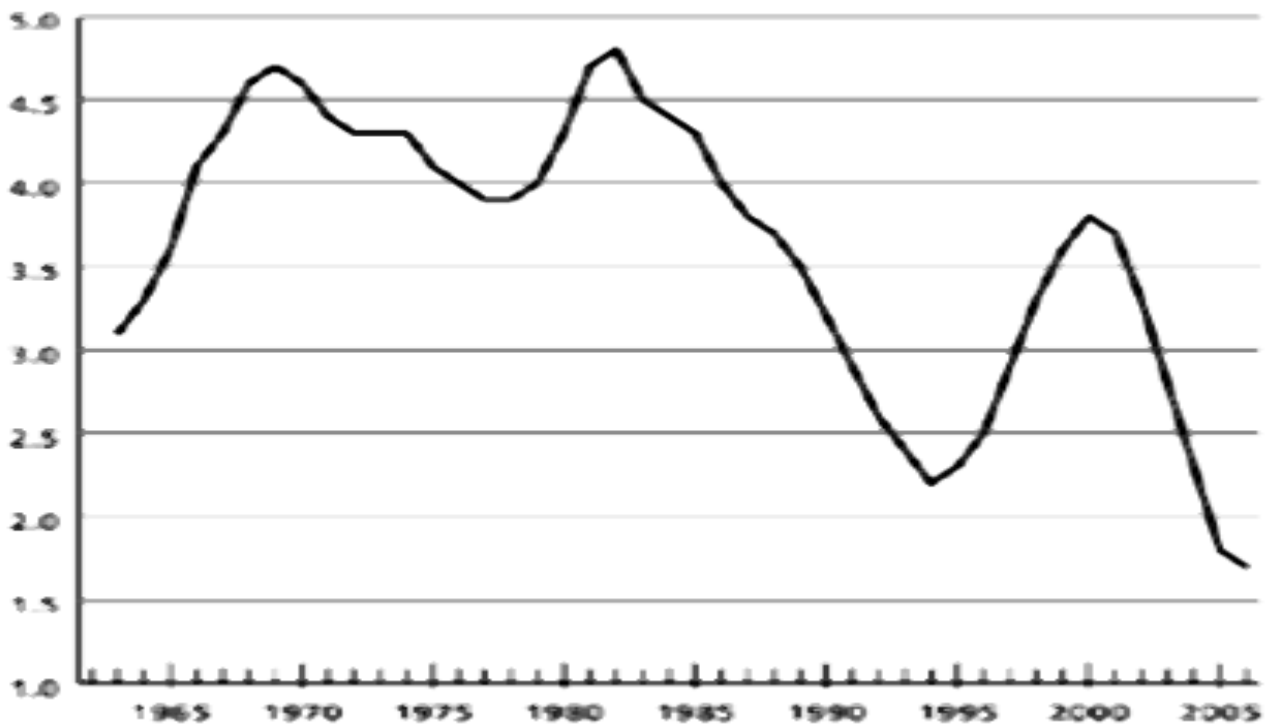


Marxisten over...



...de Financiële Crisis

met bijdragen van :

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Voorwoord

OVER DE FINANCIËLE CRISIS wordt dezer dagen veel gesproken. Een ware stoet van zogenaamde deskundigen, gespecialiseerde journalisten, economen, analisten en wat dies meer zij passeert gestaag de revue op radio, televisie en in de geschreven pers. Allemaal brengen ze onveranderlijk dezelfde mening naar voor : “er is niks wezenlijks aan de hand – de fundamenteën van 'onze' economie zijn gezond – er is hooguit een probleem inzake vertrouwen”. Met deze en soortgelijke geruststellingen wordt blijkbaar getracht het onbehagen onder te sneeuwen dat gevoed wordt door het naakte feit van de immense beursdalingen der financiële aandelen.

Slechts zeer zelden – en dan meestal nog terloops – wordt er wel eens verwezen naar de samenhang van deze wereldomspannende financiële crisis met de eveneens wereldomspannende, neoliberale sturing van het geglobaliseerde kapitalisme. Met name in het Nederlandse taalgebied ontberen we dan ook meer diepgaande analyses van deze financiële crisis.

Liever dan te wachten op vertalingen van dergelijke analyses naar het Nederlands, hebben we in deze brochure een aantal bijdragen bijeengebracht van diverse auteurs uit binnen- en buitenland. Al deze bijdragen verschenen vrij recent op diverse, Engelstalige websites. Bij elke bijdrage hebben we ook de bron vermeld.

We hebben deze bijdragen hier bijeengebracht omdat we denken dat ze allen – de één al wat diepgaander dan de ander – een bijdrage kunnen leveren aan ons aller inzicht in de huidige financiële crisis. Inzicht dat overigens broodnodig is, zeker nu wij ons hier in België voorbereiden op omvangrijke vakbondsmobilisaties tegen koopkrachtverlies en ontmanteling van collectieve voorzieningen en voor een betere politiek ten dienste van de werkende bevolking.

We openen deze brochure met '*Een Aangekondigde Crisis*', een bijdrage van *Matthias Lievens*, waarin al meteen een pertinente vinger op een aantal wonden gelegd worden.

Daarna komt '*Wereldeconomie en kredietcrisis*', een situerend artikel van *Andy Kilmister* uit het Verenigd Koninkrijk. Dit artikel verscheen oorspronkelijk in het Engelstalige *International Viewpoint* (het blad van de Vierde Internationale). Jan Taat, een kameraad van Solidariteit, het Nederlandse webzine voor een strijdbare vakbeweging, vertaalde deze tekst naar het Nederlands.

Vervolgens buigen we ons in '*Capitalism in an apocalyptic mood*' over een uitgebreid artikel van de bekende andersglobalist *Walden Bello*, die tracht de huidige, vooral financiële crisis in een breder perspectief te plaatsen.

Met de bekende Amerikaanse marxist *John Bellamy Foster* publiceren we enerzijds een interview uit het Australische *Green Left Weekly* en anderzijds het langere, analytische artikel '*The Financialization of Capital and the Crisis*' van zijn hand.

De Amerikaan *Minqi Li* verbindt in '*An Age of Transition*' de financiële crisis dan weer met de toegenomen betekenis van China en met de exorbitante stijging der olieprijsen, wat hem dan weer leidt tot het voorspellen van de teloorgang van het neoliberalisme als toonaangevende stroming binnen de kapitalistische wereldordering.

De bekende Britse publicist *Robin Blackburn* analyseert in '*The Subprime Crisis*' dan weer gedetailleerd het exacte verloop van de huidige crisis, die inderdaad begon als een crisis van overgewaardeerde (i.e. 'subprime') kredieten.

In *'A Systemic Crisis, both Global and Longlasting'* extrapoleert de Franse marxistische econoom en publicist *Michel Husson* onder de vorm van een interview de te verwachten impact van de financiële crisis op het geheel der internationale kapitalistische verhoudingen.

De Canadees *David McNally* bekijkt in *'Global Instability and Challenges to the Dollar'* de band tussen het internationale monetaire stelsel en de huidige crisis,

In *'From the credit crunch to the spectre of global crisis'* bespreekt de Britse marxist en auteur *Chris Harman* de al dan niet vermeende angst voor een globale crisis als gevolg van de huidige financiële puinhoop.

De Amerikaan *Bob Brenner* beschrijft in *'Devastating Crisis Unfolds'* hoe de huidige crisis ontstond en zich stelselmatig uitbreidde. Op dezelfde wijze buigt de Amerikaan *Nomi Prins* zich in *'The Sub-Prime Market Crisis'* over de ineenstorting van de Amerikaanse vastgoedmarkt als aanleiding tot deze crisis.

In *'Why No Outrage ?'* vragen de uitgevers van de onafhankelijk-linkse Amerikaanse *Monthly Review* zich vooral af hoe het komt dat er (voorlopig ?) nog geen publieke uitbarsting van verontwaardiging is losgekomen in de Verenigde Staten.

Dan La Botz van het Amerikaanse *ZNet* (een website 'where the spirit of resistance lives') vraagt zich in *'Will The U.S. Nationalize The Banks?'* af of en zo ja hoe de Amerikaanse regering de banken zal nationaliseren en hoe dergelijke 'nationalisatie' zich dan verhoudt tot eerdere nationalisering in andere tijden én in andere delen van de wereld.

In *'2008: The Demise of Neoliberal Globalization'* analyseert de Amerikaanse werelddenker *Immanuel Wallerstein* de gevolgen van de huidige crisis voor het werelddenken van de neoliberale globalisering, waarbij zich vooral de vraag opdringt of een eventuele gewijzigde wereldordening (bijvoorbeeld in de richting van meer regulering) uitzicht kan bieden op een nieuwe stabilisering.

Eindigen doen we met het artikel *'The US Subprime Crisis Goes Global'* van onze Belgische kameraad *Eric Toussaint* waarin deze analyseert op welke wijze precies de Amerikaanse vastgoedcrisis geleid heeft tot de huidige, globale crisis van het wereldfinancieelstelsel.

Zonder aanspraak te willen maken op volledigheid hopen we met deze brochure toch een bijdrage te kunnen leveren die nuttig is voor honderden activisten die de komende dagen hier in België hun beste beentje zullen voorzetten in de strijd tegen koopkrachtverlaging en ontmanteling van collectieve voorzieningen en vóór een betere wereldordening ten gunste van de werkende bevolking.

Voor de Socialistische Arbeiderspartij (SAP),
Belgische afdeling van de Vierde Internationale,
Peter Veltmans

Een Aangekondigde Crisis

Matthias Lievens

Bron : Socialistische Arbeiderspartij (SAP) – België

http://www.sap-rood.be/cm/index.php?view=article&id=834%3AEen+aangekondigde+crisis&Itemid=53&option=com_content

De ravage in de banksector is compleet. Overheden overal ter wereld moeten ettelijke miljarden pompen in de banken om hun overleven te garanderen. Fortis kreeg al de belofte van 11 miljard euro van de Belgische, Nederlandse en Luxemburgse regering. Vervolgens kwam Dexia, en er zullen er nog volgen.

De tussenkomsten worden verdedigd in naam van de ‘kleine spaarder’. Inderdaad, ongeveer de helft van de Belgische huishoudens heeft een rekening bij Fortis. Maar is Fortis in het nauw gedreven doordat de rekeninghouders hun geld massaal afhaalden of omdat leners hun lening bij de bank niet konden terug betalen? Neen! De bank is, net zoals tientallen andere banken, in de problemen gekomen door haar activiteiten op de financiële markten, door de massale aan- en verkoop van allerlei financiële producten, waartussen nu ontzettend veel waardeloos spul blijkt te zitten. De schuld voor de problemen bij Fortis of Dexia ligt dus niet bij de spaarrekeningen of leningen, maar bij de beleggingsactiviteiten van de banken.

De achtergrond van deze crisis is het feit dat de banken vandaag een andere rol spelen dan vroeger. De hoofdactiviteit van banken is niet meer het bijhouden van spaargeld van kleine spaarders of bedrijven en het lenen aan individuen of ondernemingen. Onder het neoliberalisme onderging de bankwereld een fundamentele omwenteling, op verschillende niveaus:

- Dereglementering: de monetaire en financiële markten werden verregaand geliberaliseerd, de controle verslakte, steeds meer regels verdwenen. Dat maakte het mogelijk dat banken steeds grotere risico's namen voor winst.
- Ontzuiling van nationale markten. De financiële sfeer is mondiaal, alle banken ter wereld zijn met mekaar verweven. Het gevolg zien we nu: als er een orkaan is in de VS, dan stormt het ook bij ons.
- ‘Desintermediatie’: dit betekent dat steeds meer niet-banken, zoals institutionele beleggers (b.v. pensioenfondsen) de oude functies van banken zijn gaan overnemen. De bedrijven financieren vandaag het gros van hun investeringen niet meer door leningen van de bank, maar door eigen kapitaal of beurskapitaal. Waar het financieelkapitaal vroeger berustte op de eenheid van banken en industriële kapitalisten, is dat al een tijdje niet meer zo. Vandaag zijn pensioenfondsen, beleggingsfondsen en verzekeringsmaatschappijen minstens zo belangrijke geldschietters geworden. Aandeelhouderskapitaal verving bankkapitaal. In naam van de concurrentie werden alle barrières en regels opgeheven zodat allerlei financiële ondernemingen, ook niet-banken, actief konden worden op terreinen die voorheen strikt aan de banken

voorbehouden waren.

De banken moesten dus op zoek naar nieuwe lucratieve bezigheden en stortten zich op de aan- en verkoop van allerlei financiële producten en hun ongelooflijk complexe derivaten (futures, swaps, afgeleiden van verzekeringen etc.). Tegelijk werden de regels voor de banken verslapt. Het gevolg hiervan is dat deze steeds meer risico's gingen nemen om, geconfronteerd met de concurrentie van nieuwe actoren, hun deel van de markt te kunnen inpalmen. Nu zien we waartoe deze risico's leiden. Alle banken houden zich vandaag bezig met speculeren, met het aankopen en verkopen van aandelen, schuldtitels en allerlei andere financiële producten op de internationale financiële markten. Ze lokken klanten om in te tekenen op schijnbaar veilige beleggingsproducten. Denk maar aan de mensen die op die manier al hun spaargeld dreigen te verliezen. Denk maar aan de Franse bank Société Générale die in februari 2008 5 miljard verloor door slechte speculaties door Jérôme Kerviel. De huidige crisis staat dus niet op zich, maar is wel de ergste die we tot nu toe te zien kregen.

De kleine spaarders redden, of de aandeelhouders?

Als de regeringen vandaag massaal met geld over de brug komen, kunnen daar serieuze vragen bij gesteld worden. Als het erom gaat de kleine spaarders te redden, kunnen we het ermee eens zijn. Maar dan zou de regering zich garant kunnen stellen voor alle spaartegoeden tot bijvoorbeeld 300.000 euro (om voor hogere bedragen gradueel de borgstelling te verlagen), en niet voor de grotere vermogens, en zeker niet voor de aandeelhouders van de banken. De regering kan zich garant stellen voor wat de kernactiviteiten van een bank zouden moeten zijn, maar niet voor alle beleggingen en financiële speculaties. Door Fortis voor de helft over te nemen, redt de regering niet alleen de kleine spaarders, maar vooral de aandeelhouders van de bank, die de afgelopen jaren samen tientallen miljarden winst opstreken, waar nu met geen vinger aan werd of wordt geraakt. Toen in de VS het reddingsplan voor de banken van 700 miljard werd voorgesteld (intussen is het (voorlopig?) verworpen), zagen we onmiddellijk de resultaten: een euforie op de beurs, en het spel van speculatie kon weer beginnen. Sommigen boerden zich serieus rijk tijdens de beursmalaise. Er is dus een politieke aanpak nodig die de kleine spaarders redt, maar de macht van de aandeelhouders en speculanten serieus terugschroeft. De financiële sector moet betalen voor haar eigen puinhoop. Daarom stellen we voor:

- op korte termijn de oprichting van een volledig publieke bank, volgens strikte criteria die haaks staan op de financiële wildgroei van de afgelopen jaren. Op langere termijn moet de banksector opnieuw in publieke handen komen (nationalisatie), en gerund worden volgens criteria van algemeen belang en onder strikte democratische controle.
- opheffen van het bankgeheim en fiscale paradijzen
- hoge belastingen op financiële meerwaarden
- controle en verbod op speculatieve operaties; belasting op internationale transacties.

