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Mathieu Dufour¹ and Özgür Orhangazi²

Abstract

The literature on the outcomes of the financial crisis in low- and middle-income countries in the post-1980 era presents three broad findings: first, the burden of crises falls disproportionately on labor in general and low-income segments of the society in particular. Wages and the labor share of income fall, unemployment increases, the power of labor declines, and income inequality and poverty increase. Capital, on the other hand, recovers quickly and gains more ground. Second, government policies favor capital, especially financial capital, at the expense of the larger public. Crises also present opportunities for further deregulation and liberalization in financial markets and the rest of the economy. Third, following financial crises, foreign capital inflows may increase as international capital seeks to take advantage of the crisis and acquire assets at fire-sale prices. The 2008 U.S. financial crisis provides an opportunity to extend this analysis to a leading high-income country. By examining the experience of the United States after the financial crisis in terms of the questions and issues typically raised in examinations of low- and middle-income countries, this paper makes an original contribution, while, at the same time, contributing to the gradually emerging literature on the consequences of the U.S. financial crisis. We first look at the distributional effects of the financial crisis and compare this with the impacts of the crisis on capital. Then, we investigate the changes in income shares of labor and capital before shifting our attention to changes in inequality and poverty. Next, we focus on the role of government policies through an analysis of government taxation and spending policies. Finally, we examine the changes in capital inflows before concluding with a discussion of our overall findings and further research areas.

JEL classifications: G01, D31, E62, F21

Keywords

financial crisis, Great Recession, 2008 crisis

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1. Introduction

The literature on the outcomes of the financial crises in low- and middle-income countries in the post-1980 era present three broad findings: first, the burden of crises falls disproportionately on labor in general and low-income segments of society in particular. Wages and the labor share of income fall, unemployment increases, the power of labor declines, and income inequality and poverty increase. By contrast, capital recovers quickly and gains more ground. Second, government policies favor capital, especially financial capital, at the expense of the larger public. Crises also present opportunities for further deregulation and liberalization, both in financial markets and in the rest of the economy. Third, following financial crises capital inflows may increase as international capital seeks to take advantage of the crisis and acquire assets at fire-sale prices (Crotty and Lee 2001; Duménil and Lévy 2006, 2011; Harvey 2003; Diwan 2000, 2001; Jayadev 2005; Onaran 2007; Wade and Venoroso 1998; Dufour and Orhangazi 2007, 2009).

The 2008 U.S. financial crisis provides an opportunity to extend this analysis to a leading high-income country. This paper makes an original contribution to the literature on financial crises by examining the U.S. experience after the crisis in terms of the questions and issues typically raised in the study of low- and middle-income countries. First, we look at the effects of the financial crisis on labor and then on capital. We compare the changes in the income shares of labor and capital before shifting our attention to changes in inequality and poverty. Next, we focus on the role of government policies following the financial crisis. Finally, we examine the changes in capital flows before concluding with a discussion of our overall findings and further research possibilities.

2. Crisis and Distribution

2.1. Unemployment and wages

Labor is a useful starting point in studying the distribution of the burden of the crisis in society, as crises typically result in increased rates of unemployment and a decrease in labor incomes. The power of labor can also be affected in different ways if, for example, the crisis is used as a pretext for labor repression, or resistance to different measures and outcomes energizes it. Figure 1 shows the official unemployment rate and a broader measure which includes marginally-attached workers, such as discouraged workers and individuals working part-time for economic reasons. The official rate almost doubled after the crisis, while the broader measure peaked at 17.1 percent. Both rates have since come down slowly, but are still significantly higher than their pre-crisis levels, suggesting that while some people are finding work, many remain underemployed or simply discouraged by their job prospects. A look at the labor force participation rate and the proportion of the civilian population that is employed reinforces that assessment. Both have been falling since 2007, with the rate of employment reaching 58.3 percent by late 2013, down from around 63 percent before the crisis, with virtually all the drop happening in 2008 and 2009. Those two rates are now at their lowest since the early 1980s.

Furthermore, there is a polarization of the workforce. According to a study by the National Employment Law Project (2012), lower-wage occupations grew 2.7 times faster than mid- and high-wage jobs during the recession. Job losses in low-wage, mid-wage, and high-wage occupations were 21 percent, 60 percent, and 19 percent, respectively, compared to job creation of 58 percent, 22 percent, and 20 percent during the recovery. As a result, the proportion of workers earning wages below poverty-level increased from 23.3 percent in 2006 to 28 percent by 2011. Moreover, the proportion of men working at or below minimum wage went from 2.5 percent in 2006 to 4.2 percent in 2009, while 4.1 percent of women worked at or below minimum wage in 2006 compared to 6.2 percent in 2009 (Mishel and Gee 2012).

