US stock market slide: a turning point in American and world politics

The Editorial Board
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US stock market investors suffered their greatest ever one-week losses during the week of March 12-16. The Dow Jones Industrial Average experienced three sharp declines in five days, including a drop of over 400 points on Monday and a 227-point drop on Friday, with a total weekly decline of 821 points—a loss of 7.70 percent. The S&P 500, a broader average of Wall Street stocks, showed a 7 percent decline, while the high tech-dominated NASDAQ index fell 8 percent.

The Dow Jones index fell below the 10,000 mark for the first time in six months, while the NASDAQ index plunged below 2,000 for the first time in three years. Since its March 2000 peak, the NASDAQ has fallen 63 percent, the biggest percentage drop in a major US stock index since the 1929 crash. Over the same period the Dow is down 16 percent and the S&P 500 down 25 percent.

Measured by the amount of paper value wiped out, the financial debacle in the American stock exchange is already among the worst in history, with no indication that a bottom has been reached. *BusinessWeek* magazine reported in its market watch column that there were hopes on Wall Street that a support level for the NASDAQ would be found at about the 1,350 mark—indicating a further 500-point decline in the high tech index was widely anticipated, which would bring the total plunge to 73 percent.

The combined losses on the NASDAQ and the New York Stock Exchange topped $4.6 trillion by the end of the week, nearly five times the losses from the October 1987 Wall Street crash. The NASDAQ by itself has fallen from $6.7 trillion in March 2000 to $2.7 trillion. The sheer magnitude of this decline is staggering. The $4.6 trillion in losses is:

* Greater than the entire publicly held federal debt
* More than the combined Social Security and Medicare trust funds
* The equivalent of the world losing the economies of Japan and South Korea
* The equivalent of the United States scrapping its auto, steel, electrical machinery and oil industries, all at once

The equivalent of the loss of the entire housing stock of the United States

* Two to three times the total value of Bush's proposed ten-year tax cut
* 1,000 times the amount that Bush would cut taxes this year, in the name of providing a stimulus to the economy and offsetting the threat of a recession

So rapid was the collapse in share values during 2000 that US household wealth saw its first net decline since the federal government began keeping such figures in 1945. Every postwar recession has only slowed the rate of increase in household wealth. But with more than 60 percent of US household assets now accounted for by the stock market, the NASDAQ-led slump produced a 2 percent drop in 2000.

The high-tech bubble

The driving force of the financial crisis has been the collapse of the speculative boom in high technology stocks, mainly those related to the Internet, computers and telecommunications. According to one study, nine of the eleven industrial sectors that make up the S&P 500 actually saw at least a modest rise in stock prices over the past year. But the two sectors that lost ground, high tech and telecommunications, were enough to push the overall index lower by 25 percent.

Another analysis, published in the *New York Times* March 18, gauged the high-tech collapse by calculating how long it would take selected stocks to regain their peak prices if they enjoyed annual increases of 15 percent—well above traditional rates of return. By this measure, Intel would take seven years to regain its top price, Cisco Systems would require 10 years, Microsoft six years, Oracle and Sun Microsystems nine years and Yahoo! no less than 20 years.

The financial deterioration of Yahoo!—a company with enviable name recognition, a huge Internet audience, and $1.7 billion in cash on hand—demonstrates how rapidly the crisis has developed and how deep is its impact. The company's market capitalization has fallen from $150 billion a year ago to under $10 billion, as its stock price has plunged from $250 a share to $17.

Three months ago Yahoo! management forecast first quarter revenues of $320 million. Now they are estimated at $170 million to $180 million, of which $117 million was already committed before the quarter began. The Internet portal thus obtained only $63 million in new sales. While Yahoo! took in $459 million in sales from other dot-coms in 2000, this is expected to fall to only $111 million in 2001.

Two weeks ago, company chairman Timothy Koogle resigned as CEO, with no replacement immediately named. In the wake of his resignation, the financial press carried reports that Yahoo!, Cisco Systems, Intel and other NASDAQ stalwarts had engaged in a practice known as “pro forma” reporting of financial results, in which the figures released to the public arbitrarily exclude certain obligations. In the case of Yahoo! and Cisco, the companies did not report the payroll taxes due for their employees—a huge expense that would have made their balance sheets much worse.

Even now Yahoo! may be grossly overvalued, since its stock was still selling at 140 times earnings. All the companies on the NASDAQ index combined were selling at 172 times earnings. If their stock prices fell to the typical historical level of 20 times earnings, the NASDAQ index would fall to about 170—compared to 5,048 in March 2000.

The impact on working people

It is hard to overstate the implications of this colossal financial liquidation for the American working class and middle class. Of the $4.6 trillion already vaporized—and trillions more which are at risk—much of it constitutes the life savings of tens of million of working people. Millions are discovering that their 401(k) plans, which have become a widespread substitute for guaranteed pensions, will no longer sustain them in a decent retirement. Three-quarters of the funds held by 401(k) plans, about $1.7 trillion, are invested in the stock market. Other people have lost savings set aside to buy a new home, finance their children's college education, or protect against the threat of a major illness.

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TIAA-CREF, the teachers' pension fund, which is the largest institutional investor in the stock market, reported a 21 percent gain in its holdings in the fiscal year that ended March 31, 2000. When TIAA-CREF closes the books on the current fiscal year, some 250,000 retired teachers, college instructors and other professionals will experience a sharp movement in the opposite direction.