- strikte transparantie van alle activiteiten van banken
- terugschroeven van pensioenfondsen, verzekeringsmaatschappijen en dergelijke, die mee aan de basis liggen van het huidige financiële systeem, en door de concurrentie banken ertoe brachten steeds grotere risico's te nemen.
- herspecialisatie van banken: hun taak is het deposito's bij te houden en geld te lenen, en niet allerlei beleggingsoperaties te doen op de financiële markten.
- invoering van drastisch gereduceerde maximumlonen voor topmanagers en kaders van banken, wiens bonussen er mee toe geleid hebben dat steeds grotere risico's werden genomen. Inbeslagname van stock-options en andere bonussen van het topmanagement.
- de oprichting van een internationaal fonds voor de hulp aan mensen die door de crisis hun huis of andere goederen verloren en in de armoede terecht kwamen.

Deze crisis is een mokerslag voor het neoliberalisme. Na 2008 zal het neoliberale discours niet meer dezelfde kracht hebben. De sociaal-democratie à la Di Rupo zit nu te pleiten voor meer regulatie van het kapitalisme. Elke stap die de macht van de financiële mastodonten kan terugdringen is natuurlijk positief. Er is echter één iets wat we niet uit het oog mogen verliezen: er is een verband tussen het steeds dalend aandeel van de lonen in de verdeling van de rijkdommen, en de stijgende omvang van de financiële sfeer. Wat de arbeiders minder kregen als loon, werd immers evenmin geïnvesteerd voor nieuwe productie, maar verdween in de zakken van de aandeelhouders en in de financiële sfeer.

De financierisering van de economie is dus geen 'parasiet' bovenop een reële economie die ok is, zoals sociaaldemocraten wel eens insinueren. De groeiende macht van de financiële sfeer was één van de hefbomen om de lonen en sociale verworvenheden terug te dringen. Ze leidde immers tot steeds meer macht en mobiliteit voor de aandeelhouders tegenover de arbeiders in bedrijven. Als je de banken en financiële markten terugdringt en fel gaat reguleren, verander je niet enkel iets in de financiële sfeer, maar mogelijk ook aan de machtsverhoudingen in de economie als geheel. Vandaar de enorme terughoudendheid onder andere bij Amerikaanse conservatieven ten aanzien van de zogenaamde reddingsplannen. Voor de arbeidersbeweging is de strijd voor hogere lonen en voor het terugdringen van de macht van de financiewereld één en dezelfde strijd. En die strijd raakt het hart van hoe het kapitalisme vandaag als zodanig functioneert; en niet louter de 'uitwassen' ervan in de financiële sfeer. Meer dan ooit verkeert het neoliberale kapitalisme in een diepe legitimiteitscrisis. Meer dan ooit moet het systeem in zijn geheel aangeklaagd worden, en niet enkel zijn perversies.

Wereldeconomie en Kredietcrisis

Andy Kilmister

Bron : Solidariteit – NL

(http://www.solidariteit.nl/extra/2008/wereldeconomie_en_kredietcrisis.html#n1)

DE HUIDIGE KREDIETCRISIS werpt vragen op over de economische orde. De snelle ontwikkeling na de Tweede Wereldoorlog werd gevolgd door een crisis in het midden van de jaren zeventig die zo'n tien jaar later werd opgelost door een nieuwe economische orde, het neoliberalisme. Die economische orde is nu in de problemen, omdat haar belangrijkste steunpilaren - lage inflatie, lage kostprijzen en stabiliteit op de internationale financiële markten - afbrokkelen.

Het belang van de huidige onrust op de financiële markten blijkt duidelijk uit het volgende citaat van Martin Wolf in de Financial Times van 26 april 2008: "Vergeet de datum 14 maart 2008 niet, de dag waarop de droom van het geglobaliseerde vrije markt kapitalisme stierf. De laatste dertig jaar hebben we marktgestuurde financiële systemen ontwikkeld. De beslissing van de Amerikaanse centrale bank - de belangrijkste speler in het vrije markt kapitalisme - om de Bear Stearns bank te redden, toont aan dat dit tijdperk voorbij is."

De kredietcrisis wordt wel eens vergeleken met de beurskrach van 1929. Dat helpt niet echt. Het is beter de systemen te analyseren die het globale kapitalisme sinds het middel van de jaren tachtig hebben gestuurd. Systemen die ontstonden als reactie op de crisis in de jaren zeventig.

Crisis jaren zeventig en tachtig

Een stabiele kapitalistische groei hangt af van twee voorwaarden. Ten eerste moet het productieproces voldoende winst opleveren. Ten tweede moet deze winst worden gerealiseerd door de verkoop van de producten op de markt. Deze twee voorwaarden leiden tot een hoofdtegenstelling, ze zijn namelijk strijdig met elkaar.

Om met winst te produceren moeten de lonen laag worden gehouden. Maar om de winsten te realiseren op de markt moet er voldoende vraag en dus koopkracht aanwezig zijn. Deze tegenstelling is de oorzaak van periodieke crisis in de kapitalistische groei. Het kapitaal weet tijdelijke oplossingen voor de hoofdtegenstelling te vinden, maar dat leidt altijd weer tot nieuwe problemen.

De tijdelijke oplossing die de groei in de jaren vijftig en zestig mogelijk maakte, was afhankelijk van drie factoren:

1. De overheidsuitgaven waren een belangrijke bron van extra vraag.
2. Het Bretton Woods systeem van vaste wisselkoersen zorgde voor een snelle groei van de wereldhandel.
3. De ontwikkeling van nieuwe consumentengoederen en -markten, zoals auto's en elektronica. Deze groei eindigde midden jaren zeventig en leidde tot een decade van economische onrust en twee internationale crises, die van 1974-1975 en 1979-1982. Halverwege de jaren tachtig werd echter een nieuw systeem voor de groei vormgegeven.

Tijdelijk oplossing crisis

De oplossing van de tegenstelling bestond uit drie onderdelen.

Ten *eerste* de snelle stijging van de schulden van de huishoudens en in mindere mate van de ondernemingen. Door de stijging van de schuld werd een vraag gecreëerd die het mogelijk maakte de winsten te realiseren, terwijl de lonen laag bleven vanwege de frontale aanval op de vakbonden en de georganiseerde arbeiders. Natuurlijk is het zo dat schulden uiteindelijk betaald moeten worden en de vraag dan alsnog inzakt. Dat de schuld een belangrijke rol heeft kunnen spelen, lag aan de andere twee onderdelen van de oplossing.

Het *tweede* onderdeel was de hernieuwde stabilisatie van het internationale financiële systeem. Het einde van het Bretton Woods systeem leidde tot sterke fluctuaties van de wisselkoersen. De stabilisatie in de tweede helft van de jaren tachtig maakte een snelle groei van de internationale handel mogelijk met een financiële deregulering en verhoogde internationale investeringen. De stabilisatie was het gevolg van de informele, maar duurzame relatie tussen de Verenigde Staten en China (en in beperkte mate de andere Aziatische landen). Het handelstekort van de Verenigde Staten werd gefinancierd door de Aziatische landen die op hun beurt zo aan hun exportbehoeften konden voldoen. Daarbij was het van belang dat de winsten op de buitenlandse investeringen van de Verenigde Staten en Groot-Brittannië stegen, waardoor de schulden niet uit de pan rezen.

Het *derde* onderdeel waren de kostprijzen die twintig jaar buitengewoon laag bleven. Daardoor was het mogelijk in de Verenigde Staten en Groot-Brittannië bij een lage rente de schuld te laten stijgen en zo de vraag op te drijven, zonder zich zorgen te maken over de inflatie.

Deze drie onderdelen hangen onlosmakelijk samen om het systeem te laten functioneren. De groei van de schuld is alleen mogelijk bij een lage rente en een gedereguleerd internationaal financieel systeem dat op zijn beurt weer stabiele wisselkoersen nodig heeft. De snelle exportstijging van China en elders was afhankelijk van de vraag in de Verenigde Staten en andere landen die gefinancierd werd door oplopende schulden. De lage kostprijzen hadden globalisatie en imperialistische expansie tot gevolg die nodig waren om de gedereguleerde schuld te financieren en de wisselkoersen stabiel te houden. Het is niet zo dat er een moment aan te wijzen is waarop dit systeem ontstond, het is in de loop van de jaren op een organische wijze gegroeid.

Huidige crisis

De huidige crisis is fundamenteel, omdat alle drie de genoemde onderdelen onder druk staan. De opgebouwde schuld was op zich al extreem vanwege de grootte, maar ook vanwege de ondoorzichtigheid en de verspreiding door de omwisseling van leningen in effecten (securitisatie²). Ondanks de overwaardering van de onroerend goed markt in de Verenigde Staten en andere landen zou de schuld het hele globale systeem niet bedreigen als de rol van de schuld niet zo essentieel was voor de groei van het huidige kapitalistische systeem.

Gevaarlijk voor het systeem is de samenloop van de problemen op de kredietmarkten, de onzekerheden in de wisselkoersen (de val van de dollar), de snelle vermindering van de winsten op buitenlandse investeringen voor de Verenigde Staten en Groot-Brittannië en het naderende einde van de lage kostprijzen, zoals te zien is aan de olie- en voedselprijzen.

De problemen worden het duidelijkst zichtbaar in het belangrijkste instrument waarvan het kapitaal de laatste dertig jaar afhankelijk was, de controle over de rentevoet. De Verenigde Staten hebben die snel laten dalen vanwege de ongedekte schulden, maar het gevolg is dat de waarde van de dollar daalt en de inflatie stijgt. De stijging van de inflatie zorgt weer voor een verdere daling van de dollar. Zo eindigt dit van kwaad tot erger.

Lost het kapitaal de crisis op?

De discussie over het gevolg van de crisis is erg speculatief. Toch is het van belang een aantal mogelijke maatregelen de revue te laten passeren, zodat we daarop voorbereid zijn. Elke oplossing heeft te maken met de verdeling van de kosten van de crisis. Het kapitaal zal proberen die kosten zoveel mogelijk af te wentelen op de loon- en uitkeringsafhankelijken. Of dat lukt, hangt af van de sterkte van de arbeidersbeweging, zowel nationaal als internationaal.

De belangrijkste kwesties zijn de volgende:

- De vraag in China en andere landen kan de vraag in de Verenigde Staten vervangen. Een oplossing van de crisis zou afkoeling van de economie in de Verenigde Staten en soortgelijke landen zijn die wordt gecompenseerd door interne groei (investeringen en consumptie) in China en andere landen met een exportoverschot. Dit zou mogelijk zijn in een geplande globale economie, maar is veel moeilijker te realiseren in de ongeplande, spontane wereld van het huidige kapitalisme.
- De huidige crisis is misschien alleen maar een liquiditeitscrisis en geen kredietwaardigheidscrisis. Een aantal waarnemers betoogt dat de kredietcrisis voornamelijk wordt veroorzaakt door liquiditeitsproblemen en dat de grootte van de echt ongedekte schulden beperkt is. De bedrijfswinsten in de niet-financiële sector blijven hoog. Dit is op het moment het belangrijkste lichtpuntje voor het kapitaal. Het argument houdt er echter geen rekening mee dat de winsten in de niet-financiële sector afhankelijk zijn van de consumptie die door de schulden werd gestimuleerd en die nu niet meer duurzaam is.
- De stijgingen van de kostprijzen kunnen voor een groot deel veroorzaakt zijn door speculatie. Dat geldt mogelijk voor de olie- en grondstofprijzen, omdat speculanten de dollar verlaten. Maar de ernst van de ecologische crisis en het lange termijn karakter van de prijsstijgingen geven aan dat speculatie slechts een beperkte rol speelt.
- Een daling van de dollar en de pond sterling zal de export van de Verenigde Staten en Groot-Brittannië bevorderen. Op die manier zorgen de wisselkoersen voor een herstel van de handelsbalans. Met de huidige val van de dollar stijgt de export van de Verenigde Staten nu inderdaad. Maar voor het kapitaal is het riskant op dit mechanisme te vertrouwen omdat het: (a) forse verliezen betekent voor landen als China die de laatste jaren bezittingen in dollars hebben aangeschaft, (b) de inflatie in de Verenigde Staten en Groot-Brittannië bevordert, (c) de instabiliteit van de wisselkoersen net zoals in de jaren zeventig vergroot en (d) zelfs als een evenwichtiger groei door de nieuwe wisselkoersen wordt bereikt, deze veel lager zal zijn als we de laatste jaren gewend waren.
- Een verbetering van de structuur van de regulering kan het probleem oplossen. Sommige zien de structurering van de regulering in het kapitalisme als sleutel voor de oplossing van de crisis. Het eerder geciteerde artikel van Martin Wolf is hier een voorbeeld van. Deze oplossingsrichting leidt echter tot heftige kritiek: anderen zijn fel tegen meer regulering.

Al de bovengenoemde oplossingen kunnen worden geprobeerd om de crisis op te lossen, maar in

ieder geval ziet de toekomst van het kapitalisme op korte termijn er donker uit. De Nederlandse regering doet als of er geen globalisatie bestaat en steekt haar kop in het zand. De Nederlandse vakbeweging grijpt terug naar het poldermodel. Dat zijn niet de oplossingen die voorkomen dat de crisis afgewenteld wordt op de bevolking en daar ligt een mooie taak voor socialisten.

¹ Dit artikel verscheen in het juninummer van International Viewpoint <http://www.internationalviewpoint.org/spip.php?article1486>. Andy Kilmister onderwijst economie aan de Oxford Brooks Universiteit en is lid van de International Socialist Group.

² Securitatie is de overdracht, door een bank of een bedrijf, van bezittingen aan een speciaal daarvoor opgericht bedrijf (in het jargon een "special purpose vehicle"). Dit aparte bedrijf geeft om de overname van de bezittingen te kunnen betalen verhandelbare effecten uit met genoemde bezittingen als een soort onderpand. In het Engels heet dit soort effecten "asset backed securities". Een ander woord voor securitatie is effectisering: het omzetten van bijvoorbeeld leningen die een bank heeft verstrekt in verhandelbare waardepapieren. Het voordeel voor een bank is dat bij zo'n operatie de leningen niet meer in de kredietportefeuille staan en er daarom geen eigen vermogen voor dat deel hoeft te worden aangehouden. <http://www.mijnwoordenboek.nl> (terug)

Capitalism in an Apocalyptic Mood

Walden Bello

Source : Foreign Policy In Focus – USA

(<http://www.fpi.org/fpiftxt/4996>)

SKYROCKETING OIL PRICES, a falling dollar, and collapsing financial markets are the key ingredients in an economic brew that could end up in more than just an ordinary recession. The falling dollar and rising oil prices have been rattling the global economy for sometime. But it is the dramatic implosion of financial markets that is driving the financial elite to panic.

And panic there is. Even as it characterized Federal Reserve Board Chairman Ben Bernanke's deep cuts amounting to a 1.25 points off the prime rate in late January as a sign of panic, the *Economist* [admitted](#) that "there is no doubt that this is a frightening moment." The losses stemming from bad securities tied up with defaulted mortgage loans by "subprime" borrowers are now estimated to be in the range of about \$400 billion. But as the *Financial Times* [warned](#), "the big question is what else is out there" at a time that the global financial system "is wide open to a catastrophic failure." In the last few weeks, for instance, several Swiss, Japanese, and Korean banks have owned up to billions of dollars in subprime-related losses. The globalization of finance was, from the beginning, the cutting edge of the globalization process, and it was always an illusion to think that the subprime crisis could be confined to U.S. financial institutions, as some analysts had thought.

Some key movers and shakers sounded less panicky than resigned to some sort of apocalypse. At the global elite's annual week-long party at Davos in late January, George Soros sounded positively necrological, declaring to one and all that the world was witnessing "the end of an era." World Economic Forum host Klaus Schwab [spoke](#) of capitalism getting its just desserts, saying, "We have to pay for the sins of the past." He told the press, "It's not that the pendulum is now swinging back to Marxist socialism, but people are asking themselves, 'What are the boundaries of the capitalist system?' They think the market may not always be the best mechanism for providing solutions."