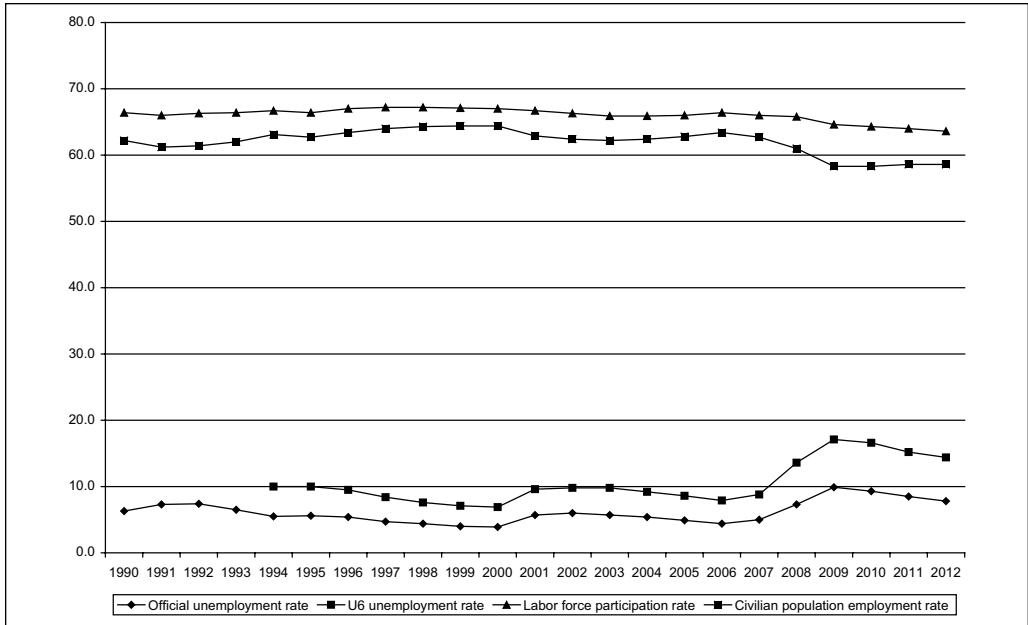


Figure 1. The rate of unemployment, labor force participation rate and employment to civilian population ratio (%). Source: FRED.

Labor income has also dropped since the beginning of the crisis. After being stagnant for over two decades, the real median hourly wage increased by a couple of 2011 dollars in the mid-1990s and stabilized at a new plateau in the early 2000s (Figure 2). The same pattern is apparent in median total compensation, a broader income measure that includes benefits. Apart from a slight increase early on in the crisis, likely due to deflation in 2009 and wage contracts with in-built inflation expectations, both measures go down following the financial crisis.

The loss of income is not uniform across income groups. Comparing average and median total compensation, it can be seen that not only did the average not stagnate from the mid-1970s onward, but the drop following the crisis was relatively smaller. The drop would have been larger for average total compensation without the deflation in 2009, but it would have set it back to 2005 levels instead of the beginning of the decade like median total compensation.¹

Last, we look at the bargaining power of labor after the financial crisis, proxied by unionization rates and data on work stoppages. Union membership has been quite low in the United States for some time. From rates around 23 percent during the 1970s, union membership experienced a secular decline and by the mid-2000s it had stabilized around 12 percent. The crisis gave it a little nudge downward and by 2012 membership was down to 11.2 percent. Most of the drop happened after 2009, suggesting that union jobs were lost in the crisis and non-union jobs were created in the recovery. The picture is even starker in the private sector. The union membership ratio decreased from 7.6 percent in 2008 to 6.6 percent by 2012.² Moreover, an examination of union activity and works stoppages data (not presented here) show that they were already at a minimum in the United States before the crisis, which itself does not seem to have changed this situation.

¹One should also look at the differential impact of the financial crisis on race and gender. On this issue see, for example, Peterson 2012; Arestis *et al.* 2013; Dymski *et al.* 2013.

²Authors' calculations from Bureau of Labor Statistics and unionstat.com.

