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**THE CRISIS IN THE WORLD ECONOMY  
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# **THE CRISIS IN THE WORLD ECONOMY**

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## **ABSTRACT**

At a superficial level world economic growth appears relatively robust. The world economy has grown by five per cent each year since 2004. Such growth has led to claims that the crisis in the world economy, evident in the years of stagflation of the 1970s, has now passed, even that we are now entering a 'new growth paradigm'. While not disputing growth in the world economy in the past decade, this article draws a much more critical assessment of the situation. The world economy has still not resolved the fundamental weakness that dragged it down in the 1970s, to wit, the rate of profit is not high enough to stimulate the world economy into a new round of comprehensive all-round international growth. In addition, the world economy is plagued by fundamental financial imbalances and by an increasing skewness towards financial speculation as against accumulation in the productive sphere of the economy.

# THE CRISIS IN THE WORLD ECONOMY <sup>1</sup>

## ***INTRODUCTION***

At a superficial level world economic growth appears relatively robust. The world economy has grown by five per cent each year since 2004 (IMF, 2006). Leading the charge have been China (9%) and India (7%) which together accounted for 41 per cent of world economic growth in the first half of the new decade (Henry, 2006). The USA, which accounted for a further 12 per cent of world growth, has grown by an average of 3.5 per cent over the past three years (IMF, 2006). US corporate profits have been growing very strongly. In second quarter 2006, corporate profits had risen by more than 10 per cent each quarter for three years (albeit off an historically low base in 2001) (Guerrera, 2006a).

Boosters of the neoliberal establishment, such as former Federal Reserve chairman Alan Greenspan, have been quick to point to such data to claim that the years of stagflation and crisis of the 1970s have been put behind us, even that we are now entering a 'new growth paradigm'. This new phase of world capitalism has, allegedly, been driven by the restructuring of US industry (new management methods, new equipment), the opening up of the world economy (rising world trade and investment) and the once in a lifetime unleashing of the market economy in China and India. Such boosterism is not just the preserve of ardent defenders of the neoliberal mainstream. Canadian leftists Leo Panitch and Sam Gindin (2004) argue that the restructuring of US capitalism since the 1980s has created the preconditions for another long phase of growth under US hegemony. Radical French economists Gerard Dumenil and Dominique Levy (2004) also suggest that US capitalism has resolved the crisis of the 1970s, albeit at the same time recognising that profitability remains well below the level attained during the post-war boom.

While not disputing growth in the world economy in the past decade, we need to draw a much more critical assessment of the situation. The world economy has still not resolved the fundamental

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<sup>1</sup> The author would like to thank Sandra Bloodworth for her extensive feedback on an earlier draft of this article.

problems that dragged it down in the 1970s, to wit, the rate of profit is not high enough to stimulate the world economy into a new round of comprehensive all-round international growth. In addition, the world economy is plagued by fundamental financial imbalances and by an increasing skewness towards financial speculation as against accumulation in the productive sphere of the economy. The Western capitalist classes have been on the attack on the working class since the early 1980s and this has afforded them some breathing space. The United States, in particular, has created some daylight between itself and its rivals Germany and Japan. But this has not created the conditions for a new sustained world boom. In addition, these attacks create the potential for resistance by the working class. Further, the national basis of all capitalist states militates against a coordinated recovery in the world system – a solution for one national capitalist class creates problems for another. The War on Terror and economic ‘beggar thy neighbour’ trade policies are expressions of this contradiction.

## ***PART 1: SLOWDOWN IN THE WORLD SYSTEM***

The evidence underpinning the ‘new growth paradigm’ is flimsy at best. Table 1 demonstrates that far from the 1990s ushering in a new phase of growth for US capitalism, the growth rate was only on a par with the 1970s and the 1980s, and substantially lower than the post-war decades. The record thus far for the 2000s has been even worse again. The new century opened with a deep recession, followed by three years of growth. However, this growth is already ebbing away – estimates for growth in US GDP in 2007 have been progressively cut from 3.5 per cent to less than two per cent. Even the growth that has occurred has been driven by an unsustainable escalation of household debt and a housing bubble, now in the process of deflating. Regardless of trends in profitability (below), these data tell us most of what we need to know about the lack of dynamism in the US economy.

**Table 1: Growth of GDP, United States**

Indicator (% average annual growth)	1950s	1960s	1970s	1980s	1990s	2000s
GDP (a)	4.1	4.4	3.3	3.0	3.0	
GDP (b)			3.3	3.7	3.5	2.5

Source:

GDP (a) Harms, J. and Knapp, T. (2003): 'The New Economy: What's New, What's Not', *Review of Radical Political Economics*, 35 (4), p. 417.

GDP (b) UNCTAD Handbook of Statistics Online (2000s= 2000-04)

A similar picture is evident in the world economy. Between 1913 and 1950, the advanced

economies grew at an average annual rate of 1.9 per cent, down from the rate of 2.5 per cent

attained between 1870 and 1913 (Armstrong, Glyn and Harrison, 1991: 117). During the post-war

boom (1950-73), growth raced ahead by an unprecedented 4.9 per cent (Armstrong et al, 1991:

117). Since the end of the boom, however, growth has now slipped back in every successive decade

until the point that the advanced capitalist economies are now growing once more at less than two

per cent (Table 2).<sup>2</sup>

**Table 2: GDP growth in world economy**

	1970-1980	1980-1989	1990-2000	2000-04
<b>WORLD</b>	<b>3.8</b>	<b>3.2</b>	<b>2.8</b>	<b>2.6</b>
<b>DEVELOPED ECONOMIES</b>	<b>3.3</b>	<b>3.1</b>	<b>2.5</b>	<b>1.9</b>
Canada	4.3	3.3	3.1	2.8
United States	3.3	3.7	3.5	2.5
EU 15	3.0	2.4	2.1	1.5
Japan	4.3	3.7	1.4	1.3
CIS (Russia etc.)	5.3	2.8	-5.0	6.6
South-East Europe	7.6	1.9	-1.2	4.9
China	5.1	10.6	10.4	8.7
India	3.3	5.7	6.0	6.1
South America	5.6	2.0	3.3	1.7
North Africa	6.8	3.0	2.4	4.3
Sub-Saharan Africa	3.0	2.1	2.5	4.0
Middle East	6.8	1.4	3.9	3.7

Source: UNCTAD Handbook of Statistics Online

Every one of the major Western European economies is growing at a fraction of the peak European

growth rate of 4.7 per cent achieved between 1960 and 1973 (Armstrong et al, 1991: 234). In

<sup>2</sup> It should be noted that the IMF (World Economic Outlook) and World Bank (World Development Indicators) report differing absolute rates of growth for the world economy but the same broad trend is evident until the 2000s. For the period 2000-05, the IMF suggests that the rate of growth in the world economy began to pick up as a result of rapid growth in China, India and other developing countries.

