



Field Notes

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Toward a New Global Recession?

Economic Perspectives for 2016 and Beyond

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FOR SWPM, DH, AS, DF, GD & DL

What economists call “macroeconomic variables” are numbers such as the gross domestic product, interest rates, tax revenue, government expenditure, exports, imports, consumption, and the like which are used to describe the economy at large. Variables like these are usually considered the most important ones to describe and understand how our economy works. There are, however, other macroeconomic variables that from an empirical point of view are essential to explain the condition and the workings of the free-market economy, alias capitalism. They are total income received as compensation for labor—i.e., wages and salaries—, total income received from capital ownership—i.e., corporate profits—, and the unemployment rate. The table to the right shows the annual change of these three variables in the United States since 1981. The first two columns show the percentage increase in total labor income (wages and salaries) and capital income (profits) in the corresponding year. Thus in 1981 wages and salaries grew 0.6% compared with 1980, while corporate profits grew 5.8%, both measured in what economists call “real terms,” i.e., discounting inflation. As for the unemployment column, it presents the annual increase, measured in percentage points, in the unemployment rate. Thus the 0.5 figure for 1981 indicates that the unemployment rate rose half a per-

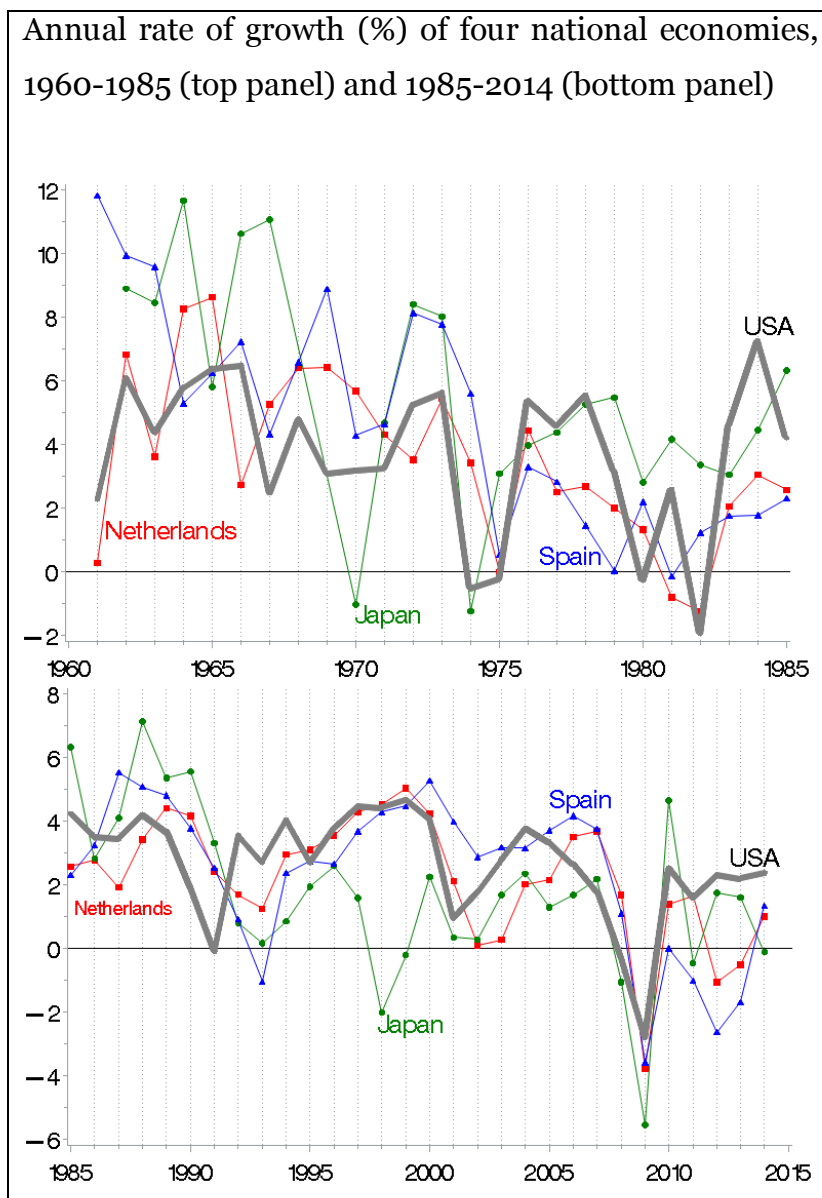
Annual growth of wages and salaries, corporate profits, and the unemployment rate, USA 1981-2014			
	W&S	Profits	Unemp.
1981	0.6	5.8	0.5
1982	-1.0	-14.6	2.1
1983	1.7	19.3	-0.1
1984	6.2	18.9	-2.1
1985	4.1	1.8	-0.3
1986	4.0	-11.7	-0.2
1987	4.7	9.0	-0.8
1988	4.4	8.7	-0.7
1989	1.9	-6.6	-0.2
1990	2.4	-5.2	0.3
1991	-0.6	6.4	1.2
1992	3.0	4.9	0.7
1993	1.4	8.1	-0.6
1994	2.9	19.7	-0.8
1995	3.4	9.9	-0.5
1996	3.9	10.1	-0.2
1997	5.4	9.0	-0.4
1998	6.7	-8.5	-0.5
1999	5.2	-0.4	-0.3
2000	5.8	-12.3	-0.2
2001	0.4	-10.1	0.7
2002	-0.7	26.3	1.1
2003	0.8	16.6	0.2
2004	2.7	18.0	-0.5
2005	1.7	11.3	-0.4
2006	3.2	8.9	-0.5
2007	2.8	-17.6	0.0
2008	0.2	-26.7	1.2
2009	-5.1	17.4	3.5
2010	0.8	28.4	0.3
2011	1.9	1.1	-0.7
2012	2.6	14.2	-0.8
2013	1.2	3.6	-0.7
2014	3.6	-1.9	-1.2