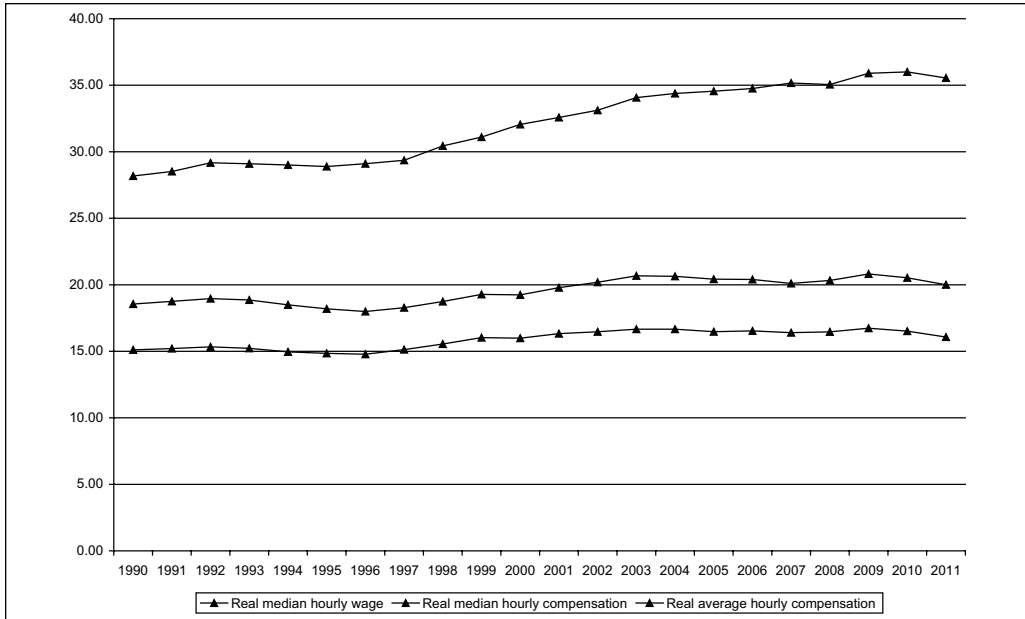


Figure 2. Real median hourly wage and hourly compensation vs. average hourly compensation (2011 dollars).

Source: Mishel and Gee 2012.

2.2. Labor vs. capital

The labor share of income, measured as total labor compensation as a percentage of GDP, illustrates the overall situation of labor after the crisis (Figure 3). It shows a slight increase in 2008 and then starts falling. Meanwhile, after experiencing a steep but very short-lived decline in the midst of the crisis, after-tax profits as a share of GDP rose again and are now at their highest level in decades. The same trend is observed within the corporate sector. In the years of the financial crisis, the long-term decline in the compensation of employees as a share of corporate gross value added is reversed temporarily, but it starts falling again to reach a new low whereas, following a brief decline, the share of after-tax profits within the gross value added of the corporate sector reaches historical heights a few years after the crisis.

The compensation of CEOs did not quite recover as quickly, though it remains at historically high levels. Two indices of CEO-to-worker compensation developed by the Economic Policy Institute (EPI), options granted and options realized, indicate that while there was a drop in that ratio during the crisis, and especially in 2009, it remains above mid-1990s levels (Figure 4).³

After-tax profits of nonfinancial corporations as a percentage of their nonfinancial assets began declining in 2007 as the economy slid into a recession, but they quickly recovered and surpassed pre-crisis levels (Figure 5). However, the profitability of the banking sector took a dive with the financial crisis (Figure 5). The financial crisis led to a significant redistribution of wealth and power within the financial sector. Bank of America, Citigroup, and JP Morgan Chase all increased their size and market shares through acquisitions and other means. The government's strategy of consolidating failing financial institutions resulted in the creation of mega financial institutions. In the following years, there was a strong recovery in the profitability of the banking sector.

³“Options realized” include salary, bonuses, restricted stock grants, long-term incentive payouts, and options exercised, while “options granted” includes the same categories, with options granted instead of realized. The measures include the CEOs of the 350 largest firms by sales. The wage measure is the hourly wage of a typical non-supervisory/production worker in the relevant industry (Mishel and Sabadish 2002).