Ruined Reputations and Policy Failures

While some appear to have lost their nerve, others have seen the financial collapse diminish their stature.

As chairman of President Bush's Council of Economic Advisers in 2005, Ben Bernanke attributed the rise in U.S. housing prices to "strong economic fundamentals" instead of speculative activity. So is it any wonder why, as Federal Reserve chairman, he failed to anticipate the housing market's collapse stemming from the subprime mortgage crisis? His predecessor, Alan Greenspan, however, has suffered a bigger hit, moving from iconic status to villain in the eyes of some. They blame the bubble on his aggressively cutting the prime rate to get the United States out of recession in 2003 and restraining it at low levels for over a year. Others say he ignored warnings about aggressive and unscrupulous mortgage originators enticing "subprime" borrowers with mortgage deals they could never afford.

The scrutiny of Greenspan's record and the failure of Bernanke's rate cuts so far to reignite bank lending has raised serious doubts about the effectiveness of monetary policy in warding off a recession that is now seen as all but inevitable. Nor will fiscal policy or putting money into the hands of consumers do the trick, according to some weighty voices. The \$156 billion stimulus package recently approved by the White House and Congress consists largely of tax rebates, and most of these, [according to](#) *New York Times* columnist Paul Krugman, will go to those who don't really need them. The tendency will thus be to save rather than spend the rebates in a period of uncertainty, defeating their purpose of stimulating the economy. The specter that now haunts the U.S. economy is Japan's experience of virtually zero annual growth and deflation despite a succession of stimulus packages after Tokyo's great housing bubble deflated in the late 1980s.

The Inevitable Bubble

Even with the finger-pointing in progress, many analysts remind us that if anything, the housing crisis should have been expected all along. The only question was when it would break. As progressive economist Dean Baker of the Center for Economic Policy Research noted in an analysis several years ago, "Like the stock bubble, the housing bubble will burst. Eventually, it must. When it does, the economy will be thrown into a severe recession, and tens of millions of homeowners, who never imagined that house prices could fall, likely will face serious hardship."

The subprime mortgage crisis was not a case of supply outrunning real demand. The "demand" was largely fabricated by speculative mania on the part of developers and financiers that wanted to make great profits from their access to foreign money that flooded the United States in the last decade. Big ticket mortgages were aggressively sold to millions who could not normally afford them by offering low "teaser" interest rates that would later be readjusted to jack up payments from the new homeowners. These assets were then "securitized" with other assets into complex derivative products called "collateralized debt obligations" (CDOs) by the mortgage originators working with different layers of middlemen who understated risk so as to offload them as quickly as possible to other banks and institutional investors. The shooting up of interest rates triggered a wave of defaults, and many of the big name banks and investors – including Merrill Lynch, Citigroup, and Wells Fargo – found themselves with billions of dollars worth of bad assets that had been given the green light by their risk assessment systems.

The Failure of Self-Regulation

The housing bubble is only the latest of some 100 financial crises that have swiftly followed one another ever since the lifting of Depression-era capital controls at the onset of the neoliberal era in the early 1980s. The calls now coming from some quarters for curbs on speculative capital have an air of *déjà vu*. After the Asian Financial Crisis of 1997, in particular, there was a strong clamor for capital controls, for a "new global financial architecture." The more radical of these called for currency transactions taxes such as the famed Tobin Tax, which would have slowed down capital movements, or for the creation of some kind of global financial authority that would, among other things, regulate relations between northern creditors and indebted developing countries.

Global finance capital, however, resisted any return to state regulation. Nothing came of the proposals for Tobin taxes. The banks killed even a relatively weak "sovereign debt restructuring

mechanism” akin to the U.S. Chapter Eleven to provide some maneuvering room to developing countries undergoing debt repayment problems, even though the proposal came from Ann Krueger, the conservative American deputy managing director of the IMF. Instead, finance capital promoted what came to be known as the Basel II process, described by political economist Robert Wade as steps toward global economic standardization that “maximize [global financial firms’] freedom of geographical and sectoral maneuver while setting collective constraints on their competitive strategies.” The emphasis was on private sector self-surveillance and self-policing aimed at greater transparency of financial operations and new standards for capital. Despite the fact that it was finance capital from the industrialized countries that triggered the Asian crisis, the Basel process focused on making developing country financial institutions and processes transparent and standardized along the lines of what Wade calls the “Anglo-American” financial model.

Calls to regulate the proliferation of these new, sophisticated financial instruments, such as derivatives placed on the market by developed country financial institutions, went nowhere. Assessment and regulation of derivatives were left to market players who had access to sophisticated quantitative “risk assessment” models.

Focused on disciplining developing countries, the Basel II process accomplished so little in the way of self-regulation of global financial from the North that even Wall Street banker Robert Rubin, former secretary of treasury under President Clinton, warned in 2003 that “future financial crises are almost surely inevitable and could be even more severe.”

As for risk assessment of derivatives such as the “collateralized debt obligations” (CDOs) and “structured investment vehicles” (SIVs) – the cutting edge of what the *Financial Times* has [described](#) as “the vastly increased complexity of hyperfinance” – the process collapsed almost completely. The most sophisticated quantitative risk models were left in the dust. The sellers of securities priced risk by one rule only: underestimate the real risk and pass it on to the suckers down the line. In the end, it was difficult to distinguish what was fraudulent, what was poor judgment, what was plain foolish, and what was out of anybody’s control. “The U.S. subprime mortgage market was marked by poor underwriting standards and ‘some fraudulent practices,’” as one report on the [conclusions of a recent meeting](#) of the Group of Seven’s Financial Stability Forum put it. “Investors didn’t carry out sufficient due diligence when they bought mortgage-backed securities. Banks and other firms managed their financial risks poorly and failed to disclose to the public the dangers on and off their balance sheets. Credit-rating companies did an inadequate job of evaluating the risk of complex securities. And the financial institutions compensated their employees in ways that encouraged excessive risk-taking and insufficient regard to long-term risks.”

The Specter of Overproduction

It is not surprising that the G-7 report sounded very much like the post-mortems of the Asian financial crisis and the dot.com bubble. One financial corporation chief writing in the *Financial Times* captured the basic problem running through these speculative manias, perhaps unwittingly, when he [claimed](#) that “there has been an increasing disconnection between the real and financial economies in the past few years. The real economy has grown...but nothing like that of the financial economy, which grew even more rapidly – until it imploded.” What his statement does not tell us is that the disconnect between the real and the financial is not accidental, that the financial

economy expanded precisely to make up for the stagnation of the real economy.

The stagnation of the real economy stems is related to the condition of overproduction or over-accumulation that has plagued the international economy since the mid-1970s. Stemming from global productive capacity outstripping global demand as a result of deep inequalities, this condition has eroded profitability in the industrial sector. One escape route from this crisis has been “financialization,” or the channeling of investment toward financial speculation, where greater profits could be had. This was, however, illusory in the long run since, unlike industry, speculative finance boiled down to an effort to squeeze out more “value” from already created value instead of creating new value.

The disconnect between the real economy and the virtual economy of finance was evident in the dot.com bubble of the 1990s. With profits in the real economy stagnating, the smart money flocked to the financial sector. The workings of this virtual economy were exemplified by the rapid rise in the stock values of Internet firms that, like Amazon.com, had yet to turn a profit. The dot.com phenomenon probably extended the boom of the 1990s by about two years. “Never before in U.S. history,” Robert Brenner wrote, “had the stock market played such a direct, and decisive, role in financing non-financial corporations, thereby powering the growth of capital expenditures and in this way the real economy. Never before had a US economic expansion become so dependent upon the stock market’s ascent.” But the divergence between momentary financial indicators like stock prices and real values could only proceed to a point before reality bit back and enforced a “correction.” And the correction came savagely in the dot.com collapse of 2002, which wiped out \$7 trillion in investor wealth.

A long recession was avoided, but only because another bubble, the housing bubble, took the place of the dot.com bubble. Here, Greenspan played a key role by cutting the prime rate to a 45-year low of one percent in June 2003, holding it there for a year, then raising it only gradually, in quarter-percentage-increments. As Dean Baker put it, “an unprecedented run-up in the stock market propelled the U.S. economy in the late nineties and now an unprecedented run-up in house prices is propelling the current recovery.”

The result was that real estate prices rose by 50% in real terms, with the run-ups, according to Baker, being close to 80% in the key bubble areas of the West Coast, the East Coast north of Washington, DC, and Florida. Baker estimates that the run-up in house prices “created more than \$5 trillion in real estate wealth compared to a scenario where prices follow their normal trend growth path. The wealth effect from house prices is conventionally estimated at five cents to the dollar, which means that annual consumption is approximately \$250 billion (2 per cent of gross domestic product [GDP]) higher than it would be in the absence of the housing bubble.”

The China Factor

The housing bubble fueled U.S. growth, which was exceptional given the stagnation that has gripped most of the global economy in the last few years. During this period, the global economy has been marked by underinvestment and persistent tendencies toward stagnation in most key economic regions apart from the United States, China, India, and a few other places. Weak growth has marked most other regions, notably Japan, which was locked until very recently into a one

percent GDP growth rate, and Europe, which grew annually by 1.45% in the last few years.

With stagnation in most other areas, the United States has pulled in some 70% of all global capital flows. A great deal of this has come from China. Indeed, what marks this current bubble period is the role of China as a source not only of goods for the U.S. market but also capital for speculation. The relationship between the United States and Chinese economies is what I have characterized elsewhere as [chain-gang economics](#). On the one hand, China's economic growth has increasingly depended on the ability of American consumers to continue their debt-financed spending spree to absorb much of the output of China's production. On the other hand, this relationship depends on a massive financial reality: the dependence of U.S. consumption on China's lending the U.S. Treasury and private sector dollars from the reserves it accumulated from its yawning trade surplus with the United States: one trillion dollars so far, according to some estimates. Indeed, a great deal of the tremendous sums China – and other Asian countries – lent to American institutions went to finance middle-class spending on housing and other goods and services, prolonging the fragile U.S. economic growth but only by raising consumer indebtedness to dangerous, record heights.

The China-U.S. coupling has had major consequences for the global economy. The massive new productive capacity by American and other foreign investors moving to China has aggravated the persistent problem of overcapacity and overproduction. One indicator of persistent stagnation in the real economy is the aggregate annual global growth rate, which averaged 1.4% in the 1980s and 1.1% in the 1990s, compared to 3.5% in the 1960s and 2.4% in the 1970s. Moving to China to take advantage of low wages may shore up profit rates in the short term. But as it adds to overcapacity in a world where a rise in global purchasing power is constrained by growing inequalities, such capital flight erodes profits in the long term. And indeed, the profit rate of the largest 500 U.S. transnational corporations fell drastically from 4.9% from 1954-59, to 2.04% from 1960-69, to -5.30% from 1989-89, to -2.64% from 1990-92, and to -1.92% from 2000-2002. Behind these figures, notes Philip O'Hara, was the specter of overproduction: "Oversupply of commodities and inadequate demand are the principal corporate anomalies inhibiting performance in the global economy."

The succession of speculative manias in the United States has had the function of absorbing investment that did not find profitable returns in the real economy and thus not only artificially propping up the U.S. economy but also "holding up the world economy," as [one IMF document put it](#). Thus, with the bursting of the housing bubble and the seizing up of credit in almost the whole financial sector, the threat of a global downturn is very real.

Decoupling Chain-Gang Economics?

In this regard, talk about a process of "decoupling" regional economies, especially the Asian economic region, from the United States has been without substance. True, most of the other economies in East and Southeast Asia have been pulled along by the Chinese locomotive. In the case of Japan, for instance, a decade-long stagnation was broken in 2003 by the country's first sustained recovery, fueled by exports to slake China's thirst for capital and technology-intensive goods. Exports shot up by a record 44%, or \$60 billion. Indeed, China became the main destination for Asia's exports, accounting for 31% while Japan's share dropped from 20 to 10%. As one account in the *Strait Times* in 2004 pointed out, "In country-by-country profiles, China is now the

overwhelming driver of export growth in Taiwan and the Philippines, and the majority buyer of products from Japan, South Korea, Malaysia, and Australia.”

However, as [research](#) by C.P. Chandrasekhar and Jayati Ghosh and has underlined, China is indeed importing intermediate goods and parts from these countries but only to put them together mainly for export as finished goods to the United States and Europe, not for its domestic market. Thus, “if demand for Chinese exports from the United States and the EU slow down, as will be likely with a U.S. recession, this will not only affect Chinese manufacturing production, but also Chinese demand for imports from these Asian developing countries.” Perhaps the more accurate image is that of a chain gang linking not only China and the United States but a host of other satellite economies whose fates are all tied up with the now-deflating balloon of debt-financed middle-class spending in the United States.

New Bubbles to the Rescue?

Do not overestimate the resiliency of capitalism. After the collapse of the dot.com boom and the housing boom, a third line of defense against stagnation owing to overcapacity may yet emerge. For instance, the U.S. government might pull the economy out of the jaws of recession through military spending. And, indeed, the military economy did play a role in bringing the United States out of the 2002 recession, with defense spending in 2003 accounting for 14% of GDP growth while representing only 4% of the overall U.S. GDP. According to [estimates cited](#) by Chalmers Johnson, defense-related expenditures will exceed \$1 trillion for the first time in history in 2008.

Stimulus could also come from the related “disaster capitalism complex” so well studied by Naomi Klein: the “full fledged new economy in home land security, privatized war and disaster reconstruction tasked with nothing less than building and running a privatized security state both at home and abroad.” Klein says that, in fact, “the economic stimulus of this sweeping initiative proved enough to pick up the slack where globalization and the dot.com booms had left off. Just as the Internet had launched the dot.-com bubble, 9/11 launched the disaster capitalism bubble.” This subsidiary bubble to the real-estate bubble appears to have been relatively unharmed so far by the collapse of the latter.

It is not easy to track the sums circulating in the disaster capitalism complex. But one indication of the sums involved is that InVision, a General Electric affiliate producing high-tech bomb-detection devices used in airports and other public spaces, received an astounding \$15 billion in Homeland Security contracts between 2001 and 2006.

Whether or not “military Keynesianism” and the disaster capitalism complex can in fact fill the role played by financial bubbles is open to question. To feed them, at least during the Republican administrations, has meant reducing social expenditures. A Dean Baker study [cited by Johnson](#) found that after an initial demand stimulus, by about the sixth year, the effect of increased military spending turns negative. After 10 years of increased defense spending, there would be 464,000 fewer jobs than in a scenario of lower defense spending.

An more important limit to military Keynesianism and disaster capitalism is that the military engagements to which they are bound to lead are likely to create quagmires such as Iraq and

Afghanistan. And these disasters could trigger a backlash both abroad and at home. Such a backlash would eventually erode the legitimacy of these enterprises, reduce their access to tax dollars, and erode their viability as sources of economic expansion in a contracting economy.

Yes, global capitalism may be resilient. But it looks like its options are increasingly limited. The forces making for the long-term stagnation of the global capitalist economy are now too heavy to be easily shaken off by the economic equivalent of mouth-to-mouth resuscitation.

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Global economic crisis:

‘No-one knows where the toxic debt is buried’

Interview with John Bellamy Foster by Peter Boyle

Source : Green Left Weekly – Australia

(<http://www.greenleft.org.au/2008/749/38711>)

The current global financial crisis is said to originate with a few dodgy “sub-prime” mortgages made by US banks to poor people.

Yes, the financial crisis that began in late 2007 is associated with the collapse of the sub-prime mortgage market. But that is just one aspect of a much larger financial crisis and that itself is one aspect of a much larger problem of the financialisation of capitalist economy that has been going on for decades.

