towards imported goods as manifested in the US CAD which peaked at $806.7 billion (about 6 percent of the GDP) in 2006. The major contributor to the CAD is the negative trade balance and, in particular, the deficit on the balance on goods which reached
$838.3 billion in 2006. Over 50 percent of the latter amount came from the combined deficits in consumer goods and automotive vehicles, parts, and engines. Another roughly 40 percent came from the deficit in industrial supplies and materials including intermediate inputs used by US firms. Despite the impressive decline of the CAD to $390 billion in 2014, the deficit on the balance on goods was still $741 billion and most unlikely to significantly decrease in near future (Ivanova, 2015). The import-oriented structure of US consumption and production explains why buoyant consumer spending during the bubble years and beyond has done relatively little to stimulate domestic investment.

Similar considerations should be taken into account in discussions of profitability trends in the US economy. Marxist economists, in particular, observe the movements of the profit rate with keen interest as the growth dynamic of a capitalist economy is seen as directly linked to the general rate of profit it generates. While there is no common agreement as to whether the rate of profit has risen or fallen prior to the recent crisis, most accounts point to the former (see Basu & Vasudevan (2013) for an overview). The mass of profits has undoubtedly risen, thereby being one of the fundamental causes of both crises studied here. It should be noted that the feasibility of the whole exercise of measuring the US rate of profit as the ratio of domestic profits to the stock of domestic investment appears somewhat questionable. The profits generated within a MNC cannot be simply split into domestic and overseas components as the spatial reorganization of production through offshoring and outsourcing raises profitability both domestically and globally. For example, labor cost saving through offshoring accounts for a large share of domestic productivity growth in manufacturing (Houseman, 2007). Thus, the improved profitability of domestic business may be simply evidence that the US MNCs have successfully optimized their operations through global restructuring.

The idea that the capacity of capitalism to continuously revolutionize its means of
production may be running out of steam is anathema to the great majority of economists (mainstream and Marxist alike). And yet there has been a recognizable slowdown in capitalism's general technological capacity to innovate in a way that could spur new investment and raise productivity growth to levels comparable with the postwar Golden Age. Different factors can account for the decline of innovation. On the one hand, there are grand-scale, civilizational factors, such as the forces of the Second Industrial Revolution that, in Gordon’s (2012) view, were unique and cannot be repeated. The resultant rapid rise in living standards is also becoming impossible to sustain. On the other hand, it can be argued that the tendency to monopolization that in one form or another has characterized American capitalism throughout its history has also eroded competition and hampered innovation (Hymer, 1979; Foster & McChesney, 2012). The combination of structural supply-side and demand-side weaknesses does not bode well for the future of the US economy. Gordon (2012) aptly captures the demand-side challenges under the heading of ‘six headwinds’. These include the reverse motion of the ‘demographic dividend’, the plateau in educational attainment combined with the ‘cost disease’ in higher education, rising inequality, the globalization of production and its vindication of the factor-price equalization theorem, energy and environmental challenges, and the overhang of consumer and government debt.

In sum, the growth prospects for American capitalism then and now are vastly different. World War Two served as a huge stimulus for the depressed economy at a time when this was exactly what was needed. The institutional regulation of demand whose foundations were laid down by the New Deal and solidified in the postwar period played an essential role in stabilizing accumulation under mass production Fordist capitalism. The present situation is different. This is not a crisis that can be solved through the institutional re-regulation of demand as the existing problems extend to the core structure of capital accumulation.
References


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Figure 1 – Gross Saving
Source: IMF, World Economic Outlook Database, October 2013

Figure 2 – Saving and Investment as Percentage of Advanced Economies’ GDP
Source: IMF, World Economic Outlook Database, October 2013
Figure 3 – Saving and Investment as Percentage of Emerging Market and Developing Economies’ GDP
Source: IMF, World Economic Outlook Database, October 2013

Figure 4 – US Net Corporate Profits, Net Dividends and Undistributed Profits in billion USD and the EMDEs’ ‘Saving Glut’ calculated as the difference between gross saving and investment in billion USD, 2000-2012.
Source: IMF, World Economic Outlook Database, October 2013; BEA, NIPA Table 1.12
Figure 5 – Real average weekly earnings in private nonagricultural industries, 1966–2014, in 1982–84 dollars.
Source: Bureau of Labor Statistics

Figure 6 – The shares of wages and salaries and of total employee compensation in national income, 1929-2014.
Source: Bureau of Economic Analysis, NIPA Table 1.12
Figure 7 – Estimated USD amounts of annual earnings per capita, in real purchasing power at 1914 prices, in US manufacturing industries, 1899-1927
Source: Brissenden (1935), p. 93, Table 35

Figure 8 – Corporate Saving and Personal Saving as Percentage of Gross Saving, 1949-2014
Source: BEA, NIPA Table 5.1
Table 1 - US Family Income by Quintile (upper limit of each quintile), in 2008 US dollars, changes in the period 1947-1977 compared to the period 1978-2008

<table>
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<th></th>
<th>Lowest 20%</th>
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<th>Third 20%</th>
<th>Fourth 20%</th>
<th>Lower limits of top 5%*</th>
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<td>29.78%</td>
<td>44.62%</td>
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* Source: Ivanova (2011b); data drawn from the US Census Bureau

* The top ‘quintile’ in this series covers only incomes from the 80-95th percentiles.

Table 2 – Saving as percent of after-tax household income by income quintile

<table>
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<th>Third quintile</th>
<th>Fourth quintile</th>
<th>Highest quintile</th>
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<td>18.1</td>
<td>36.0</td>
</tr>
<tr>
<td>2012</td>
<td>-117.8</td>
<td>-17.6</td>
<td>8.1</td>
<td>18.9</td>
<td>37.1</td>
</tr>
</tbody>
</table>

* Source: Author’s calculations from various years of the Consumer Expenditure Survey, Bureau of Labor Statistics

Table 3 - Average annual shares of rest-of-the-world profits in total US after-tax profits

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</thead>
<tbody>
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<td></td>
<td>8.3</td>
<td>10</td>
<td>13.9</td>
<td>21</td>
<td>22.6</td>
<td>26.9</td>
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* Source: Bureau of Economic Analysis, NIPA Tables 6.19B, 6.19C, 6.19D