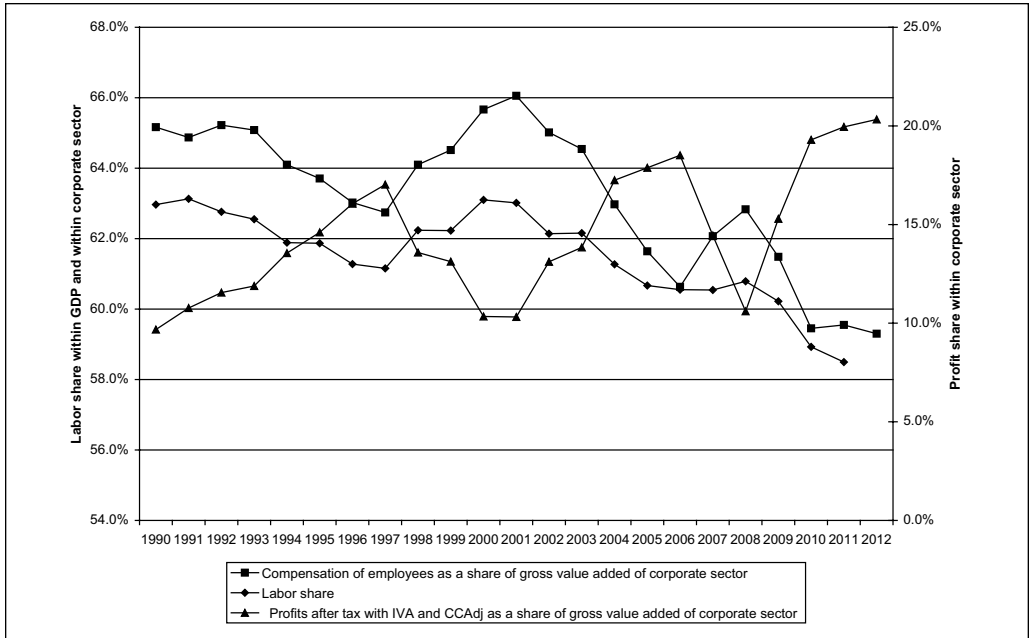


Figure 3. Total labor compensation as a percentage of GDP and income shares within gross value added of corporate sector.
Source: Bureau of Economic Analysis.

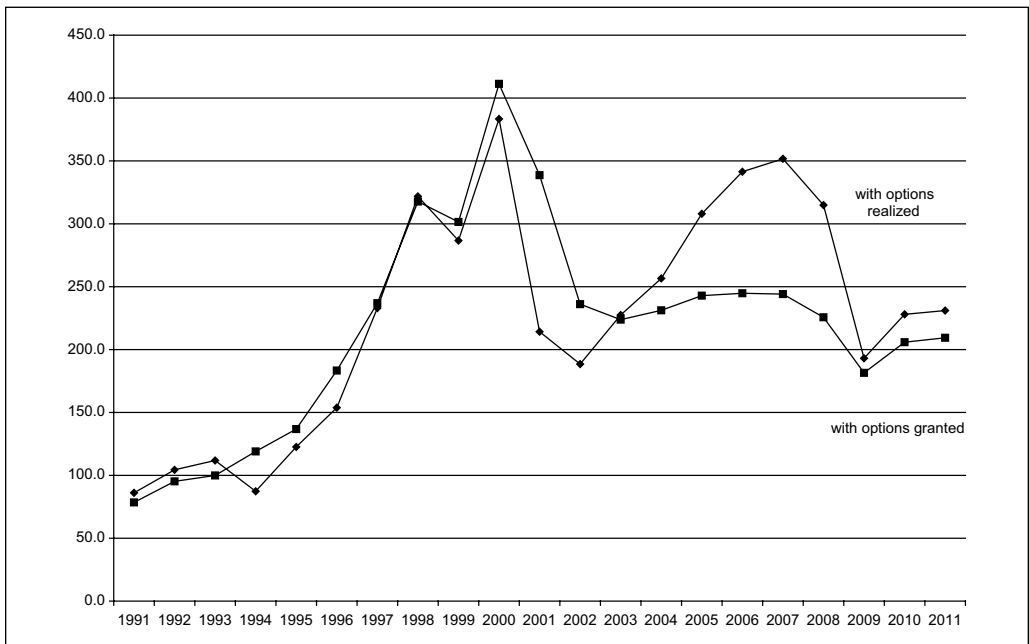


Figure 4. CEO-to-worker compensation ratio.
Source: Economic Policy Institute

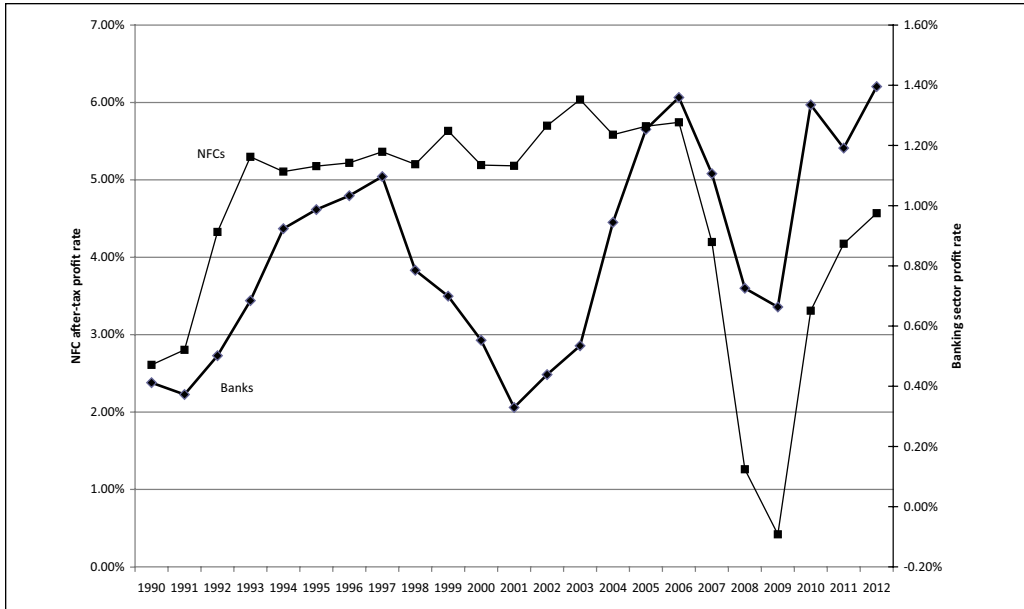


Figure 5. NFC after-tax profits as a percentage of nonfinancial assets and banking sector net income as a percentage of total assets.