Germany, for example, growth has fallen from 4.4 per cent in the 1960s to a mere 0.6 per cent in 2000-04 (Brenner, 2000: 47; UNCTAD, 2006). In France the growth rate has slid from 3.6 per cent in the 1970s to 1.5 per cent in the 2000s. The situation in Canada parallels that of the USA. Average annual growth figures for Japan over the past five decades are 10.2 per cent, 4.3 per cent, 3.7 per cent, 1.4 per cent and 1.3 per cent (Brenner, 2000: 47). Indicative of the deterioration of the situation for these great powers is enthusiasm about the current 'Japanese economic recovery' – all of 2.5 per cent in 2006!

The situation outside the advanced economies is highly uneven. China and India are the focus of current attention, and justifiably. Growth in both has over the past quarter century been running far higher than during the 1970s and, as noted, this has had an impact on world growth (Table 2).

However, there are other regions of the world which expanded rapidly for several decades but which have come to grief. Brazil recorded more than eight per cent growth in the 1970s but less than two per cent in the 2000s.<sup>3</sup> Mexican growth fell from 6.4 per cent to 1.6 per cent in the same period. The Asian Tigers, including Hong Kong, South Korea and Singapore, have also hit a brick wall. The situation in the former Eastern Bloc and North Africa indicates the catastrophic decline in growth in these countries until some bounce-back in the 2000s.

These raw data of course only tell us part of the story. Third world indebtedness continues to rise (Kettell, 2006: 41). The benefits of the growth that has occurred have been heavily skewed to those with capital. Worldwide, unemployment rose from 161 million in 1996 to 195 million in 2006, with the rate rising from 6.1 per cent to 6.3 per cent (ILO, 2007). Even the Asian economic miracle of recent decades turns out to be highly uneven - the creation of many millionaires, but impoverishment for many. Unemployment rose in South East Asia and the Pacific from 3.7 per cent to 6.6 per cent and in South Asia from 4.4 per cent to 5.2 per cent between 1996 and 2006 (ILO, 2007). The number of those around the world working for less than US\$2 per day did not shift from 1.36 billion in this period (ILO, 2007). The Director-General of the International Labour Office reported in 2005 that:

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<sup>3</sup> All figures in this paragraph are sourced from UNCTAD (2006).

The key message is that up to now job and income security for the world's workers has been an afterthought in global development. Globalization has so far not led to the creation of sufficient and sustainable decent employment opportunities around the world (ILO, 2005).

Even in China, business has benefited disproportionately from the rapid economic growth. While labour productivity increased by 170 per cent between 1990 and 1999, real wages in the manufacturing sector rose by only 80 per cent (ILO, 2007).

All of these phenomena confirm that rather than boundless prosperity, the world economy is characterised by unevenness and uncertainty. The boom of the post war decades has long gone, and the general trend towards a slowing in the world economy looks set to continue.

## ***PART 2: PROBLEMS IN THE CORE OF THE SYSTEM***

In order to understand the nature of the crisis in the world economy, it is important to consider three major contradictions: (i) the international financial imbalances that mean that the world economy is balanced finely on a knife edge; (ii) the reliance on speculative capital flows which make this balance all the more unstable; and (iii) the most important of all, the failure of the profit rate to recover sufficiently to provide a stable basis for long term economic growth.

Before we discuss the first two of these, however, it is worth briefly commenting on the significance of globalisation to the broader picture. Under capitalism, globalisation is not about *rapid expansion* of production and trade on a *world scale*, the form that it would take in a rationally organised economic system. Rather, it takes the form of a war between rival capitalists over ownership of assets, real and fictitious (within the wealthy OECD for the most part), and the relocation of production operations to a few select areas of maximum labour productivity at minimal costs, chiefly China and a small number of other developing economies. Thus, while international trade grew from 43 per cent of GDP in 15 major economies during the 1970s to 53 per cent in the 1990s, stocks of foreign direct investment (FDI) rose much faster, from 21 per cent of GDP to 93 per cent (Piazza, 2005: 295). Eighty per cent of this FDI takes the form of mergers and acquisitions. The process of monopolisation discussed by early 20<sup>th</sup> century Marxists such as

Nikolai Bukharin (1972) is now occurring on an international scale, albeit largely limited to the major blocs – NAFTA, the EU and China.

The factor underpinning these large-scale capital movements is differences in rates of consumption, savings and investment, and differentials in wage rates. The ratio of consumer spending to national income in China is 60 per cent, in the United States, 80 per cent. Savings and investment ratios are correspondingly that much higher in the former. In 2005, China devoted 41 per cent of its GDP to fixed investment, dwarfing the 17-20 per cent common in Western Europe and North America (Wolf, 2006). The resulting capital movements then become the source of both cooperation and tension between nation states.

Concretely, globalisation involves a restructuring of capitalism, with investments flowing both within the advanced Western economies and from the relatively slow-growing and high-wage West into China, creating factory closures in the former and factory openings in the latter. Globalisation is fundamentally warped by the anarchy of the world market which means that what should be a process advancing humans' capacity to feed, clothe and house themselves becomes instead the occasion of bitter conflicts and degradation of human labour. The fact that the nation state shapes and constitutes each capitalist class, and the fact that production and consumption are separate and unplanned processes under capitalism, means that the global movement of goods and capital cannot be handled harmoniously but gives rise to the kind of stresses in the world system that we now discuss.

## **1. INTERNATIONAL FINANCIAL IMBALANCES**

There are two major financial and economic imbalances in the world system, and the US is central to both.

### **(i) World trade**

The first is the imbalance in world trade, involving primarily the emergence of the US as a major net importer and debtor, the consolidation of Japan as a major net exporter and surplus nation, and the arrival on the world stage of China as a massive surplus nation.