Since the slowdown of the world capitalist economy in the 1970s, we have seen a period of stagnation where in each decade the growth rate of the world economy (and the economy in the centre states) has been slower in the decade before. The '70s had a slower rate of growth than the '60s, the '80s were slower than the '70s, the '90s were slower than the '80s, and the 2000s have so far been the slowest decade.

This slowdown is very obvious in the US economy. The slowdown has been due to a stagnation of investment, so they try and stimulate demand.

One way they have tried to do this is through enhanced military spending, which is also being carried out as part of an imperial strategy. The US is now spending about a trillion dollars a year on the military if you add in all the different elements, including the wars in Iraq and Afghanistan.

Another way they have tried to offset the stagnation is through the growth of the financial system. So all the profits the capitalists can't find investment outlets for are poured into finance. So we have a huge growth of the financial superstructure of the economy, which is now far bigger than the productive base, what the economists call the “real economy of income”.

The financial structure dwarfs that. Financialisation means a shift in gravity from the real economy (production centred-economy) to financial speculation.

This system has become more and more unwieldy. As it expanded, they have had to take on larger and larger amounts of risk. They've had to develop more and more exotic financial instruments and the system has become opaque, multi-layered, gargantuan and uncontrollable.

This is something that the financial press, the International Monetary Fund and the central banks are very concerned about. There are all sorts of growth of derivative markets that are supposed to slice and dice risk and protect capital, but it is all very unstable.

In the US in 2000 there was a stock market collapse and it was part of this financialisation problem. They had no way to save the economy but to lower interest rates and to create another bubble — this time in real estate.

They took mortgage loans and they “securitised” them — i.e. they turned them into complex investment vehicles that they could trade on. This created a whole shadow banking system to

support this.

The hedge funds are part of this. The structured investment vehicles that hold these new mortgage-based securities are collateral debt obligations. They have all these new vehicles such as credit-debt swaps, which are complex forms of speculation and insurance.

It is enormously complex and the financial world itself hardly understands it and how to evaluate it. The whole thing started to come apart last [Northern] summer, beginning in late July when Bear Stearns found that it couldn't put a value on some hedge funds that had what they called "financial toxic waste". These hedge funds had this financial toxic waste in the form of collateralised debt obligations that had some sub-prime mortgages in them.

One of these hedge funds lost 90% of its value and the other about 100% of its value. The entire financial community panicked because they realised that the phenomenal values they had placed on these things were meaningless.

The potential chain reactions were enormous because the system is opaque, which means that nobody knows where the financial toxic waste is buried. Nobody knows because the interconnections are too complex and nobody wants the mortgage-based securities anymore because they are seen as too dangerous.

They call them "nitroglycerine" or "weapons of mass destruction". The whole thing is unstable.

So we have another financial bubble that has burst and of course, it is affecting working people because the whole speculation was based on homes. Many people were pushed into taking out adjustable rate mortgages and mortgage loans in which there was no equity (i.e. for 100% of the value of the house).

People were told to refinance and refinance, to take more cash out on their home loans and treat it like a piggy bank. Since in the US people haven't had a real increase in wages for 30 years, people were just taking money out of their homes and increasing their debt just to survive and consume.

So the working class is left in terrible shape. And if consumption collapses in the US, that affects the Chinese economy and the whole world economy.

So this is extremely unstable and dangerous.

The root of this crisis is the stagnation of the economy that has been going on for a long time — financialisation was supposed to be the answer to that. It has turned out to be a crisis in itself.

They have no answer to this in the US but to lower interest rates again, have the Federal Reserve take over hundreds of billions of dollars of bad loans and bail out the financial institutions as much as they can. Then they have to find a way to blow another bubble.

You have described this financialisation of the economy as "gargantuan"; can you give us some figures that indicate the scale of this process? What is the size of the "bad debt" held by US banks?

No one has any idea. In the derivatives market, all the values are in nominal terms and there is no real way of relating these values to the real economy. You can talk about tens of trillions of dollars of these financial instruments but nobody really knows how to value these things and a lot of it is based on fictional incomes, like the non-existent servicing of the sub-prime mortgages.

These values can inflate or deflate very quickly. It doubles in price one year and goes down by as much in the next year. Their nominal values only measure a possible loss, but what does that mean?

If, when it doubled in price, you concluded you were much richer and went and borrowed on it, increasing your debt, then when it goes down in price you find you did not have that wealth at all but you have these debts.

Debt has expanded so fast in the US that by the end of 2005, the debt in the US economy was equal to the gross world product, the income of the entire world. In the first half of 2007, they started to panic at the decline in housing prices and the implications of this.

There was a 49% increase in credit-debt swaps, which was an attempt by financial institutions to protect themselves. So the credit-debt swaps, which comprise only one part of the derivatives market, rose to US\$40 trillion — exceeding by a number of times US gross national product (which was \$14.2 trillion at end of 2007). So it is huge compared even to the total incomes of all the workers and companies — it is dangerous for that reason alone.

Probably the only thing all economists would agree on is that an economy grows on the basis of investment. If you want economic growth you have to have net investment. Undistributed profits are supposed to go into net investment and that is the whole rationale for the capitalist class. That's the purpose they are supposed to carry out — accumulate profits and use it to invest.

In the US the net investment in the late '60s was about 4.8% of GDP, but it has been falling pretty steadily since, with some up and down movement. By 2005, which was the peak of the latest economic cycle, it had fallen to 1.5% of GDP. Now net investment in the US has almost completely disappeared.

Capitalists are not investing in the productive sector at all. And it is not because they don't have any profits to invest. Right now, net investment has probably fallen below 1% of GDP. The corporations have \$600 billion in cash that they are sitting on and are not investing because there are no profitable investment outlets out there.

So they are sitting on this big pile of cash.

Meanwhile, in the US the job situation has deteriorated so that the proportion of the adult population (males especially) who are employed is the lowest since the Great Depression.

This is not reflected entirely in unemployment figures because people are dropping out of the job market altogether as they are so discouraged. Jobs are disappearing and people are more and more desperate. And this supposedly is the leading economy on Earth.

Why doesn't the US government and reserve banks, those champions of neo-liberal economics, say let the companies with the bad debt go to the wall, take the pain and let the economy fix itself according to laissez faire economic theory?

In this crisis, these institutions have already decided that this approach is definitely out. The big capitalists have said to the reserve banks and to the government that they have to be rescued on this. In March, the US Federal Reserve board loaned \$200 billion to the leading financial institutions and supervised the bail-out of Bear Stearns and its absorption by JP Morgan-Chase. The federal reserve is taking over a lot of these mortgage-based securities, something they have never done before.

They are taking over the securities that no one wants and there is no market for, and they are taking them for what they call "non-recourse loans". They don't want to call it a bail out but it means the same thing — the losses will be borne by the federal reserve board and the taxpayer.

They are doing everything they can to pour liquidity into the system. They lowered the interest rate at record speed, pouring liquidity not only into the major banks but also into the shadow economy of the hedge funds and other similar financial institutions.

So capital has already made its decision, as well as the federal reserve board and other central banks. They justify it by saying that if they didn't the whole financial system would come tumbling down. The amounts at risk are too immense and the relationships between financial institutions and

other companies are too complex.

Bear Stearns, for instance, had a couple of trillion dollars of credit-debt swaps and so the consequences for other financial institutions of it going down would have been unbelievable. And they would have been world-wide. So they had to move in, they had no choice.

However, while the federal reserve board cannot let these institutions fail, the “Keynesian” approach is not really available. What people usually mean by taking a Keynesian approach is introducing regulations on these financial institutions.

But regulations can’t be imposed very easily because the whole financialisation process requires increased risk and increased speculation and an increase in the number of financial instruments available. If this process is not allowed to go on, then there will be a financial contraction and the system starts to come apart.

The federal reserve board and the US government are not in control of the situation. They have the bull by the horns and they can’t let go. They can only provide more liquidity and remove regulations.

They can’t impose regulations because their only solution is to blow another speculative bubble, because fundamentally the economy is ill and has been for three decades and financialisation has failed to cure it.

Because Australia now exports most of its raw materials to China, there is a lot of speculation about how much the growth in the Chinese economy is dependent on the health of the US economy.

The US is no longer China’s number-one trading partner. It has become Europe. So some people say that this stabilises things, but not really.

But what is generating the growth in the Chinese economy is its export surplus. The export surplus of the Chinese economy is equivalent to the current account deficit of the US economy, so these economies remain inter-dependent. If the US economy contracts seriously then that will affect China.

Europe is basically in trade balance with China, so if the US economy contracts China loses its market and the basis of its export surplus. So China could have a very severe economic crisis as a result of this.

In addition, the Chinese currency has been pegged to the US dollar and the collapse of the US dollar has an impact of China’s foreign reserves.

However, China has an advantage because of its relatively weak internal demand so it could compensate by expanding the consumption of its working class. It could create a more internally oriented economy, which would also be the best thing for its population. This would mean that wages would have to go up.

But the immediate effect of a real crash in US consumption would be a big slowdown in the Chinese economy. China has been rapidly building up its industrial capacity and it could find that capacity unusable.

Historically there has never been an economy that has grown so fast and for so long as the Chinese economy. So the idea that the Chinese economy is going to be able to increase at this rate of 8-9% a year, year after year, goes against historical experience, which would suggest that it is bound to experience a slowdown.

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The Financialization of Capital and the Crisis

John Bellamy Foster

Source : Monthly Review – USA

(<http://www.monthlyreview.org/080401foster.php>)

WITH THE BENEFIT OF HINDSIGHT, few now doubt that the housing bubble that induced most of the recent growth of the U.S. economy was bound to burst or that a general financial crisis and a global economic slowdown were to be the unavoidable results. Warning signs were evident for years to all of those not taken in by the new financial alchemy of high-risk debt management, and not blinded, as was much of the corporate world, by huge speculative profits. This can be seen in a series of articles that appeared in this space: “The Household Debt Bubble” (May 2006), “The Explosion of Debt and Speculation” (November 2006), “Monopoly-Finance Capital” (December 2006), and “The Financialization of Capitalism” (April 2007). In the last of these we wrote:

So crucial has the housing bubble been as a counter to stagnation and a basis for financialization, and so closely related is it to the basic well-being of U.S. households, that the current weakness in the housing market could precipitate both a sharp economic downturn and widespread financial disarray. Further rises in interest rates have the potential to generate a vicious circle of stagnant or even falling home values and burgeoning consumer debt service ratios leading to a flood of defaults. The fact that U.S. consumption is the core source of demand for the world economy raises the possibility that this could contribute to a more globalized crisis....

In the September 2006 *Global Financial Stability Report* the IMF executive board directors expressed worries that the rapid growth of hedge funds and credit derivatives could have a systematic impact on financial stability, and that a slowdown of the U.S. economy and a cooling of its housing market could lead to greater “financial turbulence,” which could be “amplified in the event of unexpected shocks.” The whole context is that of a financialization so out of control that unexpected and severe shocks to the system and resulting financial contagions are looked upon as inevitable.¹

This scenario, which was already beginning to be played out at the time that the above passage was written, of stagnant and falling home prices, a flood of defaults, and a global economic crisis due to financial contagion and a drop in U.S. consumption, has now become a concrete reality. Since the collapse of the subprime mortgage market in July 2007, financial distress and panic have spread uncontrollably not only across countries but also across financial markets themselves, infecting one sector after another: adjustable rate mortgages, commercial paper (unsecured short-term corporate debt), bond insurers, commercial mortgage lending, corporate bonds, auto loans, credit cards, and student loans.

Banks, hedge funds, and money markets are all under assault. Given the already weak condition of U.S. production, it did not take long for this financial unraveling to be registered in negative numbers in the “real” economy: falling employment, weakening consumption and investment, and

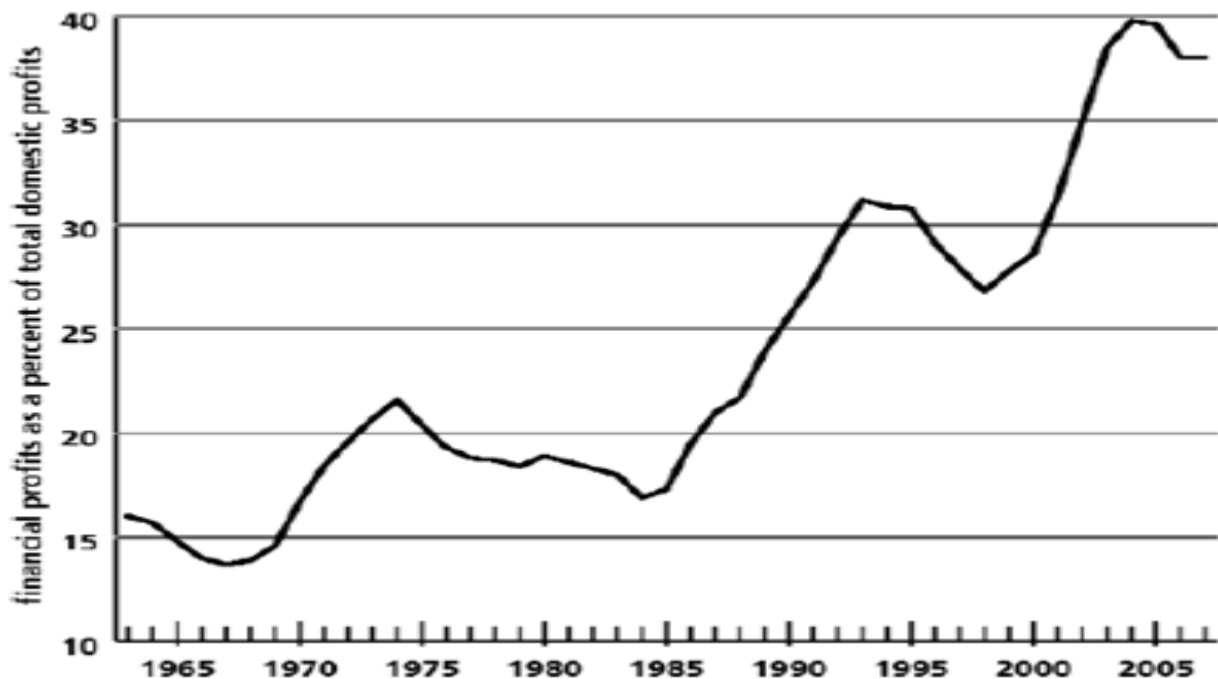
decreasing production and profits. Most business and economic analysts now believe that a full blown recession is ahead both for the United States and the world economy, and may already have begun. “As of right now,” former Federal Reserve Board Chairman Alan Greenspan stated on February 25, 2008, “U.S. economic growth is zero. We are at stall speed.”²

What we will argue here is that this is not just another massive credit crunch of the kind so familiar in the history of capitalism, but signals a new phase in the development of the contradictions of the system, which we have labeled “monopoly-finance capital.” The bursting of two major financial bubbles in seven years in the citadel of capitalism points to a crisis of financialization, or of the progressive shift in gravity from production to finance that has characterized the economy over the last four decades.

What Paul Sweezy just over a decade ago called “the financialization of the capital accumulation process” has been the main force lifting economic growth since the 1970s.³ The transformation in the system that this has brought about is reflected in the rapid growth since the 1970s of financial profits as a percent of total profits (see chart 1). The fact that such financialization of capital appears to be taking the form of bigger and bigger bubbles that burst more frequently and with more devastating effect, threatening each time a deepening of stagnation—i.e., the condition, endemic to mature capitalism, of slow growth, and rising excess capacity and unemployment/underemployment—is thus a development of major significance.

In order to address this issue we will first examine the evolution of the immediate crisis identified with the bursting of the housing bubble. Only then will we turn to the question of the long-run trend of accumulation, namely the stagnation-financialization dynamic, where the larger historical conditions of the present crisis are to be found.