Source: Flow of Funds Accounts of the US and FDIC.

2.3. Income inequality

Income inequality in the United States has been increasing since the 1970s, but the trend briefly reversed in the midst of the crisis, as illustrated by the initial relative decrease in the CEO-to-worker compensation ratio. This temporary lull is most likely related to the decline in the market values of financial assets and the corresponding decline in the income streams of top earners, and the upward trend in inequality resumed as financial markets recovered. This movement can be observed both in the Gini coefficient, which dropped slightly in 2007 and 2008, and the share of income going to the top quintile (Census Bureau and Figure 6). Conversely, the share of the second and third quintile rose slightly during the crisis, but then resumed its downward trend of the last three decades, while the fourth and fifth quintiles' shares simply continued to decrease. Interestingly, there were some fluctuations in the top percentiles of income distribution. While the income share of the top 1 percent declined by almost 4 percent during the crisis, going from 23.50 percent to 19.82 percent between 2007 and 2011, the share of the 90th to 99th percentile actually increased during the period, mitigating the overall loss for the top 10 percent, which went from 49.74 percent to 48.20 percent (Piketty and Saez 2003). Overall, the income share decrease of the top 1 percent was redistributed within the top 20 percent and largely in the top 90-99 percent.⁴

⁴There have also been changes in wealth inequality (Wolff 2013; Pfeffer *et al.* 2013). For example, between 2007 and 2011, about one-fourth of families lost more than 75 percent of their wealth and about half lost more than 25 percent of their wealth. Pfeffer *et al.* (2013) find that "multivariate longitudinal analyses document that these large relative losses were disproportionately concentrated among lower-income, less educated, and minority households" (650).

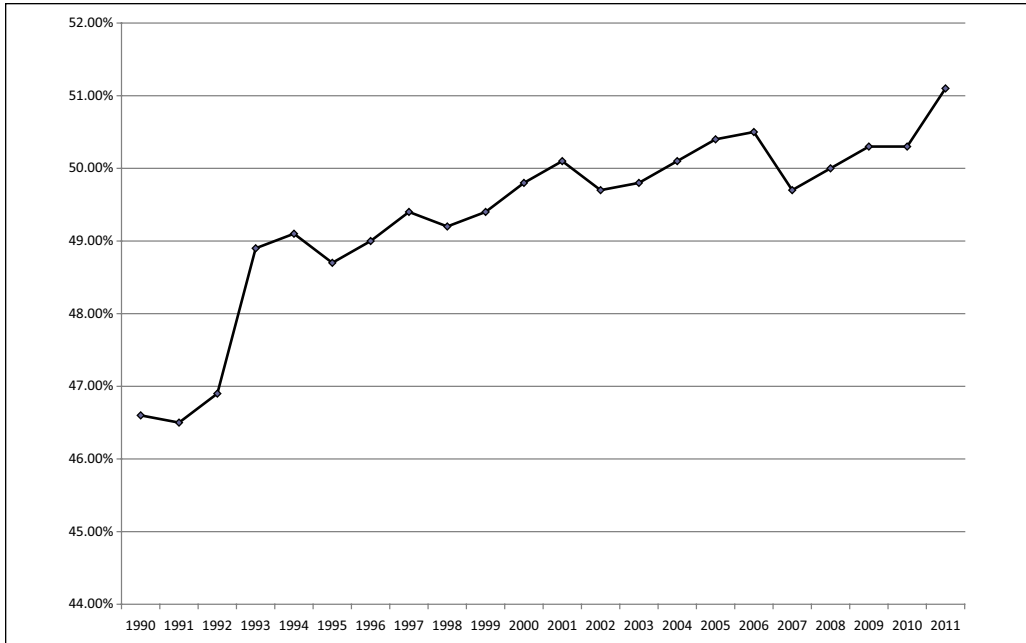


Figure 6. Top quintile income share.

Source: Census Bureau.