During its economic heyday in the post-war decades, the United States ran a balance of trade surplus (and thereby accumulated foreign capital reserves) and enjoyed relatively high rates of domestic savings as living standards and profits both rose. These then found outlets in international investment in Europe and elsewhere, and US multinationals expanded their operations overseas. In the 1980s and early 1990s the decline of domestic savings in the US associated with declining or stagnant real wages and the growth of consumer debt meant that the US began to run trade deficits equivalent to around two per cent of GDP. These were financed by excess savings elsewhere in the world system by trade surplus nations, chiefly Japan but also at times the OPEC nations and Germany.

A series of factors changed this relatively sustainable debt situation for the USA. The apparently permanent recession in Japan in the 1990s further exacerbated the need for East Asian countries to export to the United States, given the systemic current account deficits that they had with Japan. The same Japanese recession tended to dampen consumer spending at home and thereby to cut imports and raise still further the savings ratio in Japan.

The emergence of significant overproduction in the world economy brought down the major exporting nations of East and South East Asia in the crisis of 1997-98. The accompanying devaluation of many Asian currencies led to the cheapening of their exports. The US Federal Reserve Bank responded to the threat of international contagion from Asia by flooding the world economy with US dollars. This stimulated the US economy and sparked off the tech boom of the late 1990s as well as the property boom that succeeded it. These in turn encouraged a wave of foreign investment in the United States, providing a short-term boost to US capital but a long-term tail of interest and dividend payments on the accumulated debt and equity.

Finally, the emergence of China, a country with cheap labour and high savings rates (and low consumer spending), on the world stage, also transformed the US economy by encouraging US firms to relocate production to China (thereby simultaneously reducing US exports and raising US imports). The recovery in the US economy after the recession of the early 2000s then provided a

booming consumer market for Chinese-made goods (whether by US- or Chinese-domiciled companies).

All of these factors shifted the US trade situation from a steady and manageable trade deficit to a yawning trade deficit which began to rise rapidly. The US current account deficit is now approaching seven per cent of GDP, while China and Japan run current account surpluses equivalent to five to seven per cent of GDP (Brittan, 2006).

In most countries this situation would lead to the imposition of an IMF-organised structural adjustment program. The US dollar, however, is the world's reserve currency and this has enabled the United States to keep walking the tightrope. Geier (2005) describes the conjuring trick as follows:

Rather than converting dollars from exports to the US into their own local currencies, the Asian economies keep their export revenues in dollar reserves, which they then loan to the US treasury, keeping interest rates low in this country [the US] and holding down the value of their own currencies. This in turn keeps their exports cheap.

There is in effect a mutually beneficial arrangement at work here. The US is sucking in vast amounts of the pool of world savings (most importantly from the Asian central banks overseeing massive trade surpluses) in order to pay for its excess of imports over exports. This is enabling the US to enjoy higher living standards than it would otherwise be able to. Effectively it is akin to the US building up an enormous tab which someone else is kindly agreeing to 'look after'.

The United States has now become the world's largest debtor nation, an invidious situation for any player seeking the role of world hegemon. Not just invidious but unprecedented – this is the first time in world history where the leading superpower is also the largest debtor. The future fortunes of the US ruling class are now partly in the hands of the Asian central banks.

These banks have an interest in taking care of the US's debt because insisting on payment in full (in e.g. yen or yuan) would lead to a collapse in the US dollar which would render banks' remaining holdings of US debt and US assets reduced in real value. The Chinese and Japanese central banks also know that the success of their export drives lies in an open and expanding US domestic market.

Even though Chinese companies have been increasing trade relations with Asia, it is still the case

that one-third of all Chinese merchandise exports go to the US. The same is true of one-quarter of Japan's. A sharp fall in the US dollar would lead to their own exports becoming substantially more expensive, thereby dampening their own domestic growth which in the case of Japan is still sickly. As Kettell (2006: 42) argues: "The prosperity of the world economy now rests on an ever-rising mountain of American debt".

This situation cannot persist forever, however. A resolution can take the form either of a crash in the USA or a more managed arrangement. Both are fraught with problems. The following are some possible medium-term 'solutions' to the global imbalances.

- a) A gentle decline in the US dollar and a rise in the yuan and yen, making US exports more competitive and imports more expensive, thereby gradually wiping out the current account deficit. In theory quite possible. In practice, the trick is preventing the decline in the US dollar from becoming a rout which would have a big impact on inflation, already an emerging worry for the US Federal Reserve. Further, the Chinese government has proven very resistant to allowing any significant appreciation of the yuan.
- b) An induced recession in the US, involving higher interest rates and a winding back of US domestic consumption. This might choke off imports, but it would also threaten to bring the US consumer debt pyramid crashing to the ground. In 2004, US household debt amounted to 126 per cent of annual disposable income, up from 92 per cent in 1998 and 66 per cent in 1984 (Dumenil and Levy, 2004: 83; Beams, 2006). A US recession would also have a dampening effect on world growth. The solution would be to team a US slow-down with expansion in the EU. The IMF and OECD have long advocated a major program of 'shock Thatcherism' in the European Union which would shake up EU capitalism and boost consumption spending and economic growth (for a period at least). Such growth would divert excess Chinese and Japanese savings to the EU rather than the USA. However, it would also entail a frontal assault on the European working class, and the failure of the

French Government to impose the CPE (First Employment Contract) in April 2006 indicates the obstacles to this possible solution.

- c) An expansion of domestic consumption in China and Japan, the winding back of the pool of savings, increased spending on imports from the United States and the diversion of goods from exports to the home market. In theory, quite possible. In practice, this would involve the lifting of wages in China which would remove the incentive for Western business to relocate there, thereby stifling foreign investment which has been central to Chinese economic advance.
- d) The imposition of tariffs and quotas on imports by the US Government. Theoretically possible. Practically, creating enormous political difficulties both within the US establishment (angry US investors in China; US companies which have relocated their operations to China now denied an open market for their goods) and in relation to the Asian governments which may be tempted to retaliate by offloading the US dollar. It would also raise the possibility of retaliation by the EU and further pressure on the WTO, which is already in strife over its failing Doha Round of trade liberalisation.

## **(ii) US Government debt**

The second major debt mountain is that incurred by the United States Government. Federal government debt has been a significant feature of the US economy since the massive expansion of government spending during Vietnam, partially explaining the growth of inflation in the early 1970s. Reagan exacerbated the problem with his policy of 'military Keynesianism' – arms expenditure expanded enormously and the government deficit along with it.