Chart 1. Financial profits as a percent of total profits (five-year moving average)



Source: Table B-91. Corporate Profits by Industry, 1959–2007, *Economic Report of the President, 2008*.

The Five Phases of a Bubble

Although the massive stock market decline in 2000 seemed to presage a serious economic decline, business losses were cushioned and wider economic disruptions were curtailed by a real estate bubble—leading to only a relatively minor recession in 2001. Financial analyst Stephanie Pomboy at MacroMavens aptly dubbed this in 2002 as “The Great Bubble Transfer,” in which a speculative bubble in the home mortgage market miraculously compensated for the bursting of the stock market bubble.⁴ Fed by low interest rates and changes in reserve requirements of banks (which made more funds available) capital flowed massively into the housing market, mortgage lending skyrocketed, housing prices soared, and hyperspeculation soon set in.

What occurred followed the basic pattern of speculative bubbles throughout the history of capitalism, as famously depicted by Charles Kindleberger in *Manias, Panics, and Crashes: a novel offering, credit expansion, speculative mania, distress, and crash/panic*.⁵

Novel Offering

A novel offering may be a new market, a revolutionary new technology, an innovative product, etc.⁶ The novel offering in this case was the “securitization” of mortgage loans through a new financial instrument known as the collateralized debt obligation (CDO). Since the 1970s banks had been pooling individual mortgage loans, using the cash flow provided by these loans to generate residential mortgage-backed securities. These securitized loans in a later development were themselves repackaged in the form of CMOs (“Collateralized Mortgage Obligations”). The CMOs were comprised of what were known as “tranches,” or groupings of income streams from mortgages divided so as to pay off the principal of each tranche’s debt in sequence—the highest tranche, first, and so on. In the 1990s, and especially at the end of the decade, banks began to construct CDOs, which mixed together low-risk, middle-risk, and high-risk (subprime) mortgages, along with other types of debt.

The tranches now represented risk of default, with the lowest tranche absorbing all defaults before the next higher tranche, and so on. The three major credit agencies gave the higher tranches of these new CDOs investment-grade ratings. (An investment grade bond is one judged likely enough to meet payment obligations that banks are allowed to invest in them—a bond below investment grade is a junk bond.) The assumption was that geographical and sector dispersion of the loan portfolio and the “slicing and dicing” of risk would convert all but the very lowest of the tranches of these investment vehicles into safe bets. In many cases the highest (and largest) tranche of such CDOs obtained the best possible rating (“AAA”—equivalent to the rating of the obligations of the U.S. government) through the device of being “insured” against default by a bond-insuring company that itself had been granted AAA ratings. All of this created a vastly expanded market for mortgage lending. This quickly encompassed so-called “subprime” borrowers with poor credit histories and/or low incomes previously outside the mortgage market. And by obtaining high credit ratings for the resulting instruments, the bank creators of these securities obtained the ability readily to dispose of them throughout the new global financial markets.

Crucial to the housing bubble were off-balance-sheet conduits set up by banks, known as structured investment vehicles (SIVs)—themselves virtual banks—designed to hold CDOs. These special entities financed their purchases of CDOs by drawing on the commercial paper market for short-term funds. This meant that they were borrowing short-term funds (through the issue of “asset-backed commercial paper”) to invest in long-term securities. In order to reassure investors, “credit

default swap” arrangements were made with banks, involving big banks like Bank of America, whereby SIVs (in this case the swap buyers) made quarterly payments in return for banks (the swap sellers) promising to make a large payment if the SIVs found their assets declining and their credit drying up and were forced into default. This along with other factors had the effect of leaving banks potentially exposed to risks that they had supposedly transferred elsewhere.⁷

Credit Expansion

An expansion of credit—which means people or corporations are taking on more debt—is required to feed any asset price bubble. In the housing bubble extremely low interest rates following the bursting of the stock market bubble and changes in reserve requirements of banks expanded the credit available to borrowers across the board, regardless of their credit history. Beginning in January 2001, the Federal Reserve Board lowered interest rates in twelve successive rate cuts, reducing the key federal funds rate from 6 percent down to a post-Second World War low of 1 percent by June 2003.⁸

In the resulting housing bubble cheap financing expanded the number of mortgage borrowers despite the increasing prices of houses. The combination of extraordinarily low interest rates and longer mortgages resulted in affordable monthly payments even while prices were rapidly increasing. If such monthly payments were still unaffordable—as they often were given that real wages had stagnated for thirty years and entry level jobs rarely paid more than close to the minimum wage—means were devised to lower the initial payments yet further. This often took the form of adjustable rate mortgages with low “teaser” interest rates, which would be reset after a specified introductory period, usually three to five years or less. Paying almost no interest and making no capital payments, new buyers could now “afford” homes at even higher prices.

Unsophisticated home buyers were readily gulled by the overpowering real estate boom euphoria, and easily led to believe that the continual rise in the prices of their homes would allow them to refinance their mortgages when teaser rates expired. Many subprime mortgage loans amounted to 100 percent of the appraised value of the house. The originators of the subprime loans had every incentive to generate and bundle together as many of these loans as possible since the repackaged loans were quickly sold off to others. And, of course, the rapidly inflating home purchase costs covered by these subprime mortgages included a rich rake-off in the form of commissions and fees to a vast predatory swarm of intermediaries in the brokerage and mortgage generating “industry.” “The amount of subprime mortgages issued and imbedded in Mortgage Backed Securities shot up from \$56 billion in 2000 to \$508 billion at the peak in 2005.”⁹

Speculative Mania

Speculative mania is characterized by a rapid increase in the quantity of debt and an equally rapid decrease in its quality. Heavy borrowing is used to buy up financial assets, not based on the income streams they will generate but merely on the assumption of increasing prices for these assets. This is what economist Hyman Minsky famously called “Ponzi finance” or hyperspeculation.¹⁰ CDOs, with their exposure to subprime mortgages or financial “toxic waste,” increasingly took this classic form.

Not just mortgage lenders and subprime borrowers were caught up in the frenzy. A growing crowd of real estate speculators got into the business of buying houses in order to sell them off at higher prices. Many homeowners also began to view the rapid increase in the value of their homes as natural and permanent, and took advantage of low interest rates to refinance and withdraw cash

value from their homes. This was a way to maintain or increase consumption levels despite stagnant wages for most workers. At the height of the bubble new mortgage borrowing increased by \$1.11 trillion between October and December 2005 alone, bringing outstanding mortgage debt as a whole to \$8.66 trillion, equal to 69.4 percent of U.S. GDP.¹¹

Distress

Distress marks an abrupt change in the direction of the financial market often resulting from some external event. The housing bubble was first pricked in 2006 due to rising interest rates, which caused a reversal in the direction of housing prices in the hot subprime regions, primarily California, Arizona, and Florida. Borrowers who had been depending on double-digit increases in home prices and very low interest rates to refinance or sell homes before the adjustable rate mortgages were reset were suddenly confronted with falling home prices and mortgage payments that were ratcheting (or would soon ratchet) upwards. Investors began to worry that the cooling down of the housing market in some regions would spread to the mortgage market as a whole and infect the overall economy. As an indicator of such distress, credit debt swaps designed to protect investors and used to speculate on credit quality, increased globally by 49 percent to cover a notional \$42.5 trillion in debt in the first half of 2007.¹²

Crash and Panic

The final stage in a financial bubble is known as crash and panic, marked by a rapid selling off of assets in a “flight to quality” (i.e., liquidity). Cash once again becomes king. The initial crash that shook the market occurred in July 2007 when two Bear Stearns hedge funds that held nearly \$10 billion in mortgage-backed securities imploded. One lost 90 percent of its value, while the other melted down completely. As it became apparent that these hedge funds were unable to figure out the actual value of their holdings numerous banks, in Europe and Asia as well as the United States, were forced to acknowledge their exposure to toxic subprime mortgages. A severe credit crunch ensued as fear spread among financial institutions, each of which was unsure as to the level of financial toxic waste the other was holding. The seepage of the credit crunch into the commercial paper market cut off the main source of funding for the bank-sponsored SIVs. This brought to the fore the very heavy risk exposure of some of the big banks arising from credit default swaps. A key event was the failure and subsequent bailing out and nationalization of the British mortgage lender Northern Rock, which in September 2007 was the first British bank in over a century to experience a bank run, with customers lining up to withdraw their savings accounts. U.S. bond insurers also began to implode—a development particularly threatening to capital—due to their underwriting of credit-default swaps on mortgage-backed securities.¹³

The financial panic quickly spread around the globe, reflecting the fact that international investors were also heavily tied into speculation on U.S. mortgage-backed securities. Widespread fears emerged that world economic growth would drop to the 2.5 percent or lower level that for economists defines a world recession.¹⁴ Much of the fear that swept through global financial markets was due to a system so complex and opaque that no one knew where the financial toxic waste was buried. This led to a stampede into U.S. Treasury bills and a drastic decrease in lending.

By January 19, 2008, the *Wall Street Journal* openly declared that the financial system had entered “The Panic Stage,” referring to Kindelberger’s model in *Manias, Panics, and Crashes*. The Federal Reserve Board responded in its lender of last resort function by pouring liquidity back into the system, drastically lowering the federal funds rate from 4.75 percent in September to 3 percent in

January with more interest rate cuts expected to come. The federal government stepped in with a \$150 billion stimulus package. Nothing, however, has served, as of this writing (in early March 2008), to halt the crisis, which is based in the insolvency of much of the multi-trillion dollar mortgage market, with new shocks to follow as millions of adjustable rate mortgages see jumps in interest rates. Above all, the end of the housing bubble has undermined the financial condition of already hard-pressed, heavily indebted U.S. consumers, whose purchases equal 72 percent of GDP.

How serious the economic deceleration will be in the end is still unknown. Financial analysts suggest that house prices must fall on average by something like 20–30 percent, and much more in some regions, to get back in line with historical trends.¹⁵ The decline in U.S. housing prices experienced an accelerated decline in the fourth quarter of 2007.¹⁶ That plus the fact that consumers are being hard hit by other problems such as rising fuel and food prices guarantees a serious slowdown. Some observers now refer to a “bubble cycle” and look to another bubble as the only way to avert catastrophe and quickly restore growth to the economy.¹⁷ Others see a period of persistently weak growth.

One thing is certain. Large capitalist interests are relatively well-placed to protect their investments in the downswing through all sorts of hedging arrangements and can often call on the government to bail them out. They also have a myriad of ways of transferring the costs to those lower down on the economic hierarchy. Losses will therefore fall disproportionately on small investors, workers, and consumers, and on third world economies. The end result, as in all such episodes in the history of the system, will be increased economic and financial sector concentration on both the national and global scales.

A Crisis of Financialization

Little more can be said at the moment about the evolution of the downturn itself, which will still have to work its way through the system. From a long-term historical perspective, however, these events can be seen as symptomatic of a more general crisis of financialization, beyond which lurks the specter of stagnation. It is by exploring these wider and deeper issues rooted in class-based production that we can throw the light on the significance of the above developments for capital accumulation and the future of capitalist class society.

Numerous commentators have castigated the U.S. economy for its “monstrous bubble of cheap credit...with one bubble begetting another”—in the words of Stephen Roach, chairman of Morgan Stanley Asia. Elsewhere Roach has observed that “America’s bubbles have gotten bigger, as have the segments of the real economy they have infected.” Household debt has risen to 133 percent of disposable personal income, while the debt of financial corporations has hit the stratosphere, and government and non-financial corporate debt have been steadily increasing.¹⁸ This huge explosion in debt—consumer, corporate, and government—relative to the underlying economy (equal to well over 300 percent of GDP by the housing bubble’s peak in 2005) has both lifted the economy and led to growing instability.¹⁹

Mainstream commentators often treat this as a national neurosis tied to a U.S. addiction to high consumption, high borrowing, and vanishing personal savings, made possible by the infusion of capital from abroad, itself encouraged by the hegemony of the dollar. Radical economists, however, have taken the lead in pointing to a structural transformation in the capital accumulation process itself associated with the decades-long historical process—now commonly called financialization—in which the traditional role of finance as a helpful servant to production has been stood on its head,

with finance now dominating over production.

The issue of financialization of the capital accumulation process was underscored a quarter-century ago in *Monthly Review* by Harry Magdoff and Paul Sweezy in an article on “Production and Finance.” Starting with a theory (called the “stagnation thesis”)²⁰ that saw financial explosion as a response to the stagnation of the underlying economy, they argued that this helped to “offset the surplus productive capacity of modern industry” both through its direct effect on employment and indirectly through the stimulus to demand created by an appreciation of assets (now referred to as the “wealth effect”).²¹ But the question naturally arose: Could such a process continue? They answered:

From a structural point of view, i.e., given the far-reaching independence of the financial sector discussed above, financial inflation of this kind can persist indefinitely. But is it not bound to collapse in the face of the stubborn stagnation of the productive sector? Are these two sectors really that independent? Or is what we are talking about merely an inflationary bubble that is bound to burst as many a speculative mania has done in the past history of capitalism?

No assured answer can be given to these questions. But we are inclined to the view that in the present phase of the history of capitalism—barring a by no means improbable shock like the breakdown of the international monetary and banking system—the coexistence of stagnation in the productive sector and inflation in the financial sector can continue for a long time.²²

At the root of the financialization tendency, Magdoff and Sweezy argued, was the underlying stagnation of the real economy, which was the normal state of modern capitalism. In this view, it was not stagnation that needed explaining so much as periods of rapid growth, such as the 1960s.

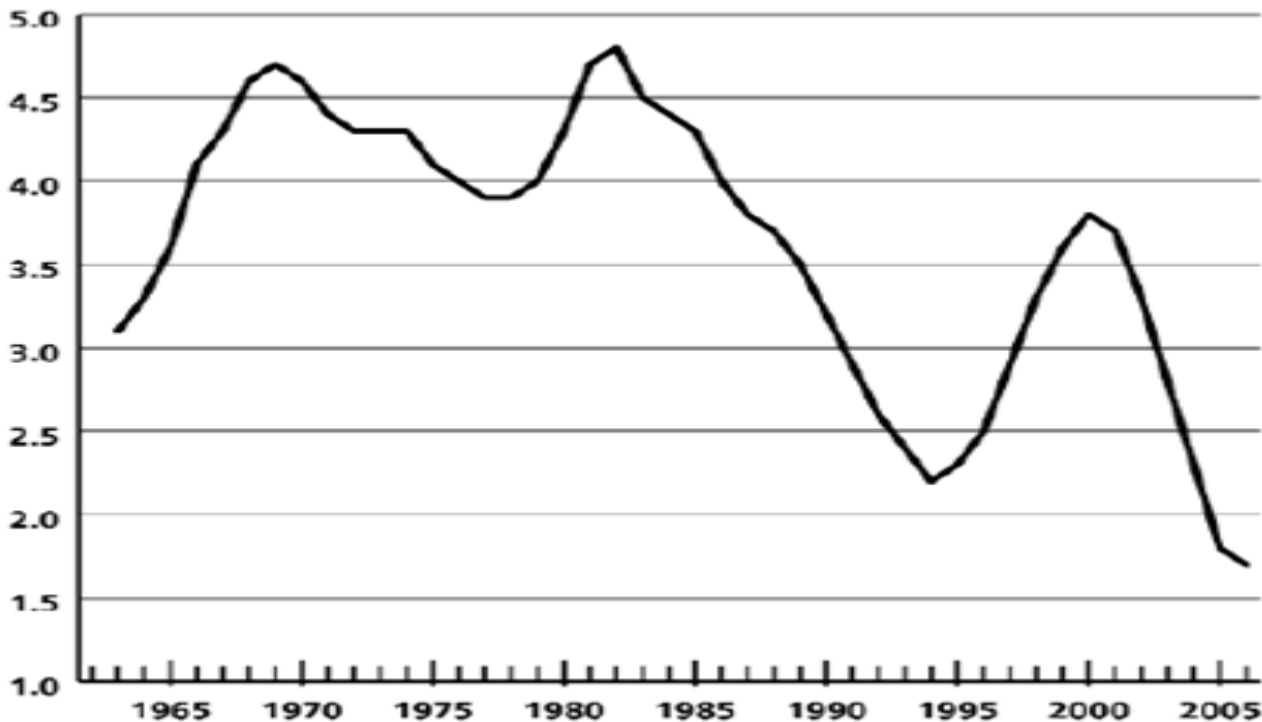
Mainstream economists have paid scant attention to the stagnation tendency in the mature economies. In received economic ideology rapid growth is considered to be an intrinsic property of capitalism as a system. Confronted with what looks like the onset of a major economic slowdown we are thus encouraged to see this as a mere cyclical phenomenon—painful, but self-correcting. Sooner rather than later a full recovery will occur and growth will return to its normal fast-pace.