centage point that year (in particular, the unemployment rate was 7.1% in 1980 and 7.6% in 1981).

The table depicts several periods of economic crisis or “recession,” in the usual terminology. In these periods unemployment rises (the annual growth is positive) and wages and salaries drop (the annual growth is negative). This is what happens in the early 1980s, the early 1990s, after the turn of the century, and then, again, in 2009. But every crisis is preceded by a drop in the return to capital, which appears as a negative growth of profits. Then in a year or two, sometimes in the same year, wages and salaries start falling at the same time that unemployment rises. For example, in 1989 and 1990 profits decreased by 6.6% and 5.2%, respectively, and in 1991 wages dropped and unemployment, which had been declining in previous years, increased. In 2007 and 2008 profits dropped 17.6% and 26.7%, respectively, and that decline in profits was immediately followed by the slump of 2009 in which wages dropped by 5.1%—the highest wage contraction throughout the period considered—and unemployment increased 3.5 percentage points. In 1998-2001 there were persistent contractions in profits and immediately following them, wages fell and unemployment rose in 2002. Thus, the pattern is one of falling profits (e.g. 2000-2001) followed by falling wages and rising unemployment (2002-2003). Falling wages, rising unemployment and rising profits (2002) lead to a period of expansion with rising wages and falling unemployment (2003-2007), until profits start falling (2007) and the cycle starts again with another recession.

Now, it can be thought that these are phenomena of the so-called U.S. business-cycle that have little to do with the rest of the world. However, it is easy to show that what happens in the U.S. economy has a lot to do with what happens in other countries. The figure on next page shows the annual rate of growth of four national economies in 1960-1985 (top panel) and 1985-2014 (bottom panel). Recessions are apparent as troughs in the growth curve. Focusing in the most recent period (bottom panel) the figure shows clearly the U.S. recessions of the early 1990s, 2001, and then the 2008-2009 slump usually called the “Great Recession.” Interestingly, the other countries in the graph also had major declines in economic growth in the early 1990s (somewhat after the US), immediately following the turn of the century, and in the Great Recession of 2008-2009. Comparing the top panel and the bottom panel of the figure it is apparent

that the oscillations of the four economies are more synchronized in the most recent period. While in the 1960s and 1970s the four economies oscillated more or less independently, they have oscillated very closely since the 1980s. Indeed, the Japanese recession of the late 1990s is the only discordant note in a quartet playing quite in tune during the past three decades. Of course the crises have not occurred exactly in the same year and with the same intensity in the four countries, but they have a significantly similar timing which has grown more synchronized over time.