The Clinton administration, however, ran a tight spending model, slashing welfare spending. The end of the Cold War also allowed for some slow-down in the rate of defence spending. Clinton ran budget surpluses, helping to run down the accumulated Government debt and reduce reliance on foreign borrowings.

The Bush administration, however, has reversed this trend. On the spending side of the ledger already meagre social welfare provisions have been cut further, but military and ‘national security’ spending have been ramped up. On the income side taxes have been cut for the wealthy. The outcome was that Clinton’s US\$250 billion surpluses were transformed to US\$450 billion deficits under Bush. These deficits have to be funded in some way. The run-down in household savings over the 1990s meant that the US government has had to rely on issuance of debt (in the form of Treasury bills and bonds) to foreign banks. Indebtedness to foreign banks is thereby further increased.

Taking both phenomena of trade deficits and government debt together, the result has been the escalation of US foreign debt to, depending on differing estimates, anywhere between US\$2.7 trillion and \$4.5 trillion (Geier, 2005).

The great unknown in relation to the financial imbalances is the US dollar and interest rates. The response of the Federal Reserve Bank to the 2000-02 stock market meltdown and the 9/11 attack was to push interest rates low. While ensuring that the recession did not get still worse, this move only encouraged further financial speculation, the further build-up of consumer debt and a housing price spiral. In order to curtail the rise of US debt and creeping inflation the Federal Reserve tightened US monetary policy in 2004-06. However, rising interest rates are dampening US growth. These deficits pose major problems for the world’s financial systems. It is not ruled out that they can be unwound by a series of IMF-coordinated steps involving actions by the key governments, as outlined above. However, each of the necessary measures imposes some economic pain or some political risk on the state undertaking it. Far easier simply to demand that every other great power take corrective action first. In the meantime, the debts keep accumulating and the potential for a melt-down in the financial system persists.

## **2. THE EXPANSION OF THE CASINO ECONOMY**

The second major fault-line in the US economy, indeed the world economy, is the increasing role of speculation. We have already discussed the rapid growth of FDI over the past two decades. Such

growth has, however, been dwarfed by the rise of speculative investment. Some indication of the amount of speculation that is now occurring is given by the fact that the value of funds used for foreign exchange trading rose from US\$20 billion in 1973 to US\$1.25 trillion by 2000, far in excess of the growth of trade in goods and services (Kettell, 2006: 38).

The invention of new financial instruments or the rapid extension of existing instruments (e.g. futures, derivatives, hedge funds, swaps, spreads) has been a feature of the past quarter century. The amounts involved are enormous: no-one knows exactly how much is in play, but it is estimated that the derivatives market is now valued at five to ten times the size of the world economy (Beams, 2006). In other words, the financial system is being swamped by fictitious capital. Such instruments allow firms to spread risk in the short term but in the long term add instability to the system. The entry of millions of workers into the world of stock exchanges by pension funds and personal trading accounts further contributes to the funds on tap. The use of IT and 24-hour trading means that speculation is around the clock. And the relaxation of trading controls in the name of 'self regulation' only heightens the volatility.

The rise of the casino economy merits attention for several reasons. First, it denotes that the capitalists of the world are less confident that investment in productive expansion will yield them significant returns, an indication of the loss of their faith in their own system. They prefer to gamble on assets than invest in expansion. Second, speculation is not just the preserve of day-traders, banks or the Warren Buffets of the world, but also the major industrial enterprises which are the engines of value creation in the world economy. These companies speculate both because of their belief that the returns are greater and because they now also hold trillions of dollars in pension accounts for their own employees.

The inter-penetration of financial and industrial capital has been a feature of capitalism from the late 19<sup>th</sup> century. The degree to which the former has moved from a marginal activity in the world system (during the post-war boom for example) to a more central role is a clear signal that parasitism has become a very significant feature of world capitalism. This in turn is associated with

ever more obvious corruption which, by propping up unprofitable companies by deceit, draws in funds from 'sound' companies and threatens both with bankruptcy. When companies such as Xerox, Enron, World Com, Global Crossing default, they drag others with them, for example Anderson Consulting, auditors for Enron. These were not small fry: Enron was the seventh largest US company, Anderson was one of the accountancy world's Big Five, and WorldCom was the US's largest internet carrier.

A severe financial crisis has the potential to unwind markets spectacularly. The US stock market, although lower than its peak in 2000, is still marked by historically high price/earnings ratios. The collapse in US stock markets in 2000-03, when the Dow Jones lost more than a third of its value, is still a living memory (Ellis, 2006). In the 1990s the US government had to twice intervene to prevent financial collapse associated, first, with the savings and loans scandal, and second, with the bankruptcy of Long Term Capital Management. The US financial system cannot be isolated from greater vulnerability in the world financial system. During the post-war boom (1945-71), there were 37 separate currency crises in the world economy, one banking crisis and one episode where both crises coincided. In the period 1973-97, the numbers shot up to 86, 26 and 27 respectively (O'Hara, 2005).

It would be foolish to suggest that a domino-style collapse is definitely on the cards. We only have to see the way in which the productive economy was able to sail through the 1987 Wall Street crash to understand that a financial bust does not automatically create a new Depression. Nonetheless, in the case of 1987, the productive economy was only shielded for a period and in such a way that problems were stored up for the medium term. Low interest rates and the diversion of funds to property fuelled two more years of growth but could not prevent the sharp recession of 1990-92, only now with much higher consumer debt levels.

Furthermore, the fact that so many workers have their pension schemes completely exposed to the market (see below) and the fact that many have drawn down equity on their houses to invest in the stock market will mean that severe hardship may follow for many millions in the event of a

financial collapse. The fate of Enron workers and their worthless pensions potentially lies in store for millions of American workers.

### **3. THE FALLING RATE OF PROFIT IN THE UNITED STATES**

The imbalance between rival states in their relative rates of productivity, consumption and savings, which underpins the first fault line, and the expansion of parasitism which constitutes the second, are underscored by a third and the most serious fault line, sluggishness in US corporate rates of profit and their failure to recover to the rates which drove the long post-war boom. A variety of researchers have investigated trends in the rate of profit in the US economy since World War Two. No matter which method of calculating profitability is used, the findings are the same: “There was a major decline of the profit rate from the first decades following the war to the early 1980s; since then a new upward trend is apparent” (Dumenil and Levy, 2002: 440).

