

Personal Debts and US Capitalism

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Personal Debts and US Capitalism

by Rick Wolff

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There is no precedent in US — or any other — history for the level of personal debt now carried by the American people. Consider the raw numbers. In 1974, Federal Reserve data show that US mortgage plus other consumer debt totaled \$627 billion. By 1994, the total debt had risen to \$4,206 billion, and by 2004, it reached \$9,709 billion. For the second quarter of 2005, the Fed announced that the nation's debt service ratio (debt payments as a percentage of after–tax income) was 13.6%, the highest since the Fed began recording this statistic in 1980. Past borrowing now costs Americans so much in debt service that more borrowing is required to maintain, let alone expand consumption.

These facts raise two questions: what caused this mountain of debt to arise and what are its consequences? Answering these questions is an urgent matter since, as has been known for centuries, the risks of high debt include economic collapse.

Since the real wages of most workers stagnated or fell since 1975, they responded partly by borrowing to maintain or raise their living standards. Over the last twenty five years, ever more enterprises (stock brokers, insurance companies, lending branches of industrial corporations, etc.) are seeking high profits by offering easier loans (credit cards, basic mortgages, home equity lines, mortgage refinancing, tax–refund advances, etc.). After the stock market bubble burst in 2000, the Federal Reserve tried to contain the damage by drastic, sustained cuts in interest rates. Already debt–addicted, US households responded to cheap, available credit by borrowing much more.

Historically low interest rates and intense competition among lenders drew millions of Americans into borrowing to buy a first home. Not only the native–born exchanged rental apartments for "the American dream." Millions of immigrants borrowed to partake of that dream too. Millions of other Americans borrowed for costly home expansions and renovations. The resulting boom in residential construction and its dependent industries partly offset

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the depressive economic effects of the stock market bubble burst in 2000. A stock market bubble gave way to a housing bubble. As housing prices were bid up, homeowners' "equity" in houses rose, and that allowed them to borrow still more with their higher "home equity" as collateral.

In all debt-based economic upswings, the crucial issue is: How long will lenders keep feeding rising debt demands? Nowadays, banks lending to US homeowners usually resell that debt to investors in the form of "mortgage-backed securities." Because the US government is believed to guarantee those securities, more or less, investors around the world have been buying them. The two biggest buyers recently have been banks in Japan and the People's Republic of China. They are therefore — and note the irony — among the biggest ultimate recipients of the monthly mortgage payments made by American homeowners. The US housing bubble postpones bursting only so long as Americans keep borrowing and the major housing lenders, including the Japanese and Chinese banks, keep the cycle of rising home prices and rising home indebtedness rolling.

Nothing guarantees that the lending and borrowing binges will continue. Americans' rising debt levels may frighten them into slowing or ending their borrowing. Countless other possibilities from political shifts to military reverses to cultural changes — including the tougher bankruptcy laws that will take effect on Monday, October 17 — could likewise reduce Americans' abilities or willingness to borrow. Similarly, all sorts of considerations may dissuade lenders, foreign or domestic, from continuing to provide credit. If and when either the borrowing or the lending slows, the housing bubble will likely burst. As home buying slows, housing prices will stop rising. Inventories of new homes will become difficult to sell, resulting in lower home prices. Housing construction will stop, raising unemployment in that industry and all others dependent on it. Rising unemployment will likely further depress home prices since the unemployed cannot maintain mortgage payments, and so on.

The economic optimism required to keep the Bush regime afloat regularly issues from economists and politicians. They offer reasons why American homeowners will keep borrowing and why lenders will keep providing the credit. Because rising home prices have made American homeowners richer, they are willing to keep borrowing. Likewise, lenders are willing to provide more credit to richer borrowers. Yet these "reasons" explain nothing; they merely describe the bubble itself. Identical predictions in 1999 promised that rising stock prices enriched stock owners who could then afford more stock purchases at higher prices and so on. Yet, the stock market bubble burst. Why should the same not happen to housing prices?

Some optimists try another line of reasoning. Japan and China will keep lending to US homeowners because, if they do not, a collapse in the US housing market will hurt them. Japan and China depend heavily on sales of their goods to Americans. An economic downturn here will cut demand for their goods and so spread to them. Thus, they have no choice but to support the US economy by endless lending to Americans.

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This argument's flaw emerges from a brief look at capitalism's history. Every previous capitalist depression, including the devastating one in 1929, was thought to be impossible because everyone wanted to avoid it since everyone foresaw how a depression would hurt everyone. Today again, US homeowners, businesses and the government want to avoid a burst housing bubble. The Japanese and Chinese banks and government as well as all the other lenders into the US housing boom want the same. The history of capitalism teaches us that what everyone wants provides no guarantee that it will happen. Everyone may want to keep the boom afloat, but because everyone is also hyper-vigilant to get out of a market that seems to be on the way down, once a downturn starts, it can quickly become a collapse. It has happened many times.

Once again, capitalism brings us to a precipice. Surely the human race can devise a better system. And if not now, when?

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