There is, however, a radically different economic view, of which Magdoff and Sweezy were among the chief representatives, that suggests that the normal path of the mature capitalist economies, such as those of the United States, the major Western European countries, and Japan, is one of stagnation rather than rapid growth. In this perspective, today’s periodic crises, rather than merely constituting temporary interruptions in a process of accelerated advance, point to serious and growing long-term constraints on capital accumulation.

A capitalist economy in order to continue to grow must constantly find new sources of demand for the growing surplus that it generates. There comes a time, however, in the historical evolution of the economy when much of the investment-seeking surplus generated by the enormous and growing productivity of the system is unable to find sufficient new profitable investment outlets. The reasons for this are complex having to do with (1) the maturation of economies, in which the basic industrial structure no longer needs to be built up from scratch but simply reproduced (and thus can be normally funded out of depreciation allowances); (2) the absence for long periods of any new technology that generates epoch-making stimulation and transformation of the economy such as with the introduction of the automobile (even the widespread use of computers and the Internet has not had the stimulating effect on the economy of earlier transformative technologies); (3) growing inequality of income and wealth, which limits consumption demand at the bottom of the economy,

and tends to reduce investment as unused productive capacity builds up and as the wealthy speculate more with their funds instead of investing in the “real” economy—the goods and services producing sectors; and (4) a process of monopolization (oligopolization), leading to an attenuation of price competition—usually considered to be the main force accounting for the flexibility and dynamism of the system.²³

Chart 2. Net private non-residential fixed investment as a percent of GDP (5-year moving average)



Source: Bureau of Economic Analysis, National Income and Product Accounts, Table 5.2.5. Gross and Net Domestic Investment by Major Type, Annual Data 1929-2006; *Economic Report of the President, 2008*, Table B-1. Gross Domestic Product, 1959-2007.

Historically, stagnation made its presence felt most dramatically in the Great Depression of the 1930s. It was interrupted by the economic stimulus provided by the Second World War and by the exceptionally favorable conditions immediately after the war in the so-called “Golden Age.” But as the favorable conditions waned stagnation resurfaced in the 1970s. Manufacturing capacity utilization began its secular decline that has continued to the present, averaging only 79.8 percent in the 1972–2007 period (as compared to an average of 85 percent in 1960–69). Partly as a result net investment has faltered (see chart 2).²⁴

The classical role of net investment (after accounting for replacing depreciated equipment) in the theory of capitalist development is clear. At the firm level, it is only net investment that absorbs investment-seeking surplus corresponding to the undistributed (and untaxed) profits of firms—since the remainder of gross investment is replacement investment covered by capital consumption allowances. As economist Harold Vatter observed in an article entitled “The Atrophy of Net Investment” in 1983,

On the level of the representative individual enterprise, the withering away of net investment spells approaching termination of the historical and deeply rooted *raison d’être* of the non-financial firm:

accumulation of capital. In consequence, undistributed accounting profits, if not taxed away, would lack the traditional offsets [effective demand in the form of net investment], at least in a closed economy.²⁵

It was net investment in the private sector that was once the major driver of the capitalist economy, absorbing a growing economic surplus. It was relatively high net private non-residential fixed investment (together with military-oriented government spending) that helped to create and sustain the “Golden Age” of the 1960s. The faltering of such investment (as a percent of GDP) in the early 1970s (with brief exceptions in the late 1970s–early 1980s, and late 1990s), signaled that the economy was unable to absorb all of the investment-seeking surplus that it was generating, and thus marked the onset of deepening stagnation in the real economy of goods and services.

The whole problem has gotten worse over time. Nine out of the ten years with the lowest net non-residential fixed investment as a percent of GDP over the last half century (up through 2006) were in the 1990s and 2000s. Between 1986 and 2006, in only one year—2000, just before the stock market crash—did the percent of GDP represented by net private non-residential fixed investment reach the *average* for 1960–79 (4.2 percent). This failure to invest is clearly not due to a lack of investment-seeking surplus. One indicator of this is that corporations are now sitting on a mountain of cash—in excess of \$600 billion in corporate savings that have built up at the same time that investment has been declining due to a lack of profitable outlets.²⁶

What has mainly kept things from getting worse in the last few decades as a result of the decline of net investment and limits on civilian government spending has been soaring finance. This has provided a considerable outlet for economic surplus in what is called FIRE (finance, insurance, and real estate), employing many new people in this non-productive sector of the economy, while also indirectly stimulating demand through the impact of asset appreciation (the wealth effect).

Aside from finance, the main stimulus to the economy, in recent years, has been military spending. As empire critic Chalmers Johnson noted in the February 2008 *Le Monde Diplomatique*:

The Department of Defense’s planned expenditures for the fiscal year 2008 are larger than all other nations’ military budgets combined. The supplementary budget to pay for the current wars in Iraq and Afghanistan, not part of the official defense budget, is itself larger than the combined military budgets of Russia and China. Defense-related spending for fiscal 2008 will exceed \$1 trillion for the first time in history....Leaving out President Bush’s two on-going wars, defense spending has doubled since the mid-1990s. The defense budget for fiscal 2008 is the largest since the second world war.²⁷

But, even the stimulus offered by such gargantuan military spending is not enough today to lift U.S. capitalism out of stagnation. Hence, the economy has become more and more dependent on financialization as the key vehicle of growth.

Pointing in 1994 to this dramatically changed economic condition in a talk to Harvard economic graduate students, Sweezy stated:

In the old days finance was treated as a modest helper of production. It tended to take on a life of its own and generate speculative excesses in the late stages of business cycle expansions. As a rule these episodes were of brief duration and had no lasting effects on the structure and functioning of the economy. In contrast, what has happened in recent years is the growth of a relatively independent financial sector, not in a period of overheating but on the contrary in a period of high-level stagnation (high-level because of the support provided to the economy by the military)

oriented public sector) in which private industry is profitable but lacks incentives to expand, hence stagnation of private real investment. But since corporations and their shareholders are doing well and, as always, are eager to expand their capital, they pour money into the financial markets, which respond by expanding their capacity to handle these growing sums and offering attractive new kinds of financial instruments. Such a process began in the 1970s and really took off in the 1980s. By the end of the decade, the old structure of the economy, consisting of a production system served by a modest financial adjunct, had given way to a new structure in which a greatly expanded financial sector had achieved a high degree of independence and sat on top of the underlying production system. That, in essence, is what we have now.²⁸

From this perspective, capitalism in its monopoly-finance capital phase has become increasingly reliant on the ballooning of the credit-debt system in order to escape the worst aspects of stagnation. Moreover, nothing in the financialization process itself offers a way out of this vicious spiral. Today the bursting of two bubbles within seven years in the center of the capitalist system points to a crisis of financialization, behind which lurks deep stagnation, with no visible way out of the trap at present other than the blowing of further bubbles.

Is Financialization the Real Problem or Merely a Symptom?

The foregoing argument leads to the conclusion that stagnation generates financialization, which is the main means by which the system continues to limp along at present. But it needs to be noted that recent work by some radical economists in the United States has pointed to the diametrically opposite conclusion: that financialization generates stagnation. In this view it is financialization rather than stagnation that appears to be the real problem.

This can be seen in a November 2007 working paper of the Political Economy Research Institute written by Thomas Palley, entitled “Financialization: What It Is and Why It Matters.” Palley notes that “the era of financialization has been associated with generally tepid economic growth....In all countries except the U.K., average annual growth fell during the era of financialization that set in after 1979. Additionally, growth also appears to show a slowing trend so that growth in the 1980s was higher than in the 1990s, which in turn was higher than in the 2000s.” He goes on to observe that “the business cycle generated by financialization may be unstable and end in prolonged stagnation.” Nevertheless, the main thrust of Palley’s argument is that this “prolonged stagnation” is an outgrowth of financialization rather than the other way around. Thus he contends that such factors as the “wage stagnation and increased income inequality” are “significantly due to changes wrought by financial sector interests.” The “new business cycle” dominated by “the cult of debt finance” is said to lead to more volatility arising from financial bubbles. Thus “financialization may render the economy prone to debt-deflation and prolonged recession.” Palley calls this argument the “financialization thesis.”²⁹

There is no doubt that a prolonged deep stagnation could well emerge at the end of a financial bubble, i.e., with the waning of a period of rapid financialization. After all, this is what happened in Japan following the bursting of its real estate-stock market asset bubble in 1990.³⁰ The analysis that we have presented here, however, would suggest that an economic malaise of this kind is most usefully viewed as a *crisis of financialization* rather than attributable to the negative effects of financialization on the economy, as suggested by Palley. The problem is that the financialization process has stalled and with it the growth it generated.

The point we are making here can be clarified by looking at another (October 2007) working paper

(also from the Political Economy Research Institute) by economist Özgür Orhangazi on the subject of “Financialization and Capital Accumulation in the Non-Financial Corporate Sector.” Orhangazi argues that “increased financial investment and increased financial profit opportunities crowd out real investment by changing the incentives of the firm managers and directing funds away from real investment.” Noting that “the rate of capital accumulation [referring to net nonresidential fixed investment by non-financial corporations] has been relatively low in the era of financialization,” Orhangazi sees this as due to “increased investment in financial assets,” which “can have a ‘crowding out’ effect on real investment”: stagnation then is converted from a cause (as in the stagnation thesis) to an effect (the financialization thesis).³¹

Yet, the idea of the “crowding out” of investment by financial speculation makes little sense, in our view, when placed in the present context of an economy characterized by rising excess capacity and vanishing net investment opportunities. There are just so many profitable outlets for capital in the real economy of goods and services. A very narrow limit exists with regard to the number of profit-generating opportunities associated with the creation of new or expanded automobile or appliance manufacturers, hair salons, fast food outlets, and so on. Under these circumstances of a capital accumulation process that lacks profitable outlets and constantly stalls, the amassing of more and more debt (and the inflation of asset prices that this produces) is a powerful lever, as we have seen, in stimulating growth. Conversely any slowdown in the ballooning of debt threatens that growth. This is not to say that debt should be regarded as a cure-all. To the contrary, for the weak underlying economy of today no amount of debt stimulus is enough. It is in the nature of today’s monopoly-finance capital that it “tends to become addicted to debt: more and more is needed just to keep the engine going.”³²

Still, as important as financialization has become in the contemporary economy, this should not blind us to the fact that the real problem lies elsewhere: in the whole system of class exploitation rooted in production. In this sense financialization is merely a way of compensating for the underlying disease affecting capital accumulation itself. As Marx wrote in *Capital*, “The superficiality of political economy shows itself in the fact that it views the expansion and contraction of credit as the cause of the periodic alterations of the industrial cycle, while it is a mere symptom of them.” Despite the vast expansion of credit-debt in the capitalism of today, it remains true that the real barrier to capital is capital itself: manifested in the tendency toward overaccumulation of capital.

The well-meaning critique of financialization advanced by Palley, Orhangazi, and others on the left is aimed at the re-regulation of the financial system, and elimination of some of the worst aspects of neoliberalism that have emerged in the age of monopoly-finance capital. The clear intention is to create a new financial architecture that will stabilize the economy and protect wage labor. But if the foregoing argument is correct, such endeavors to re-regulate finance are likely to fail in their main objectives, since any serious attempt to reign in the financial system risks destabilizing the whole regime of accumulation, which constantly needs financialization to soar to ever higher levels.

The only things that could conceivably be done within the system to stabilize the economy, Sweezy stated at Harvard in 1994, would be greatly to expand civilian state spending in ways that genuinely benefited the population; and to carry out a truly radical redistribution of income and wealth of the kind “that Joseph Kennedy, the founder of the Kennedy dynasty” referred to “in the middle of the Great Depression, when things looked bleakest”—indicating “that he would gladly give up half his fortune if he could be sure the other half would be safe.” Neither of these radical proposals of

course is on the agenda at present, and the nature of capitalism is such that if a crisis ever led to their adoption, every attempt would be made by the vested interests to repeal such measures the moment the crisis had passed.³³

The hard truth of the matter is that the regime of monopoly-finance capital is designed to benefit a tiny group of oligopolists who dominate both production and finance. A relatively small number of individuals and corporations control huge pools of capital and find no other way to continue to make money on the required scale than through a heavy reliance on finance and speculation. This is a deep-seated contradiction intrinsic to the development of capitalism itself. If the goal is to advance the needs of humanity as a whole, the world will sooner or later have to embrace an alternative system. There is no other way. (March 5, 2008)

Notes

1. John Bellamy Foster, "Financialization of Capitalism," *Monthly Review* 58, no. 11 (April 2007): 8–10. See also John Bellamy Foster, "The Household Debt Bubble," *Monthly Review* 58, no. 1 (May 2006): 1–11, and "Monopoly-Finance Capital," *Monthly Review* 58, no. 7 (December 2006); and Fred Magdoff, "The Explosion of Debt and Speculation," *Monthly Review* 58, no. 6 (November 2006), 1–23.
2. "U.S. Recovery May Take Longer than Usual: Greenspan," *Reuters*, February 25, 2008.
3. Paul M. Sweezy, "More (or Less) on Globalization," *Monthly Review* 49, no. 4 (September 1997): 3.
4. Stephanie Pomboy, "The Great Bubble Transfer," *MacroMavens*, April 3, 2002, http://www.macromavens.com/reports/the_great_bubble_transfer.pdf; Foster, "The Household Debt Bubble," 8–10.
5. The following discussion of the five phases of the housing bubble relies primarily on the following sources: Juan Landa, "Deconstructing the Credit Bubble," *Matterhorn Capital Management Investor Update*, 3rd Quarter 2007, <http://www.matterhorncap.com/pdf/3q2007.pdf>, and "Subprime Collapse Part of Economic Cycle," *San Antonio Business Journal*, October 26, 2007, and Charles P. Kindleberger and Robert Aliber, *Manias, Panics, and Crashes* (Hoboken, New Jersey: John Wiley and Sons, 2005).
6. In the analysis of financial bubbles that Charles Kindleberger provided based on the earlier theory of financial instability introduced by Hyman Minsky, the phase in the bubble associated here with a "novel offering" is more frequently referred to as "displacement" a concept that is supposed to combine the ideas of economic shock and innovation. Since "novel offering" is, however, more descriptive of what actually happens in the formation of a bubble, it is often substituted for "displacement" in concrete treatments. See Kindleberger and Aliber, *Manias, Panics, and Crashes*, 47–50.
7. Floyd Norris, "Who's Going to Take the Financial Weight?," *New York Times*, October 26, 2007; "Default Fears Unnerve Markets," *Wall Street Journal*, January 18, 2008.
8. Federal Reserve Bank of New York, "Historical Changes of the Target Federal Funds and Discount Rates," <http://www.newyorkfed.org/markets/statistics/dlyrates/fedrate.html>.
9. Landa, "Deconstructing the Credit Bubble."
10. Hyman Minsky, *Can "It" Happen Again?* (New York: M.E. Sharpe, 1982), 28–29.
11. "Household Financial Condition: Q4 2005," Financial Markets Center, March 19, 2006, <http://www.fimcenter.org>; Foster, "The Household Debt Bubble," 8.
12. "Global Derivatives Market Expands to \$516 Trillion (Update)," *Bloomberg.com*, November 22, 2007.
13. "Bond Insurer Woes May Mean End of Loophole," *Reuters*, February 13, 2008.
14. "Global Recession Risk Grows as U.S. 'Damage' Spreads," *Bloomberg.com*, January 28, 2008. This report refers to the world recession level, as depicted by economists, as 3 percent or lower. But 2.5 percent is probably more accurate, i.e., more closely in line with recent world recessions and IMF views.
15. Stephen Roach, "America's Inflated Asset Prices Must Fall," *Financial Times*, January 8, 2008.
16. "Decline in Home Prices Accelerates," *Wall Street Journal*, February 27, 2008.
17. Eric Janszen, "The Next Bubble," *Harper's* (February 2008), 39–45.
18. Roach, "America's Inflated Asset Prices Must Fall," and "You Can Almost Hear it Pop," *New York Times*, December 16, 2007.
19. Fred Magdoff, "The Explosion of Debt and Speculation," 9.
20. The term "stagnation thesis" was originally associated primarily with Alvin Hansen's argument in response to the

Great Depression. See Hansen, “The Stagnation Thesis” in American Economic Association, *Readings in Fiscal Policy* (Homewood, Illinois: Richard D. Irwin, Inc., 1955), 540–57. It was later applied to Baran and Sweezy’s *Monopoly Capital*. See Harry Magdoff, “Monopoly Capital” (review), *Economic Development and Cultural Change* 16, no. 1 (October 1967): 148.