Research also confirms that despite the upward trend of the past two decades, the profit rate in US industry in 2000 was still lower than during the post-war boom, as may be seen from Figure 1.

Mohun (2006: 347), for example, argues that the rate of profit in 2001 was 57 per cent of the level prevailing in 1965. However, if the rate of profit has risen in the past 20 years, can it continue to do so? In order to answer this question we have to understand the factors which have underpinned trends in the rate of profit since World War II. The argument in what follows is mostly drawn from Dumenil and Levy (2002) and, to a lesser extent Harman (1984) (in relation to the impact of the permanent arms economy), but Wolff (2003) and Mohun (2006) also provide interpretations which follow broadly the same line of argument as the former.



**Figure 1: Profitability, the organic composition of capital, and the rate of exploitation in US industry (Restricted Business), 1948 to 2000**



Key:

Profit rate = (net product–labor compensation)/fixed capital (—) (r);

Inverse of the organic composition of capital = labor compensation/fixed capital (- - -) (1/γ);

Rate of surplus-value = profits/labor compensation (- - -) (τ).

Normalized to 1 for 1956–65.

Source: G. Duménil. and D. Lévy, ‘The profit rate: where and how much did it fall? Did it recover? (USA 1948-2000)’, *Review of Radical Political Economics*, 34, 2002, p. 456.

## Explaining the trends

### (i) Why the decline in the rate of profit in the post-war decades through to 1982?

The rate of profit falls when

- the organic composition of capital (OCC) rises (i.e. a rise in the value of investment in plant, machinery, raw materials etc (constant capital) relative to the value of expenditure on employing productive labour (variable capital)); *and/or*
- the rate of surplus value falls (i.e. a decline in the time the worker spends producing surplus value for the capitalist (surplus) compared to the time that they spend on producing goods equivalent to their own living standard (variable capital)).

For the period from the 1940s through to 1981, Figure 1 indicates the trend decline in *inverted* organic composition of capital (i.e. a *rise* in the organic composition of capital) and also a trend decline in the rate of surplus value. Thereafter the organic composition of capital stabilises while the rate of exploitation rises steadily.

In understanding trends in the OCC in the first part of the boom, it is crucial to refer to the destruction of productive capital occasioned by the combination of the Great Depression and WW2. This gave a fresh charge to the expansionary capacity of Western capitalism in the post-war decades by significantly lowering the OCC. The permanent arms economy (PAE) allowed this dynamism to persist far longer than it might otherwise have because it siphoned off into the waste of arms production many billions of dollars that would otherwise have entered the cycle of accumulation in the productive sectors of the economy.<sup>4</sup> The PAE thereby limited the rise in the organic composition of capital, and prevented the rate of profit from falling precipitously.

The process was further helped by the domination of the US whose supremacy allowed it to underwrite the recovery of what had been its erstwhile economic rivals in Western Europe and Japan. However, the very success of the German and Japanese economies forced the US to eventually respond, by re-equipping manufacturing industry, thereby raising the OCC. The PAE effect had worn off – between 1964 and 1982, the organic composition of capital rose sharply, peaking in 1982 at approximately 35 per cent higher than in 1948.

In addition, output rose more slowly than capital investment in the latter period – every one per cent rise in GDP required a greater increase in capital investment than hitherto. Taken together, both these factors kicked along the OCC and thus dragged down the rate of profit.

Trends in the OCC were compounded by the sharply declining rate of exploitation. Figure 1 indicates that, other than a period from the late 1950s to the mid 1960s, the rate of exploitation trended consistently down through to 1982. In bourgeois terms this trend may be expressed as the relatively faster rate of growth of labour costs as against labour productivity, as we may see from the first column in Table 3.

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<sup>4</sup> See Harman (1984) for a discussion of the impact of the permanent arms economy.

**Table 3: Average annual growth rates of hourly labour costs and labour productivity (%) (Restricted Business)**

	1948-65	1965-82	1982-2000
Hourly labour cost	2.60	1.28	1.54
Labour productivity	2.28	0.46	1.97

Source: Dumenil and Levy, 2002, p.454.

During the boom years between 1948 and 1965 both labour costs and labour productivity rose strongly but the former rose slightly faster. Full employment and strong trade unions allowed workers to drive up living standards (both wages and other benefits to the working class) even while labour productivity was also on the rise. Although US unions were politically conservative, they were, by Western standards, industrially militant – of the big six OECD economies, the strike rate in the US was the highest (1950s) or second highest (1960s through to 1976) (Armstrong et al, 1991: 263).

Although many were left behind during the long post-war boom (Harrington, 1962), workers in unionised jobs enjoyed an unprecedented rise in living standards. This had a flow-on effect to most of those in work – trade unions covered 30 per cent of the US workforce in the 1950s, but the real number covered directly or indirectly by collective bargaining was 50 per cent or more. Wages rose across the board, and social security benefits and public expenditure on health and education expanded (albeit at miserable levels compared to Western Europe and Japan). The effect of the differential in the rates of growth of labour costs and productivity was therefore to push down profitability.

From 1965 to 1982, the numbers changed: the rate of growth of both variables fell sharply but the differential between the two was maintained, even increased. Labour productivity growth fell by 80 per cent as against a decline in the growth rate of real wages of ‘only’ 50 per cent. The result was a sharp drop in the profit share.

In summary, between 1948 and 1982, a consistent decline in the rate of exploitation and the onset of rising organic composition of capital in the mid-1960s contribute to the steady decline in the rate of

profit which finally made its effect felt in the broader economy in the early 1970s. The quadrupling of oil prices in 1973-74 which ushered in years of stagflation was only the straw that broke the camel's back, not the cause of the crisis.

***(ii) Why the recovery in the rate of profit since 1982?***

The inverted OCC, the rate of labour exploitation and the rate of profit all continued to fall through the 1970s, bringing about a second deep recession in 1980-82. However, from 1982 onwards, the rate of profit began to recover. What explains its revival? What are its limits? Again, trends in the OCC and labour exploitation give us some answers.