What has been illustrated here with the cases of the United States, Spain, Japan, and the Netherlands could be also illustrated with many other countries. The national economies are increasingly synchronized and there are many reasons to see the slumps around the turn of the century and then in 2008-2009 as crises of the world economy. And the same could be said about recessions in the mid-1970s, the early 1980s, and the early 1990s.

Now, what could explain the increasing synchronization of the national economies? A possible reason would be that the economy of the world at large is becoming increasingly dependent on the U.S. economy. Thus the U.S. economy would be the locomotive

pulling the rest of the world and recessions or expansions of the U.S. economy would spread to all the other national economies. This explanation is supported by quite a number of economists and politicians, for instance, in Latin America and Europe. It seems unlikely, however, for several reasons. First, there is general agreement that the weight of the U.S. in the world economy has been declining in recent decades. That would tend to produce less rather than more synchronization if the synchronization were caused by the economy of the rest of the world being dependent on the U.S. Second, the links between the U.S. and economies which have been highly synchronized with the U.S. economy in recent decades are not particularly strong. Thus, for instance, the graphs show that the expansions and recessions of Spain and the U.S. are highly synchronized, even from the 1970s on. However, Spain has much stronger commercial links with the countries of the European Union than with the United States. Third, the timing of the crises does not support the idea that the U.S. is leading and the other economies following. Thus we see, for instance, that the crisis of the early 1980s in the U.S. was in fact preceded by a big decline in economic growth in Spain during the late 1970s, with Spanish GDP growth reaching 0.0% in 1979. Then in the early 1990s the recession occurred earlier in the U.S., when economic growth was -0.1% in 1991, and followed in Spain two years later, when economic growth dropped to -1.0% in 1993. Thus the crisis of the early 1980s started earlier in Spain though it was more intense in the U.S., while in the early 1990s the crisis manifested first in the U.S. but was more intense in Spain.

For these reasons, the view that the U.S. economy is the one that determines the economic conditions of the world is increasingly discredited. With very large rates of growth of so-called emergent economies in the past two decades, while GDP growth has been anemic in the U.S. and the share of U.S. GDP in total world economic output has been shrinking, the idea that the American economy is the engine of the global economy is increasingly unbelievable. It is obvious, however, that the interconnections of the national economies have grown stronger every year, so that expansions and recessions are increasingly synchronized, as it was noted already in 1997 by Allan W Gregory. The opinion of some historians, like Immanuel Wallerstein, is that the world economy was a reality already several centuries ago. That is arguable, but it is unarguable that the world economy has become a very tangible reality in recent decades, when the links binding

together national economic spaces—trade, capital flows, flows of people, financial shocks—have become much stronger. Of course, to assert the existence of the global economy does not imply that national economies have no autonomy. In fact, as the figure illustrates, the economies of the U.S., Japan, the Netherlands, and Spain evolved quite differently after the Great Recession of 2008-2009. While the U.S. economy had a weak but real recovery, the Spanish, Japanese, and Dutch economies have been mired in crisis and negative growth throughout the present decade.

Many economists and economic commentators claim that the different evolution of the economies of the U.S., Western Europe, and Japan after the 2009 slump illustrates how different economic policies— austerities or expansionary monetary policy (i.e., quantitative easing)—generate different economic performances. However, the synchronization of national economies actually makes it increasingly hard to believe that economic performance has much to do with the role of national governments. Since national governments have applied different economic policies in past decades, if economic policy had a major influence on economic growth we would expect a broad dis-synchronization of national economies, but we observe precisely the opposite.