21. The concept of the “wealth effect” refers to the tendency for consumption to grow independently of income due to rising asset prices under financialization. The earliest known use of the term was in a January 27, 1975, article in *Business Week* entitled “How Sagging Stocks Depress the Economy.” Alan Greenspan employed the concept of the “wealth effect” in 1980 to refer to the effect of the increase in the price of homes in stimulating consumption by home owners—Greenspan, “The Great Malaise,” *Challenge* 23, no. 1 (March–April 1980): 38. He later used it to rationalize the New Economy stock market bubble of the 1990s.

22. Harry Magdoff and Paul M. Sweezy, “Production and Finance,” *Monthly Review* 35, no. 1 (May 1983): 11–12.

23. The basic argument here was articulated in numerous publications by Paul Baran, Paul Sweezy, and Harry Magdoff in the 1950s through 1990s.

24. Federal Reserve Statistical Release, G.17, “Industrial Production and Capacity Utilization,” February 15, 2008, <http://www.federalreserve.gov/releases/g17/Current/default.htm>;

John Bellamy Foster, “The Limits of U.S. Capitalism: Surplus Capacity and Capacity Surplus,” in Foster and Henryk Szlajfer, ed., *The Faltering Economy* (New York: Monthly Review Press, 1984), 207.

25. Harold G. Vatter, “The Atrophy of Net Investment,” in Vatter and John F. Walker, *The Inevitability of Government Spending* (New York: Columbia University Press, 1990), 7. Vatter notes that that net investment as a share of net national product (NNP) dropped by half between the last quarter of the nineteenth century and the mid-twentieth century, Vatter and Walker, *Inevitability of Government Spending*, 8.

26. “Companies are Piling Up Cash,” *New York Times*, March 4, 2008. This piling up of cash has been the product of the last decade, with the average level of cash as a percent of total assets of corporations in the Standard & Poor’s 500-stock index doubling between 1998 and 2004 (and the median ratio tripling).

27. Chalmers Johnson, “Why the US has Really Gone Broke,” *Le Monde Diplomatique* (English edition), February 2008. Johnson’s \$1 trillion figure for U.S. military spending is arrived at by adding the supplemental requests for the wars in Iraq and Afghanistan to the Department of Defense fiscal year 2008 budget (creating a grand total of \$766 billion), and then adding to this the hidden military spending in the budgets for the Department of Energy, the Department of Homeland Security, Veterans Affairs, etc.

28. Paul M. Sweezy, “Economic Reminiscences,” *Monthly Review* 47, no. 1 (May 1995), 8–9.

29. Thomas I. Palley, “Financialization: What It Is and Why It Matters,” *Working Paper Series*, no. 153, Political Economy Research Institute, November 2007, 1, 3, 8, 11, 21,

<http://www.peri.umass.edu/Publication.236+M505d3f0bd8c.0.html>

30. See Kindelberger and Aliber, *Manias, Panics, and Crashes*, 126–35.

31. Özgür Orhangazi, “Financialization and Capital Accumulation in the Non-Financial Corporate Sector,” *Working Paper Series*, no. 149, Political Economy Research Institute, October 2007, 3–7, 45,

[http://www.peri.umass.edu/Publication.236+](http://www.peri.umass.edu/Publication.236+M547c453b405.0.html)

[M547c453b405.0.html](http://www.peri.umass.edu/Publication.236+M547c453b405.0.html).

32. Harry Magdoff and Paul M. Sweezy, *The Irreversible Crisis* (New York: Monthly Review Press, 1988), 49.

33. Sweezy, “Economic Reminiscences,” 9–10.

An Age of Transition

The United States, China, Peak Oil, and the Demise of Neoliberalism

Minqi Li

Source : Monthly Review – USA

(<http://www.monthlyreview.org/080401li.php>)

UNTIL RECENTLY, the global capitalist economy has enjoyed a period of comparative tranquility and grown at a relatively rapid pace since the global economic crisis of 2001–02. During this period of global economic expansion there have been several important economic and political developments. First, the United States—the declining hegemonic power but still the leading driving force of the global capitalist economy—has been characterized by growing internal and external financial imbalances. The U.S. economy has experienced a period of debt-financed, consumption-led “expansion” with stagnant wages and employment, and has been running large and rising current account deficits (the current account deficit is a broad measure of the trade deficit). Second, China has become a major player in the global capitalist economy and has been playing an increasingly important role in sustaining global economic growth. Third, global capitalist accumulation is imposing growing pressure on the world’s natural resources and environment. There is increasingly convincing evidence that the global oil production will reach its peak and start to decline in a few years. Fourth, the U.S. imperialist adventure in the Middle East has suffered devastating setbacks and there has been growing resistance to neoliberalism and U.S. imperialism throughout the world.

As the U.S. housing bubble bursts and the dollar’s dominance over the global financial system becomes increasingly precarious, the U.S. economy is now going into recession and the global capitalist economy is entering into a new period of instability and stagnation. The coming years are likely to see a major realignment of the various global political and economic forces and will set the stage for a new upsurge of the global class struggle.

Neoliberalism and the Global Imbalances

Since the 1980s, neoliberalism has become the dominant economic ideology of global capitalism. Under the neoliberal policies and institutions (such as monetarism, privatization, deregulation, labor market “reform,” and trade and financial liberalization), inequalities in income and wealth distribution surged, and in many parts of the world, people suffered devastating declines in living standards. As financial capital flowed between countries in search of speculative gains, one national economy after another was destroyed. Under the pressure of financial capitalists and their institutional representatives (such as the International Monetary Fund, the World Bank, and the U.S. Treasury Department), many national governments were committed to so-called “responsible” fiscal and monetary policies, often leading to disastrous economic and social consequences.

By the 1990s, the contradictions of neoliberalism led to increasingly more violent financial crises. From 1995 to 2002, the global economy was struck successively by crises that developed in Mexico, countries in Southeast Asia, Russia, Argentina, and Turkey. The Japanese economy

struggled with deflation and stagnation following the burst of the asset bubble in 1990. There was a serious danger that the entire global capitalist economy could fall into a vicious circle of financial breakdowns and sink into depression. In this context, the U.S. current account deficits played an indispensable stabilizing role.

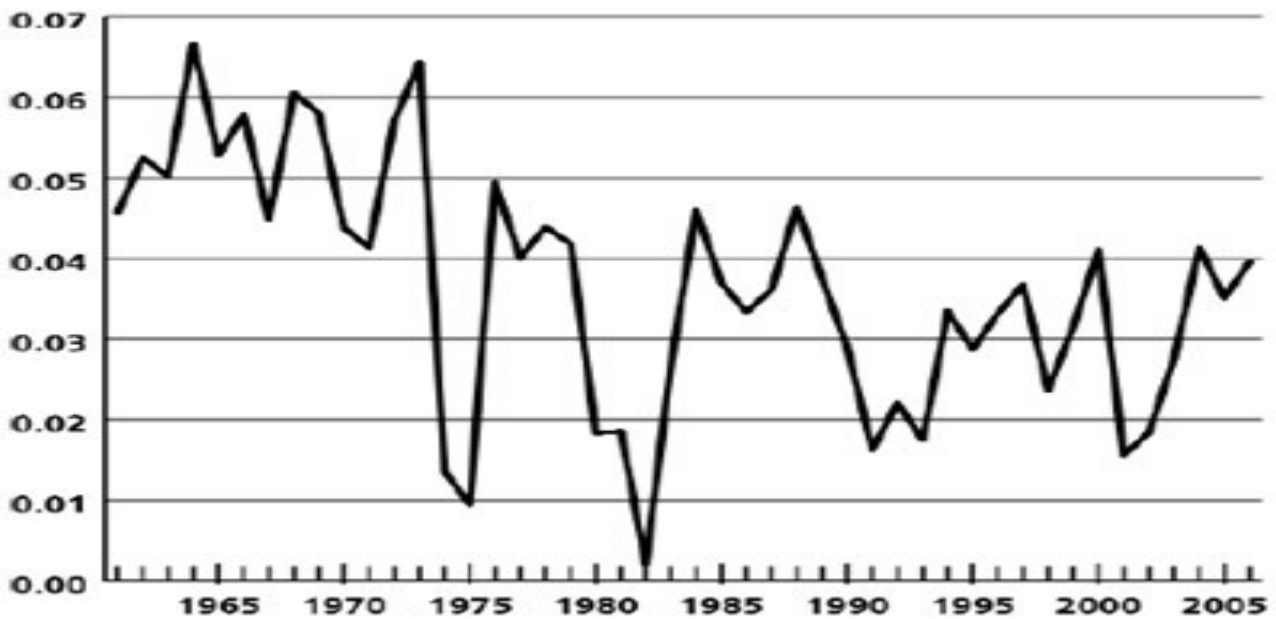
In the 1990s, the United States experienced the greatest stock market bubble in history. Despite stagnating real wages and family incomes, household consumption expanded rapidly as household debt surged. In the 2001 recession, fearing that the United States could fall into a persistent, Japanese-style stagnation, the Federal Reserve drastically cut the policy interest rate and kept the real policy interest rate at below zero for several years. As a result, the stock market remained highly overvalued by historical standards and the excessive supply of money and credit capital in turn fueled a major housing bubble.

Fueled by one asset bubble after another, the U.S. economy has been able to maintain a relatively rapid expansion of domestic demand. As the rest of the world suffers from insufficient internal demand, U.S. imports of goods and services have tended to grow more rapidly than exports. As a result, the United States has been running large and rising current account deficits, which reached more than 800 billion dollars or 6 percent of GDP by 2006.

The U.S. current account deficits directly generate effective demand for the rest of the world economy, allowing many economies, including the Asian economies and oil and commodities exporters, to pursue export-led economic growth. But perhaps more importantly, the U.S. current account deficits represent U.S. spending in excess of income that must be financed by borrowing from the rest of the world. The U.S. deficits thus create assets for the rest of the world.

The central banks of the Asian economies and oil exporters have become the major financiers of the U.S. current account deficits. From 1996 to 2006, the total foreign exchange reserves of the low- and middle-income countries surged from 527 billion dollars to 2.7 trillion dollars and their share in the world GDP more than tripled from 1.7 percent to 5.6 percent. Rising foreign exchange reserves have reduced the risk of massive capital flight and financial crisis, allowing these countries to have some space to pursue expansionary macroeconomic policies. China, in particular, has played a crucial role in financing the U.S. current account deficits and has accumulated the world's largest foreign exchange reserves currently standing at about 1.6 trillion dollars.

Chart 1. Annual world economic growth rate, 1961–2006, constant (2000) U.S. dollar



Source: World Bank, *World Development Indicators Online*, <http://devdata.worldbank.org/dataonline>.

Chart 1 presents the world economic growth rates from 1961 to 2006, with the world GDP measured in constant 2000 U.S. dollars. In the “golden age” of the 1960s, the global economy expanded rapidly with annual growth rates fluctuating between 4 and 7 percent. Since the 1970s, the global economy has been struggling with sluggish growth with growth rates mostly fluctuating between 2 and 4 percent. During four periods, 1974–75, 1980–82, 1991–93, and 2001–02, the global economy was in deep crisis (although there is no official definition, the global economy is generally considered to be in recession when world economic growth rate falls below 2.5 percent a year). Since 2003, the global economy has enjoyed some relative stability and has grown at about 4 percent a year. However, with the U.S. economy now going into recession, this short-lived relative stability is about to come to an end.

The U.S. Economic Expansion since 2001

Table 1 presents selected economic indicators of the U.S. economy. The U.S. economic recovery after the recession in 2001 was very weak. Since then, the average annual growth rate has been only 2.4 percent compared to 4 percent in the 1960s and 3.3 percent in the 1980s and 1990s. Both employment and workers’ real wages have been stagnant. Measured in 1982 dollars, the U.S. private sector workers’ average real hourly wage in 2006 was 8.2 dollars, about eighty cents lower than in 1972. Since 2000, real median family income has been falling.

However, corporate profits have surged. Corporate profits as a share of GDP rose from 5.8 percent in 2001 to 9.8 percent in 2006. The stock price to earnings ratios remain excessively high, suggesting that the stock market bubble has not yet been fully deflated. The stock market boom in the late 1990s led to pervasive over-investment. In the early 2000s, the industrial capacity utilization rates were at the lowest levels decade by decade in the post-Second World War period. With substantial excess production capacity, private investment has been sluggish despite the dramatic improvement in corporate profitability.

U.S. economic growth since 2001 has been led by the expansion of household consumption, which

now accounts for over 70 percent of GDP. As the majority of households suffer from falling or stagnant real incomes, the expansion of consumption has been financed by the explosive growth of household debt. U.S. household debt soared from about 90 percent of personal sector disposable income to 103 percent in 2000, and to 140 percent in 2006. By 2007, the household debt services (interest and principal payments on debt) had risen to 14 percent of disposable income, the highest on record. In the meantime, the household saving rate (the ratio of household saving relative to disposable income) has fallen from the historical average of near 10 percent to virtually zero now.

Table 1. Selected indicators of the U.S. economy, 1961–2007

	1961 -1970	1971 -1980	1981 -1990	1991 -2000	2001 -2007
Economic Growth (%)	4.2	3.2	3.3	3.3	2.4
Industrial Capacity Utilization (%)	85.1	82.7	79.8	82.2	77.9
Share of GDP (%):					
Personal Consumption	61.8	62.5	64.7	67.3	70.1
Private Investment	15.5	17.0	16.7	15.7	15.9
Government Spending	22.2	20.8	20.6	18.6	18.9
Net Exports	0.6	-0.3	-1.9	-1.5	-4.9
Employment Growth (%)	1.8	2.4	1.8	1.4	0.9
Real Wage Growth (%)	1.2	-0.6	-0.4	0.5	0.4
Real Median Family Income Growth (%)	n.a.	0.3	0.6	1.0	-0.5
Corporate Profits Share (%)	10.1	7.7	6.6	7.7	8.1
S&P Price-Earnings Ratio	17.6	11.4	12.8	23.0	26.2
Household Saving Rate (%)	8.5	9.7	8.7	4.7	1.4
Household Debt Income Ratio (%)	67.9	68.3	77.1	94.5	122.0
Household Debt Service Ratio (%)	n.a.	n.a.	11.4	11.7	13.8

Source: the U.S. Bureau of Economic Analysis, <http://www.bea.gov>; the *U.S. Economic Report of the President*, <http://www.gpoaccess.gov/eop/tables07.html>; the U.S. Federal Reserve Board, <http://www.federalreserve.gov/releases>.