The organic composition of capital, which rose steadily from 1964 to 1982, fell modestly in the early 1980s, contributing somewhat to the recovery in the rate of profit from this point. There have been several factors underlying the decline. First is the slowdown in the rate of growth of physical capital investment in US industry (one sign of weakening confidence by the US ruling class in its own system), and the simultaneous cheapening of that capital, the result of the computer and IT revolution. Wolff (2003) also points to a shift in the distribution of the workforce from sectors with a high OCC (e.g. mining; communications) to sectors with a low OCC (e.g. construction, retail, and private services), leading to a reduction in the economy-wide OCC. This is associated in turn with an increase in the non-productive sphere of capital relative to the productive. In addition, output rose more rapidly than capital investment in the 1980s and 1990s, the result of capital being used more efficiently following the concentration and centralisation of capital and the clearing-out of inefficient capital associated with bankruptcies of household names such as PanAm and Eastern Airlines. Other things being the same, this ensured that the OCC did not need to rise as quickly as hitherto in response to growth in GDP.

More significant than trends in the OCC has been the steady rise in the rate of exploitation.

Exploitation can be increased by two main routes. One is the process evident throughout the history of capitalism of raising productivity and reducing the value of labour power by means of investment in capital equipment which reduces the cost of producing the means of subsistence for the working

class. However, precisely because the rate of profit has been at historically low levels in the past two decades, this method of raising the rate of exploitation has not been of prime importance. The onus has instead been on raising absolute surplus value by increasing hours of work and reducing wages, in other words, sweating.

The 1970s were bleak years for the US capitalist class. Economically the US was under increasing pressure from Japan and Germany. Internationally its reputation was shot by its defeat in Vietnam. At home it faced a restive working class. Social security payments were on the rise. Initial attempts to halt inflation by freezing wages failed. President Nixon was forced to resign in disgrace.

President Carter, elected in 1976, attempted to turn the tide, beginning what we now know as the neoliberal offensive against the working class.<sup>5</sup> Initial attempts at deregulation of the US economy, starting with trucking, airlines and railways, signalled the turn to a more aggressive strategy against the working class. This was promoted most forcefully by Reagan and continued by all subsequent US presidents, Democrat and Republican alike. Its key constituent parts have been tax cuts for the rich, high interest rates (in the first half of the 1980s) which wiped out weak and inefficient capitals, declining expenditure on discretionary government spending, in particular social security, the run-down of investment in infrastructure such as ports, railways, power generation (laid bare by the Californian power cuts in 2003 and Hurricane Katrina in 2005), and attacks on union rights. Bush's massive tax cuts in 2005 only continue the pattern of the last quarter-century. At the level of corporations, the neoliberal offensive comprises large scale redundancies ('downsizing'), reduced entitlements for workers and a clear shift to an aggressive union-busting strategy.

Since the late 1970s, real wages for US production workers have declined (Figure 2). While average incomes rose by 27 per cent between 1979 and 2004, the bottom 60 per cent of individual Americans suffered a five per cent fall (Johnston, 2006). Family incomes have just kept pace with inflation, but this has been entirely due to the rising participation rate of women in the workforce and longer working hours, without which incomes would have fallen. US workers work the longest

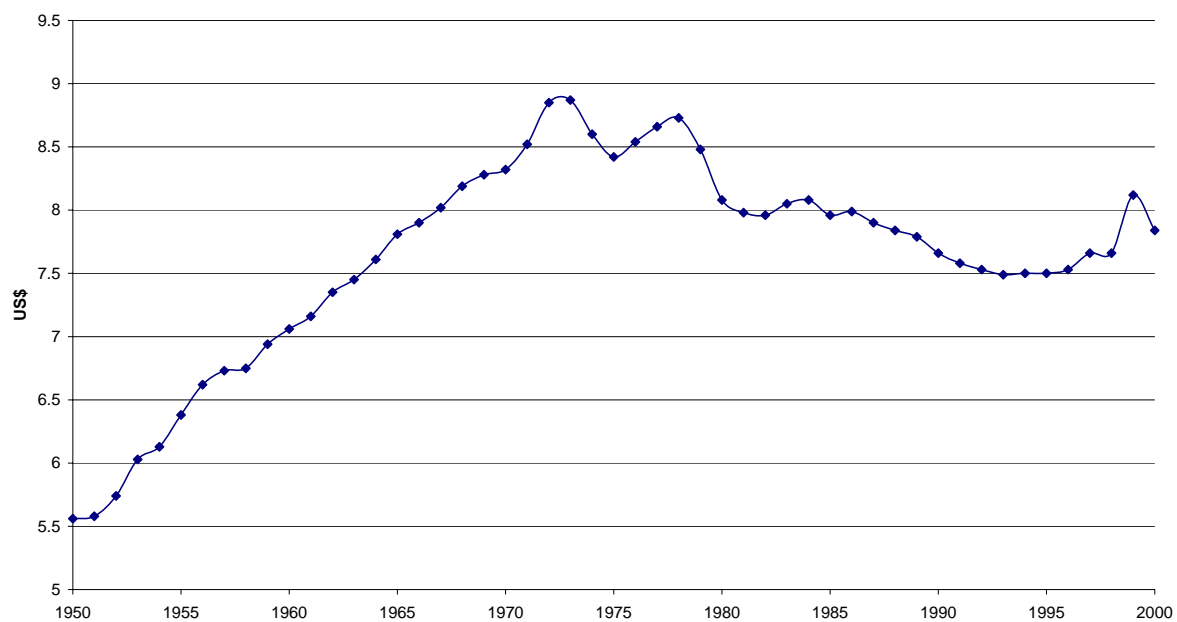
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<sup>5</sup> See Smith (2006) for a full discussion of the employer offensive over the past quarter-century.

hours in the Western world, 1,966 hours per year, up from 1,905 in 1979 and well above the 1,500-1,600 worked in France and Germany (Harms and Knapp, 2003: 430).

**Figure 2**

**Hourly wages US production workers (1982-84 constant \$)**  
(Source: Harms and Knapp, 2003, p.424)



Wages are only one part of worker compensation. In the absence of state provision of health care and pensions, US workers are very dependent on corporate provision. Here, as with wages, the picture since the late 1970s has been bleak. Although coverage has only declined slightly or not at all, the cost burden has been shifted onto workers. The proportion of workers covered by employer health schemes has fallen marginally, from 70 per cent in 1979 to 67 per cent in 2000. But workers are now much more likely to have to pay for it: the proportion of workers in medium and large businesses who had to make a financial contribution to their health scheme rose from 26 per cent in 1980 to 69 per cent in 1997 (Harms and Knapp, 2003: 428).