2.4. Poverty

While inequality fluctuated, poverty unequivocally increased as a result of the crisis. The rate of people living below the poverty line, as measured by the U.S. census, increased from 12.5 percent in 2007 to 15 percent in 2011, offsetting all the progress made on that front since the 1990s (Figure 7). Data from the U. S. Census Bureau also indicate that many households slid downward in terms of income. Between 2007 and 2011, the proportion of households earning less than \$15,000 increased from 11.9 percent to 13.5 percent and the proportion earning between \$15,000 and \$24,999 went from 11 percent to 11.5 percent (DeNavas-Walt *et al.* 2012). The largest decreases happened in the \$75,000-\$99,999 and \$100,000-\$149,999 brackets.

3. Crisis and Government Policies

Financial crises in low- and middle-income countries were used to further the neoliberal agenda of deregulatory policies and to open up these economies to international capital. Government budgets were oriented towards generating a primary surplus in accordance with IMF structural adjustment programs and cuts in social expenditures were common (Dufour and Orhangazi 2007, 2009). The United States did not face any such external constraint. Furthermore, the Fed took actions well beyond its past role and supported banks, other financial institutions, and even some nonfinancial corporations through its asset purchase programs. Immediately after the crisis, a stimulus package of \$152 billion in tax rebates for 2008 and a package in 2009 of \$787 billion were passed. Furthermore, around \$3 trillion in government subsidies were allocated to buy toxic financial assets and recapitalize insolvent financial institutions (Tcherneva 2012: 4).

Public debt significantly increased following the crisis, showing that the government shouldered a significant part of the burden (Figure 8). Income security spending, consisting largely of unemployment benefits, retirement benefits, disability payments, and welfare and social services

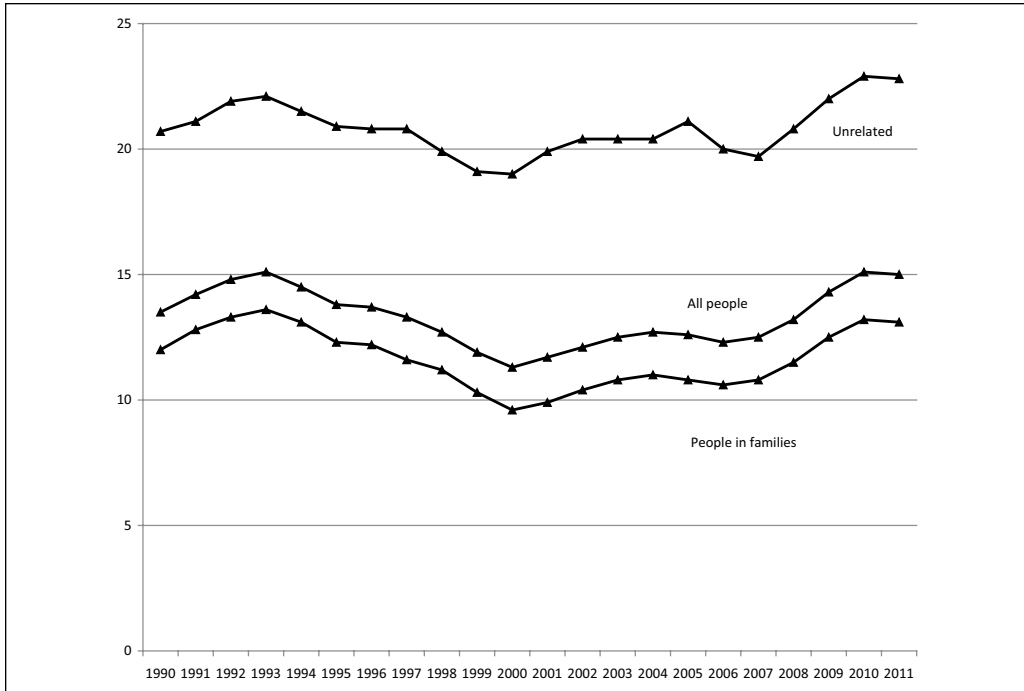


Figure 7. Poverty rates.

Source: Census Bureau.

payments, has been decreasing after an original increase, but still stands above pre-crisis levels and so do social expenditures. This differs from most developing country crisis experiences because of three reasons. First, benefits such as unemployment insurance are much more established in the United States and the automatic stabilizers kick in when there is a slowdown. Second, the United States did not have to follow an IMF structural adjustment program forcing them to cut social expenditures.⁵ Third, the U.S. government, despite the crisis, could borrow at low interest rates, which gives it much more room than governments in developing countries. In fact, interest payments as a percentage of current expenditures remained fairly low during and after the crisis. Moreover, the U.S. government was able to borrow from abroad all through the crisis and after because the dollar still serves as the main reserve currency and there is a high level of instability in other parts of the world, especially in the Eurozone. Incidentally, while developing countries typically devote a great deal of resources to reserve accumulation after a crisis, a precautionary cost to ward off possible future crises (Dufour and Orhangazi 2007, 2009), the United States does not have to do this so long as the dollar remains a reserve currency. This is yet another way in which the U.S. government has greater room for maneuver than its counterparts in developing countries.⁶

⁵Moffitt (2013) finds that “aggregate per capita expenditures in safety net programs grew significantly, with particular strong growth in the SNAP, EITC, UI, and Medicaid programs” (143). However, the state and local governments in many cases had to make dramatic reductions in their spending as their tax incomes fell. For example, in the case of higher education, Barr and Turner (2013) find that despite federal aid policies becoming more generous, the decline in state budget allocations had a negative effect on colleges and universities in maintaining programming and accommodating student demand.