In 1999, as the bull market reached its zenith, the net worth of American households rose 14.1 percent. Douglas R. Cliggott, a strategist at J. P. Morgan Chase, told the *New York Times*: “It influenced the size of the homes we live in, the type of cars we drive, how we go on vacation. Because of the extraordinary improvement in the average American's net worth, it made us feel comfortable carrying what by historic standards would have been an extraordinary amount of debt.”

It is a paradox that explains much of the political character of the 1990s that, side by side with soaring paper values on the stock market and rising corporate profits, both consumer and corporate debt increased astronomically. The 1990s boom was fueled by a borrowing binge that leaves the entire financial structure of the country poised on the edge of a precipice.

Consumer debt has doubled since 1990, to $7.5 trillion—more than $50,000 per household, over $25,000 for every man, woman and child in America. Much of this has involved homeowners taking out home equity loans to finance consumption, pay other debts, or gamble in the stock market. In 1982 homeowners owed lenders 30 percent of the market value of their residences. By 1999 this figure was up to 46 percent.

During the 1990s, the ratio of household debt, including mortgages, to disposable income rose by almost 25 percent. The average American family now has debts that exceed its average after-tax income. This debt is unequally distributed—in a manner diametrically opposite the distribution of wealth. The top ten percent of the population own over 70 percent of the national wealth, while the bottom 90 percent of the population, with less than 30 percent of the wealth, owe 70 percent of the consumer debt.

In corporate America as well, the 1990s has been an era of growing debt—topping $10.6 trillion by the end of 1999. By and large, companies have been unwilling or unable to finance expansion and new investment by issuing new stock, for fear that this would dilute the holdings of shareholders and cause a decline in the price. Rather, corporations have gone into debt, even borrowing money on the financial markets to buy up their own stock and boost its price.

The result is that instead of the traditional trade-off of equity and debt, with debt decreasing during a boom and swelling during a downturn, most companies have seen their debts increase during the stock market boom. The present financial crisis, let alone any severe and prolonged recession, will mean corporate bankruptcies on a vast scale—with predictable effects on jobs, benefits, pensions and living standards generally.

A global slowdown

The financial crisis in the United States has incalculable consequences for the world economy. This year marks the first time in a quarter century that all three of the main centers of world capitalism—the United States, Japan and Western Europe—are simultaneously experiencing an economic slowdown. In the case of Japan, stagnation has been protracted throughout the 1990s, since the collapse of the “bubble economy” in 1989-90. This financial debacle, triggered by the collapse of inflated real estate values, is now being widely compared to the puncturing of inflated stock values in the US. A *Washington Post* editorial last week pondered whether the US economic decline would be V-shaped, U-shaped, or “a Japanese-style L.”

The US and Japanese crises are intertwined, since Japanese banks and corporations are heavily invested in the US securities and bond markets, as well as dependent on the United States as their leading export market. Japanese concerns own $350 billion in US Treasury bills, and even larger amounts of corporate stocks and bonds, as well as $150 billion in direct investments, more than any other country except Great Britain. There have been reports of Japanese banks unloading billions in US stocks in order to improve their balance sheets before the Japanese fiscal year ends on March 31.

A Japanese sell-off of American assets, sparked either by declining US stock prices or financial pressures within Japan itself, would depress stock prices even further. It would also depress the value of the dollar, since Japanese companies would have to convert dollar-denominated assets into yen in order to repatriate them. A falling dollar would undermine the ability of the Federal Reserve to cut US interest rates, or even force it to raise rates to prevent investor flight from the US currency.

Economic growth in the European Union is now estimated at 2.8 percent for 2001, down from previous projections of 3.3 percent, as the slowdown in the US and Japan takes its toll, and Germany, the most powerful component of the European economy, experiences both an acceleration of inflation and a fall in its real growth rate. Auto sales in Germany fell 12 percent. Eight of the nine largest European stock exchanges have seen lower prices since the beginning of the year, with most of them down over 10 percent.

Social and political consequences

The onset of a sharp financial crisis in the United States, and a more general global economic slowdown, will inevitably have the most profound consequences for the social and political stability of the major capitalist nations. The series of announcements of major layoffs in the US has already shaken consumer confidence, demonstrating once again that job security is a thing of the past for even the most skilled and highly paid workers.

Any significant increase in the US unemployment rate will confront millions with the consequences of the policy changes of the past two decades, in which social programs that once cushioned the impact of the capitalist business cycle have been abolished or largely gutted. Millions of people, especially the masses of low-paid service and contingent workers, will be thrown on the economic scrap heap with no social safety net and no personal resources to fall back on.

Equal to the material impact of the financial crisis will be the shattering of illusions so assiduously promoted by the media and ruling class opinion makers over the past 20 years, and especially in the decade since the collapse of the Soviet Union. The American people have been told incessantly that capitalism is the only credible form of economic organization, and that the unrestrained domination of giant corporations and the “market,” backed by central bankers like Fed Chairman Alan Greenspan, would guarantee an ever-rising level of prosperity.

Now capitalism is revealing its ugly face, in the gross misallocation of resources and the sheer irrationality of a system that piles up trillions for the corporate elite, while wiping out the retirement savings of millions, bankrupting small businesses, and depriving countless workers of their livelihood. As the crisis deepens, working people will inevitably reject the claims that all concern for social justice and equality must be subordinated to the imperatives of the market. Growing numbers will look for an alternative to the profit system and turn to the development of a mass political movement directed against it.

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