Similarly, the proportion of workers with employer-provided pensions did not change between 1979 and 1998, but the proportion of medium and large private sector employers who provided defined *benefit* schemes (as opposed to defined *contribution* schemes, where the worker bears the entire risk of stock market falls) dropped from 84 per cent to 50 per cent (Harms and Knapp, 2003: 429)

Furthermore, there has been a trend towards reduction in the value of these non-wage benefits.

Although the value of such benefits grew by 1.1 per cent annually in the 1980s, they fell by 2.1 per cent per annum in what were held up as the ‘boom years’ of 1995-99 (Harms and Knapp, 2003: 429).

In contrast to the working class, the super-rich have been raking it in. The pay of top executives rose by double digits every year from 1989. The share of declared income of the top five per cent fell from 17.3 per cent in 1950 to 14.4 per cent in 1981 but shot up by nearly one-half to 20.8 per cent by 2000 (Harms and Knapp, 2003: 427). One-third of the entire increase in national income between 1979 and 2004 went to the top one per cent of income earners (Johnston, 2006). These trends have only escalated since 2004 (Guerrera, 2006b). The situation for wealth holdings is even more acute. The proportion of assets held by the richest one per cent of American households fell steadily from 35 per cent to 22 per cent between 1965 and 1976. By 1998 it had risen to 37 per cent (Dumenil and Levy, 2004: 139).<sup>6</sup>

The squeeze on the working class may have been led by the US government and business sector, but the recipe was soon followed elsewhere. Neoliberalism became the order of the day, first in the ‘Anglo-Saxon’ countries of the USA, UK, Australia and New Zealand, and now as a world model, courtesy of the IMF and World Bank. Across the OECD, employee compensation rose by an annual average of 12 per cent between 1975 and 1985 (Kettell, 2006: 42). Between 1996 and 2002, growth fell back to only 4.2 per cent. The wages share of GDP fell from 54.3 per cent in the early 1980s to 50.8 per cent two decades later (Kettell, 2006: 42). The result of this assault on the working class was a revival of US profitability for 15 years starting in 1982.

### ***(iii) Current trends in profitability***

As we may see from Figure 1, the rate of exploitation steadily rose until the mid-1990s and the OCC was stable. The rate of profit grew steadily as a result. However, this trend came to an end in about 1997, when the rate of profit fell back as the rate of exploitation was at last modestly reduced.

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<sup>6</sup> Assets are defined here to include real estate, securities, monetary holdings and durable consumption goods, minus debt.

The cause of the latter was most likely the recovery in real wages associated with falling unemployment and labour shortages. The rate of profit then fell back still further in the deep recession of the early 2000s but recovered in 2003-05 with the mass of profits now at a record high on the back of rapid increases in productivity and falling real wages (Greenhouse and Leonhardt, 2006).<sup>7</sup> It is likely therefore that the rate of profit has recovered to where it stood in 1997.

But can the US capitalist class now rely on a resumption of increasing rates of profit to the point that they recover to the level prevailing in the 1950s and 1960s? Obviously all speculation on this point can only be that. However, three main factors suggest not: one is the fact that the OCC will eventually have to start rising (if it has not already). The large one-off element of capital cheapening that occurred with the IT revolution of the 1980s and 1990s will eventually subside, meaning that constant capital once again becomes dearer. At some point the shift of the workforce out of capital intensive to labour intensive sectors will level off. The ratio of output growth to capital investment may also start to slow down. And, as China continues its heavy investment in capital equipment, this will have an effect on the global OCC which will impact on the USA as the fortunes of these two economies have become increasingly intertwined.

The second factor suggesting a limit to the recovery in the rate of profit is the limits on the ability of US business and government to keep raising the rate of exploitation, as labour productivity begins to slacken and/or because of working class resistance. And, finally, the insertion of China and India as major operating bases for Western investment represents a significant windfall by serving to cheapen labour power in circuits of Western capitalism. The entry of tens, if not hundreds, of millions of new labourers has brought about a global reduction in the socially necessary labour time required for the reproduction of the working class by cheapening consumer goods. Once this allegedly inexhaustible supply of new labour begins to dry up, wages will be bid up further in China, most likely halting the process of reducing the cost of labour power in the West.<sup>8</sup>

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<sup>7</sup> Annual changes in real wages for production workers for the period 2000 to 2006 were as follows: +1.7%; +0.6%; -0.1%; -0.7%; -0.3%; +1.8% (Bureau of Labor Statistics, 2007)

<sup>8</sup> There are already signs of this occurring in the Pearl River Delta in Southern China. Chinese workers are now heading for higher wages in Shanghai, forcing Pearl River companies to offer higher wages to draw them back.



While the rise in wages in China and India may create mature markets for Western services industries, we only have to recall the fate of Japan in the 1990s to understand the potential for stagnation in these new figures on the international capitalist stage. Yesterday's miracle economy, whether it be Germany, France, Italy, Japan, or the Asian Tigers, has in every case turned out to be all too prone to the inherent contradictions of capitalism. The Chinese economy is subject to all the stresses and strains that might be expected following more than two decades of ten per cent growth, including evidence of excess capacity, large numbers of financially insolvent banks and endemic corruption. Regardless of the economic situation, the tens of thousands of protests that occur in China each year could at some point coalesce into a major threat to the regime (Harman, 2005). Pressure on the rate of profit has important consequences for the future of the world economy. First, the relatively low profitability makes any institutional or short-term crisis arising out of the first two fault lines – global imbalances and financial speculation – much more likely to lead to a global loss of confidence and to spin out of control. For example, the rise of financial speculation is premised not on confidence in the world economy but on nervousness, and this anxiety is framed around the problems evident in US industrial capital (for example, autos). A speculative crash therefore has no productive 'floor' which would limit it. Rather, the crisis in the productive core would only compound a speculative meltdown.

Second, attempts by the US financial and political establishment to keep boosting the rate of profit can lead to some short-term relief but store up two problems:

- by suppressing working-class living standards, they contribute to the problem of rising consumer debt; and secondly,
- they undermine the ideological hold of capitalism on the US working class.

This latter point takes us to the final part of this document – the political consequences of the long-term crisis in the US economy.

### **PART 3: PROSPECTS FOR THE WORLD SYSTEM**

It is important to recognise first of all that crisis does not mean permanent decline nor does it have to be resolved quickly (in the way that medical crises do with either death or recovery). Historians commonly talk about the ‘crisis in the feudal mode of production’, the ‘crisis of the *anciens regimes*’, or the ‘crisis of Tsarist Russia’. In each case, production continued to rise, and the crisis lasted decades if not centuries.

