Another wolf at our door

Exactly like the Roaring 20s, the latest economic 'miracle' has been bought on credit

Special report: the US elections

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While the US presidential debates were in full swing, I was pondering what I would ask the candidates if I had the opportunity to pose just one question. So here it is, Vice President Gore and Governor Bush: are you at all concerned about the mounting consumer debt spreading across every demographic sector of the United States population?

Gore and Bush seem to agree that the economy is humming, and have chosen to debate merely how best to allocate all of the surplus revenues. In the meantime, they both ignore a darker reality, one that could quickly change all of the up-beat economic forecasts coming out of Wall Street and Washington.

Although economists and politicians don't want to talk about it, the fact is that the "American miracle" has, to a great extent, been bought on credit. It is impossible to understand the dramatic growth of the American economy and reduction in US unemployment in recent years without examining the close relationship that has developed between economic expansion, job creation and the amassing of record consumer debt. Consumer credit has been growing for nearly a decade. Credit card companies are extending credit at unprecedented levels. Millions of American consumers are buying "on credit", and because they are, millions of other Americans have gone back to work to make the goods and perform the services being purchased. As a result, the economy seems healthier than ever.

Today, according to the Federal Reserve, Americans are spending more than they are taking in, marking the first time since the Great Depression that the country has experienced a negative savings rate. Just eight years ago the average savings rate in the US was 8% of after-tax income. Savings are now at their lowest level - 0.2 % - since monthly records began in 1959.

Britain is fast following the American lead. In just the past year, the UK household savings rate plunged from 6.7% to 3%. If it continues to decline at this pace, the savings rate will likely be negative by this time next year, with potentially ominous consequences for the economy and society.

An analogous situation occurred in the 1920s. Like today, that was a period of great economic change. Electricity replaced steam power across every major industry, greatly increasing the productive capacity of the country. Productivity gains, however, were not

matched by a significant increase in worker compensation. Wages remained relatively flat, while many marginal workers lost their jobs in the wake of cheaper, more efficient technology substitutions. By the late 1920s, American industry was running at only 75% of capacity in most key sectors. The fruits of the new productivity gains were not being distributed broadly enough among workers to sustain increased consumption. Concerned over ineffective consumer demand, banks and retailers extended cheap credit in the form of instalment buying to encourage workers to spend more and keep the economy growing. By late 1929, consumer debt was so high it could no longer be sustained. Even the bull market was being stoked by record purchases of stocks on brokers' credit. Finally, the entire house of cards collapsed.

The short-term substitution of consumer credit in lieu of a broad redistribution of new productivity gains is a subject that has received little, if any, attention among economists. Still, the fact remains that great technology revolutions generally spread quickly, once all of the critical elements are in place. The problem is that it generally takes at least a generation or more after a defining new technology finally comes on line, for social movements to build enough coherence and momentum to demand a fair share of the vast productivity gains that have been made possible. In the 1920s, the crisis of increased productive capacity and ineffective consumer purchasing power was met by the extension of consumer credit to unprecedented levels.

The same phenomenon is occurring today. The productivity gains brought on by the information and telecommunication revolutions are finally being felt and, in the process, virtually every major industry is facing global underutilisation of capacity and insufficient consumer demand. Once again, in the US, consumer credit has become the palliative, a way to keep the economic engines throttled up, at least for a time.

Consumer credit is growing by a staggering 9% annual rate and personal bankruptcies are increasing. In 1994, 780,000 Americans filed for bankruptcy. By 1999, the number of bankruptcies had soared to 1,281,000.

If countries of the European Union were to lower their current family savings rate to zero, as the US has, they could probably accelerate economic growth and reduce unemployment to under 4%. Millions of people spending money "on credit" would assuredly grow the economy and bring millions of European workers back to work to make the goods and perform the services being purchased on credit. But following the US lead would only result in a short-term fix and create the conditions for an even more profound long-term period of economic instability when the extension of credit reached its limits, pushing consumers into default and the economy into a downward spiral, as occurred in the late 1920s and early 1930s.

The issue at hand is: how long can Americans continue to spend more than they make, moving deeper and deeper into commercial debt? In the current situation, any number of external events could tip the scale, with potentially calamitous consequences. If the energy crisis were to deepen, raising fuel and energy costs, or the stock market were to

experience a sudden and sustained down-turn, or major lending institutions were to pull back on their loans, the effect on all of our lives could be sobering indeed.

The new economy won't be a reality until we have found a way to distribute the productivity gains of the e-commerce revolution broadly, to ensure enough consumer purchasing power to match the increases in productive capacity. In the past, that has always meant increases in wages and benefits and a reduction in work hours. If, instead, wages and benefits for middle and working-class Americans are allowed to remain relatively stagnant, as they have been for nearly a decade, and instead artificially prop up purchasing power by pushing millions of Ameri cans into record debt, we may squander the historic opportunity we now have to create a truly new economy that works for everyone.

It is unlikely that either of the presidential candidates will focus on the troubling spectre of negative savings. Yet, whoever takes over the White House, it's a sure bet that sooner or later, the issue of ever-expanding consumer debt will force all of us to take notice. We may look back on the current "prosperity" with the same cynical regard as earlier generations who lived through the short-lived boom years of the Roaring 20s.

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