But let's leave this controversial issue to return to the economic perspective for the world economy. What has been just said could be taken as suggesting that we have to look at numbers for the world economy to get some insight into the economic perspective for the next years. Numbers for the whole world economy like those in the table accompanying this article would be ideal, but they are not available. However, the figures for the United States can probably be considered good enough to provide insight into what is going on in the world economy. Particularly, as the table shows, in 2014 corporate profits fell in the U.S. by 1.9% and indeed this contraction of profits in the U.S. can very well be taken as an indication that profits probably contracted in 2014 in other national economies and in the world economy at large. (That profits have recently declined in the world economy is also the conclusion of economists like Michael Roberts and Ryan Banerjee.)

Data show that, quite regularly, when profits have declined there has been a recession with rising unemployment and falling wages in the years immediately following. Since

profits have dropped in the U.S. economy, and very likely also in the world economy, in 2014, the most likely outlook seems a new general recession of the U.S. and the world economy starting soon, in 2016 or not much later. The pattern of declining profits followed by a recession has very strong statistical support, as it is found not only in data for recent decades but also in earlier times. Wesley Mitchell and Jan Tinbergen found it in statistics covering several decades before World War II. The statistical regularity of declining profits and subsequent recession does not mean, however, that every year of declining profits will necessarily be followed the next year by a recession. As the table shows, in 1986 profits declined and a recession did not occur until several years later. In the early 1990s and the Great Recession the slump was preceded by two years in a row (1989-1990 and 2007-2008) of declining profits, while the recession of the turn of the century was preceded by four years (1998-2001) of declining profits.

For some economists like James Hamilton and Ben Bernanke an important macroeconomic variable is the price of crude oil, the idea being that high oil prices strangle economic activity at large, leading to recession. Since oil prices have indeed increased before each recession of the world economy in recent decades, data appear to give some credence to this view. However, a closer examination of the numbers—as done for instance by Lutz Kilian and Martin Stuermer—strongly reduces the credibility of that interpretation. It happens that oil prices rise when the global economy expands and energy demand increases. So it is the global expansion that raises oil prices. These in turn might contribute to trigger the crisis, but first, the evidence that high oil prices have a direct effect in reducing economic activity is rather weak; second, at any rate, rising oil prices have their cause in the previous expansion. Oil prices have been at quite low levels in recent months and the general agreement is that this is due to the low level of economic activity in most of the world economy.

It is indeed possible that we are right now in a new recession of the world economy, though if that were the case the recession would have begun in an insidious and creeping way, not with financial turmoil like the one that marked the outburst of the Great Recession of 2008 or the recession of the turn of the century, which was very mild in the U.S. but was accompanied by financial debacles in many countries of Latin America and Asia. Another possibility is that we are now in a “rare” period of the global economy in

which there is neither a clear expansion nor a clear recession. To decide among these possibilities more perspective is needed. What is certain now is that the reduction of profits in the U.S. in 2014 is likely a manifestation of the decline in capital returns in the world economy. That is the reason why everywhere in the world huge masses of money are idle in safes and bank deposits, waiting for “investment opportunities.” Though economists tend to ignore this fact, corporate profits—returns on investment—are the engine of the capitalist system. Unless some very unexpected factor, like workers deciding to work much more for much less, increases the profitability of capital in the near future, everything suggests that the world economy will go soon into recession—if not in 2016, then not much later. But as the joke goes, predictions are always risky, especially when they concern to the future.

Sources: Growth figures of wages and salaries and corporate profits (domestic industries, before taxes) are taken from the official statistics of the Department of Commerce, NIPA tables. Before calculating annual growth values, nominal dollars were converted into 2009 dollars using the GDP deflator, also from NIPA. Unemployment data are from the Bureau of Labor Statistics. The graph is elaborated with GDP growth rates from the World Development Indicators database of the World Bank.

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Editor's note: This article was received well before early January's stock market turmoil.

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