What we mean by the crisis of US capitalism is that the motor force, the rate of profit, cannot rise to the levels experienced in the long boom. The result is that, even in periods of renewed prosperity, rates of economic growth lag behind and working class living standards stagnate. The experience is not one of ‘a rising tide lifting all boats’ and general optimism involving all social classes, as it was in the 1950s. Rather, the experience is of a more fragile prosperity resting on shaky foundations, kept alive by constant attacks on the working class and ever greater reliance on financial manipulation and speculation.

And, finally, the existence of rising profitability does not prevent sharp downturns, as was evident with the deep recession in the US in 1990-92. The fact that this recession was far deeper than those that occurred during the post war boom (when profitability was actually falling) indicates that what matters, ultimately, is not the trend, but the level of the rate of profit. Regardless of the recovery of the US economy in the past decade, the rate of profit in US industry remains significantly lower than in the post-war boom, and the organic composition of capital significantly higher. Until and unless these are fixed, it is unlikely that the system can be restored to its former rude health.

A variety of further contradictions in world capitalism continue to plague the system. First, there is the struggle between the rival capitalist classes of the world. Regardless of the partial success of US capitalism or short-term oscillations in GDP, the world economy is riven by a central contradiction – that the forces of production are increasingly organised around an international basis but continually confront the social relations of production which are defined on a national basis.

As we have seen, there is an increasing disjuncture between the economic networks of production and finance overseen by the multinational companies and the national states overseen by OECD governments. Thus, approximately 60 per cent of ‘Chinese’ exports and imports actually involve foreign companies and joint ventures. This *partial* disjuncture between economics and politics requires the increasing intervention of transnational institutions such as the World Bank, WTO and IMF. However, this does not mean that states are becoming irrelevant. Far from it, even institutions such as the WTO and IMF are transnational in name only and in practice are still dominated by a small number of powerful states. And, when all is said and done, General Motors, Airbus Industries and Toyota still rely on the political clout of ‘their’ ruling classes to advance their interests.

So, the logical organisation of production on a global basis, with an associated global division of labour, is constrained by national contests for supremacy between rival capitalist classes.

Governments, representing the interests of ‘their’ capitalist classes, pass laws or promote policies which assist their capitalists but which ultimately damage the interests of capitalism on a world stage. The use of tariffs and subsidies, trade pacts, or competitive movements in exchange rates or interest rates are examples of this process.

The USA has used the past 15 years to restore its hegemony against Germany and Japan.

Discussion in ruling class circles is no longer about the relative decline of the US but about its newfound economic confidence relative to its great rivals. It should be noted that this is not because US growth has escalated substantially, only that growth in its rivals has collapsed. However, as one set of national rivalries abate, they re-emerge in new forms. The German and French capitalist classes have used the EU as a way of projecting their interests against the US in world trade negotiations. China represents a major opportunity for US business, but also a threat, as protectionist sentiments in the US Congress attest (Korporaal, 2006).

The conflicts between capitalists also hold back production in other important ways. The capitalists of the world need to make profits. At times the only way that this can be done is by periodically throwing the entire world economy into recession and destroying significant forces of production

not just in the rich West, but also by holding back productive expansion in whole continents such as Africa, Latin America, and Asia. As Marx (1954: 358) wrote: “The true barrier to capitalist production is capital itself”. Furthermore, the resolution of crisis means attacks on the living standards of the working class, whose spending power is fundamental to prevention of bouts of overproduction.

The second set of contradictions arises in the conflict between the working class and capitalist classes of the world. During the long post-war boom, consensus politics ruled in most Western countries. Trade unions were accorded a role in domestic politics, even in the United States, as they served as guarantors of labour stability after the tumultuous labour unrest of the 1930s. The welfare state was extended.

With the onset of economic crisis, the ruling classes of each nation have gone on the offensive against the working class. In the case of the USA, these attacks have been met with little worker resistance, enabling US capitalism to restructure and provide a spur to growth and the creation of large workforce employed on very low wages and conditions. Thus, despite three years of growth and falling unemployment in 2003-05, wages and salaries now make up the lowest share of GDP since records began in 1947 (Greenhouse and Leonhardt, 2006). Job insecurity has continued – in 2005, nearly one-quarter of Americans were concerned that they could lose their jobs over the following 12 months (BBC News, 20 November 2005). In the case of the EU, employer and government attacks have in some cases been repelled, as for example with the CPE or the proposed EU Constitution (the UK, where the ruling class has inflicted heavy defeats on British workers, stands as something of an exception). In most of the EU, therefore, there does not exist a large pool of labour employed on very low wages, and the social security net still has some real content.<sup>9</sup> As European capitalism has not been able to restructure in the same way as its trans-Atlantic rival, the result is more prolonged economic stagnation, weak investment and persistent high unemployment.

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<sup>9</sup> Here I am referring to the traditional EU15, not including the post-2004 new entrants.

Trends in the United States are weakening the social consensus that underpinned US politics in the post-war decades. Mainstream commentators are well aware of the growing alienation of the US working class. In August 2006, Paul Krugman (2006), former IMF economist, wrote

The real wages of most workers fell during the ‘Bush Boom’ of the last three years. If that boom, such that it was, is already over, workers have every right to ask ‘Is that it?’. Another veteran Washington analyst, Charles Cook, commented:

There are two economies out there. One has been just white hot, going great guns. Those are the people who have benefited from globalization, technology, greater productivity and higher corporate earnings. And then there’s the working stiffs who just don’t feel like they’re getting ahead despite the fact that they’re working very hard. And there are a lot more people in that group than the other group (cited in Greenhouse and Leonhardt, 2006). Business and government attacks have weakened the base of support for the political and financial establishment amongst the mass of the population throughout the West – hence declining participation by voters in elections, reflecting a loss of confidence in any ruling class party. These attacks, however, will continue as the crisis of the system affords no relaxation in the competitive race. In the United States, the social reforms of the post-war years and the Great Society programs of the 1960s are in tatters. The flashes of public anger evident in the United States since 2003 (for example, the political crises caused by Hurricane Katrina and the war on Iraq, the enormous demonstrations by Hispanic migrant workers in May 2006, and the defeat of the Republicans at the Congressional elections of November 2006) may be a portent of things to come.

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