⁶However, the U.S. government faces similar pressures domestically. High budget deficits and possible financing problems for Social Security and Medicare have triggered a debate about fiscal austerity. As Crotty (2012) notes, there is a coalition of conservative politicians, populist right wingers, and the economic elite demanding cuts to government support and investment programs, while simultaneously pursuing tax cuts for business and the rich.

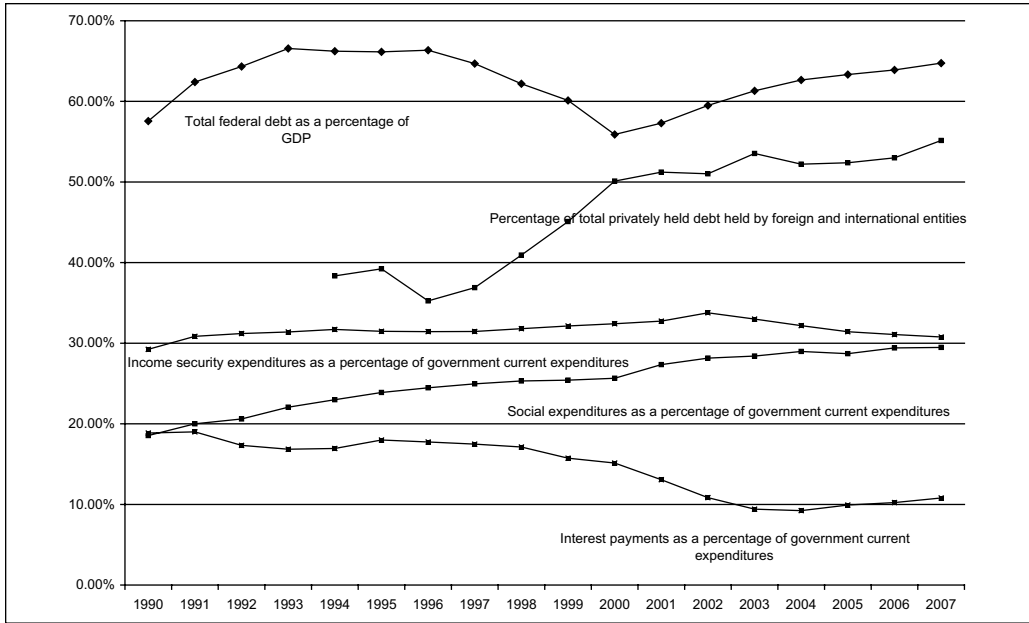


Figure 8. Total federal debt as a percentage of GDP, social and income security expenditures as a percentage of government current expenditures, interest payments as a percentage of government current expenditures, public debt held by foreign entities.
 Source: Bureau of Economic Analysis and FRED.

4. Crisis and Capital Inflows

Some of the processes at work during and after financial crises in less-developed countries had an air of neo-colonialism (Crotty and Lee 2001; Duménil and Lévy 2006; Harvey 2003; Dufour and Orhangazi 2007, 2009). Many of the countries beset by crises were pressured to liberalize their markets or leave them open during the downturn, leading to a transfer of assets to international capital. Capital inflows increased markedly during and right after financial crises, followed by an increase in the level of profits repatriated abroad a few years down the road. The U.S. case is evidently different, as there are not really any international institutions or other countries able to dictate policies to its government. Nonetheless, there has been a marked increase in international capital movements during the current crisis, suggesting that some capitalists were well-positioned to seize opportunities as they presented themselves. Inward foreign direct investment (FDI) flows peaked at the beginning of the crisis and remained relatively high thereafter, while outward FDI reached new heights during the same period (Figure 9). The inward FDI is largely made up of mergers and acquisitions, mostly by interests based in developed countries (Europe, Canada, and Japan), with a couple of notable exceptions like the purchase of 4.9 percent of Citigroup by the investment authority of the United Arab Emirates in 2008 (Kornecki 2013). Moreover, as inward FDI peaked in 2008, the largest recipient of that FDI was finance, with 31.1 percent of the total, with depository institutions getting a further 8.1 percent (*ibid.*). This suggests that this FDI was in large part targeted at grabbing financial assets while the U.S. financial industry was shaken and moving in to get a share of the market. Portfolio equity inflows were also high during this period, peaking in 2007 and only coming down in 2011. These recent inflows have contributed to a secular rising trend in foreign ownership of equity in the United States, which now stands around 10 percent of the total (Walker 2013).

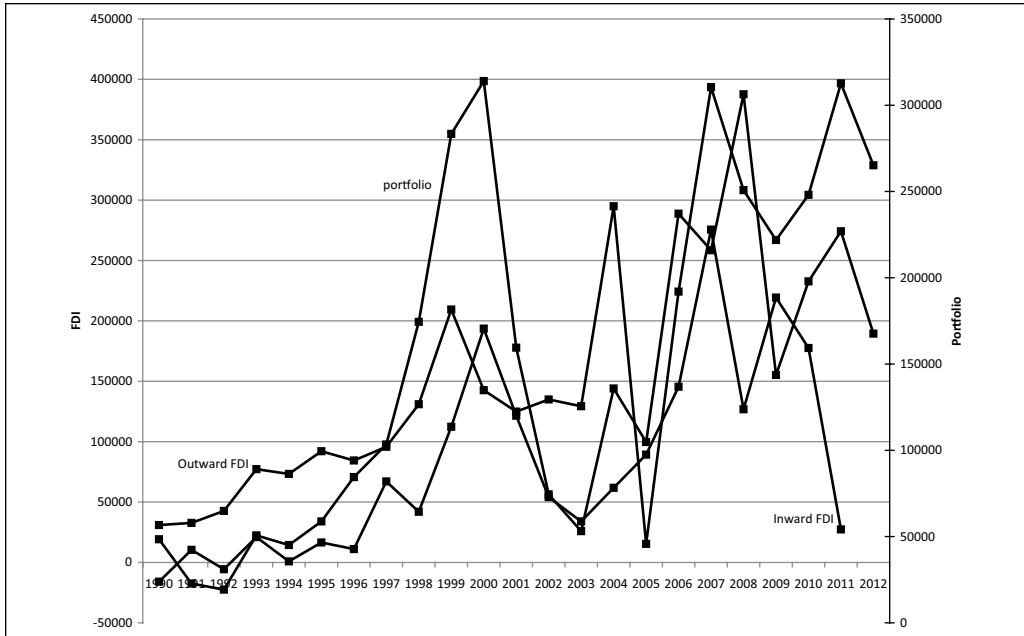


Figure 9. Foreign direct investment and portfolio equity inflows (millions of current dollars). Source: UNCTAD and World Bank.

The instability inherent in financial crises is the source of another financial transfer to countries with strong currencies: other countries trying to ward off that instability accumulate reserves, which represents seigniorage for the countries emitting reserve currencies. While the relative importance of the U.S. dollar as a reserve currency has declined over the last decade, over 60 percent of the official reserves for which the currency composition is reported (over 55 percent in 2012) was still denominated in U.S. dollars in 2012 (IMF, COFER database). Between 2007 and 2012 alone, there was an increase of over 1 trillion dollars in the official reserves known to be held in dollars, going from 2,642 billion dollars to 3,764 billion dollars (*ibid.*).

5. Concluding Remarks

In this paper, we examined the experience of the U.S. economy in the aftermath of the 2007-08 financial crisis in terms of the questions and issues typically raised in studies of low- and middle-income countries. We analyzed the consequences of the 2007-2008 financial crisis on different groups in the United States, looking at how the burden was shared, who suffered and by how much, and who profited. Our findings suggest that the burden of the crisis fell disproportionately on labor and the poorer segments of society and that the power of the labor movement was further eroded, while capital recovered rapidly overall, with some segments gaining from the situation. These results are in line with previous experiences. One major difference, though, is that the U.S. government does not face the same constraints as its counterparts in low- and middle-income countries, both in terms of its ability to finance its activities and the leeway it has regarding policy-making. Consequently, financing costs did not rise dramatically even though the public debt did and public spending was relatively more stable than what was observed in previous financial crises.

Our findings have strong implications for post-crisis economic policies. In the United States, these policies were designed to save large financial institutions and other corporations, and we

observe that this was done at the expense of larger segments of the population, especially labor and the poorer segments of society. Furthermore, the findings are in general consistent with the argument that capitalism's institutional structure and the government policies together ensure that capital in general and high-income classes in particular come out of the crisis ahead.

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Özgür Orhangazi is associate professor of economics at Kadir Has University in Istanbul. He is the author of *Financialization and the US Economy* (2008) and numerous articles and book chapters on financialization, financial crises, and alternative economic policies. He holds a PhD from the University of Massachusetts Amherst (2006) and previously taught at Roosevelt University in Chicago (2006-2011).

A longer version of this paper can be found at the Website of the Political Economy Research Institute at the University of Massachusetts Amherst as a working paper (www.umass.edu/peri).