The debt-financed consumption was clearly unsustainable. Neither household debt nor the debt service burden can rise indefinitely relative to household income. With the burst of the housing bubble, households will have to increase their saving rates and reduce their debt burden. If the household saving rate were to return to its historical average level, it would lead to a huge reduction of household spending. With the majority of U.S. households suffering from falling or stagnating real incomes, it is difficult to see how consumption can grow rapidly in the coming years. If consumption stagnates, then given the overwhelming weight of consumption in the U.S. economy, it is highly likely that it will fall into a deep recession followed by persistent stagnation.

Will the Federal Reserve be able to come to the rescue and create yet another massive asset bubble? Terrified by the turmoil of the global stock markets, the Federal Reserve has already cut interest rates drastically. However, with both the stock market and the housing market quite overvalued, one can hardly identify another major asset bubble to create. Moreover, with the household debt level so high and the household saving rate already so low, low interest rates can do very little to stimulate household consumption.

More realistically, with household consumption stagnating or contracting, the U.S. government could attempt to make up the shortfall with more public spending and an increase in the fiscal

deficit. If the household saving rate rises toward its historical average, then Washington will have to run a very large fiscal deficit, on the order of 6 percent of GDP or more. Given the current political environment in the United States, it is doubtful that an effective fiscal policy of a sufficiently large magnitude could be developed and implemented.

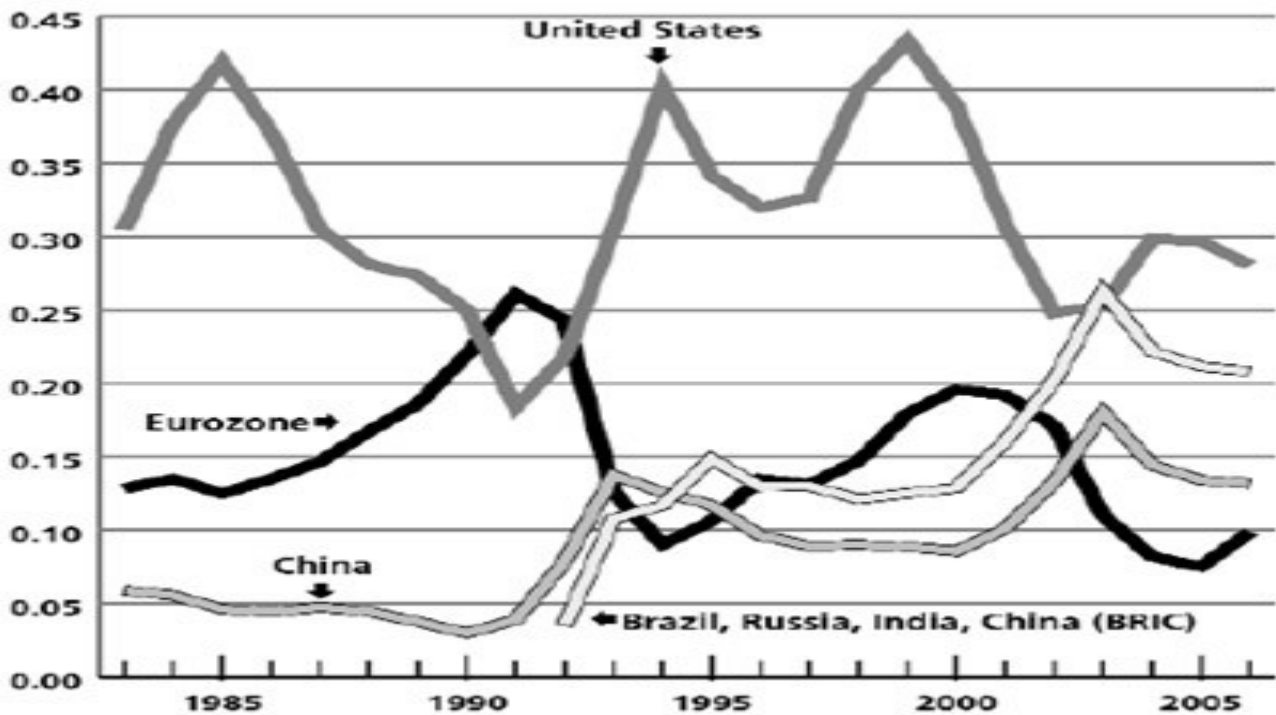
If the current, or more likely, the next administration has the nerve to use very aggressive expansionary policies to jump-start the economy, then the United States is likely to continue running very large current account deficits. With a current account deficit of 6 percent of GDP, theoretically, the U.S. net foreign debt could keep rising up to 120 percent of GDP.¹ This would clearly be impossible. Long before this theoretical limit is reached, it would become increasingly difficult for the United States to finance its current account deficits. The current relatively orderly decline of the dollar would then develop into a crash. The dollar would lose its status as the world's main reserve currency and the United States would experience its own shock therapy.

One way or the other, the United States will not be able to run large and rising current account deficits much longer. Given the crucial role of the U.S. current account deficits in stabilizing the global capitalist economy, if the U.S. economy falls into persistent stagnation and the U.S. current account deficit has to be corrected, the question arises: Which of the other large economies can replace the United States to lead the expansion of the global capitalist economy?

China and Global Capitalism

Chart 2 compares the contribution to world economic growth by the world's big economies (measured by the ratio of national economic growth to global economic growth). The U.S. contribution has fallen from about 40 percent in the late 1990s to approximately 30 percent today, and the Eurozone contribution has fallen from about 20 percent to about 10 percent. By comparison, China's contribution has risen to about 15 percent and the "BRIC" group (Brazil, Russia, India, and China combined) now generates more than 20 percent of the world's economic growth.

Chart 2. Contributions to world economic growth (as a percentage), 1981–2006, three-year averages



Sources: World Bank, *World Development Indicators Online*, <http://devdata.worldbank.org/dataonline>.

As the Eurozone lacks growth momentum and Brazil, Russia, and India remain relatively small to play decisive roles in the global economy, China seems to be the only plausible candidate to replace the United States to become the leading driving force of the global capitalist economy. Can China lead global capitalism into another period of stability and rapid growth?

After Deng Xiaoping's notorious "Southern Tour" in 1992, the Chinese Communist Party's leadership was officially committed to the goal of a "socialist market economy," which, in the Chinese context, is nothing but a euphemism for capitalism. In the 1990s, most of the state and collectively owned enterprises in China were privatized. Tens of millions of state and collective sector workers were laid off. The remaining state sector workers lost their traditional socialist rights symbolized by the "iron rice bowl" (a package of economic and social rights that included job security, medical care, child care, pensions, and subsidized housing) and were reduced to wage workers exploited by domestic and foreign capitalists. In the rural areas, with the dismantling of the people's communes, public medical care and education systems have collapsed. More than a hundred million have become migrant workers, forming the world's largest reserve army of cheap labor.

Table 2. Manufacturing workers' wage rates in selected countries, 2005

countries	monthly wage (U.S.\$)	as % of U.S. wage
United States	2,898.2	100.0
Japan	2,650.2	91.4
South Korea	2,331.4	80.4
Hungary	732.7	25.3
Czech Republic	612.0	21.1
Poland (2004)	585.9	20.2
Chile	432.4	14.9
Mexico (2004)	341.9	11.8
Brazil (2002)	308.7	10.7
Peru	237.8	8.2
China (2004)	141.3	4.9
Thailand (2003)	133.5	4.6
Philippines (2004)	98.8	3.4
India (2003)	23.2	0.8

Source: International Labour Office (Geneva), *Yearbook of Labour Statistics 2006*, 763–838, 933–1031. Wage rates are converted into U.S. dollars using exchange rates from World Bank, *World Development Indicators Online* (2007).

Table 2 compares the Chinese workers' wage rate with the workers' wage rates in selected countries. An average worker's wage rate in China is about one-twentieth of that in the United States, one-sixteenth of that in South Korea, one-quarter of that in Eastern Europe, and one-half of that in Mexico or Brazil. The Chinese wage rate now seems to be higher than those in the neighboring Southeast Asian countries. But the Chinese wage rate could be overstated as the official wage statistics only cover the workers in the urban formal sector and do not include the migrant workers.

A large, productive, and cheap labor force allows Chinese capitalists and foreign capitalists in China to profit from intense and massive exploitation. However, this raises the question how the massive amount of surplus value produced by the Chinese workers can be realized through "effective demand." With the majority of the Chinese workers and peasants heavily exploited, mass consumption at best has been growing at a slower pace than the overall economy. As mass consumption lags behind, the Chinese economy has increasingly depended on investment and exports to lead the expansion of demand. Table 3 presents selected indicators of the Chinese economy.

Table 3. Selected indicators of the Chinese economy, 1981–2005

	1981–85	1986–90	1991–95	1996–00	2001–06
Economic Growth (%)	10.7	7.9	12.3	8.6	9.7
Labor Income Share (%)	52.3	51.3	41.4	39.7	38.0
Share of GDP (%)					
Household Consumption	51.8	50.2	45.5	45.8	40.7
Government Consumption	14.6	13.6	14.6	14.5	14.9
Investment	33.9	36.5	39.0	36.6	40.6
Net Exports	-0.2	-0.4	0.9	3.1	3.7
Exports	11.4	16.2	22.9	21.2	30.9
Energy Consumption Growth (%)	4.9	5.2	5.9	1.1	9.9
Coal Consumption Growth (%)	6.0	5.3	5.4	-0.8	10.3
Oil Consumption Growth (%)	0.9	4.6	7.0	7.0	7.7

Source: China's National Bureau of Statistics, *China Statistical Yearbook 2007* and earlier years.

Labor income (the sum of the urban residents' wage incomes and the peasants' net incomes) as a share of China's GDP fell from 51–52 percent in the 1980s to 38 percent in the early 2000s. Similarly, household consumption as a share of GDP fell from 50–52 percent in the 1980s to 41 percent in the early 2000s. By contrast, the share of investment in GDP rose above 40 percent and the share of exports rose above 30 percent.

Net exports already made a significant contribution to China's economic growth in the late 1990s and early 2000s. Since then, China's trade surplus has experienced explosive growth. For 2007, China had an enormous current account surplus of \$378 billion, or 12 percent of China's GDP. In a few years, China is expected to overtake Germany to become the world's largest exporter.

How long can China's current model of growth be sustained? The United States accounts for about 20 percent of China's overall export market. In 2007, the European Union as a whole (including the Eurozone, the United Kingdom, and the new member states of Eastern Europe) actually replaced the United States to become China's single largest export market. However, for China to run large current account surpluses, some other economies have to run large current account deficits. The European overall current account balance has been in rough balance. From a global perspective, China's current account surpluses have been entirely absorbed by the U.S. current account deficits. If the United States no longer runs large current account deficits, then unless Europe starts to run large deficits, it will be very difficult for China to sustain its large trade surpluses.

China's excessively high level of investment results in massive demand for energy and raw materials. In 2006, China consumed one-third of the world's steel and one-quarter of the world's aluminum and copper. China's oil consumption was 7 percent of the world total, but since 2000, China has accounted for one-third of the world's total incremental demand for oil. China's massive demand has been a major factor behind the surging global costs of energy and raw materials. Between January 2003 and January 2008, the world energy price index rose by 170 percent and the world metals price index rose by 180 percent.²

If the current level of investment is sustained for some more years, it would leave China with a massive amount of excess production capacity that is far greater than what is needed to meet the final demand in the world market and far greater than what can be supported by the world supply of energy and raw materials. China would then be threatened with a major economic crisis. For the Chinese economy to be restructured on a more "sustainable" basis (from the point of view of sustaining capitalist accumulation), the Chinese economy has to be reoriented toward domestic

demand and consumption.

As China's investment and net exports have been rising more rapidly than the overall economy, the combined share of household and government consumption now stands at less than 50 percent of GDP. If investment were to return to more sustainable levels (about 30–35 percent of GDP) and the trade surplus were to become smaller (0–5 percent of GDP), then the combined share of household and government consumption would need to rise by more than 15 percentage points to 65 percent of GDP. But for consumption to rise, the workers' and peasants' incomes and government social spending have to rise accordingly. Table 3 shows the close correlation between labor income and household consumption. It follows that there must be a massive income redistribution from capitalist income to labor income and social spending by the amount of about 15 percent of GDP.

Will the Chinese capitalist class be enlightened enough to undertake such an economic and social restructuring? Suppose the Chinese Communist Party's leadership is sufficiently farsighted to understand that for the sake of the long-term interest of Chinese capitalism, it is necessary to make some concessions to the Chinese workers and peasants. Will the party have the necessary will and means to impose such a redistribution on the transnational corporations, on the wealthy Chinese capitalists (many of whom have intimate connections within the party and the government), and on the provincial and local governments that have in recent years developed various alliances with the domestic and foreign capitalists? These are some difficult questions for the Chinese capitalist elites.

Peak Oil and the Limits to Accumulation

Suppose the Chinese capitalist class has the necessary wisdom and will to pursue a Keynesian, social-democratic-style restructuring. Will such a restructuring take Chinese capitalism onto a path of sustained stable and rapid growth, and will the expansion of the Chinese economy in turn lead the global capitalist economy into another "golden age"?

Table 3 shows the growth of China's energy consumption. Since 2000, it has greatly accelerated. It now accounts for 15 percent of the world total and amounts to 70 percent of U.S. energy consumption. At the current growth rate, China's energy consumption will double in seven years and China will soon overtake the United States to become the world's largest energy consumer. China depends on coal for about 70 percent of its total energy consumption and China's coal consumption is also growing at a rate indicating a doubling in seven years. China's oil consumption (already accounting for one-third of the world's incremental demand for oil) is growing at a rate that implies a doubling in nine years. In other words, in about a decade if the current trend holds up, China will consume one and a half times as much energy as the United States consumes today. Will the world energy supply keep pace with China's rapidly growing demand while meeting the demand from the rest of the world?

The global capitalist economy depends on fossil fuels (oil, natural gas, and coal) for 80 percent of the world's energy supply. Oil accounts for one-third of the total energy supply and 90 percent of the energy used in the transportation sector. Oil is also an essential input for the production of fertilizers, plastics, modern medicine, and other chemicals.

Oil is a nonrenewable resource. In a recent study, the German Energy Watch Group points out that world oil discoveries peaked in the 1960s and world crude oil production has probably already peaked and will start to decline in the coming years. Outside OPEC, oil production in twenty-five major oil producing countries or regions has already peaked, and only nine countries or regions still have growth potential. All the major international oil companies are struggling to prevent their oil

production from declining.³

Colin Campbell of the Association for the Study of Peak Oil and Gas estimates that the world production of all liquids (including crude oil, tar sands, oil shales, natural gas liquids, gas-to-liquids, coal-to-liquids, and biofuels) is likely to peak around 2010. After the peak, the world oil production will fall by about 25 percent by 2020 and by about two-thirds by 2050. Campbell also estimates that the world natural gas production will peak by 2045. In an earlier study, the German Energy Watch Group expects the world coal production to peak by 2025.⁴

Nuclear energy and many renewable energy sources (such as solar and wind), in addition to their many other limitations, cannot be used to make liquid and gaseous fuels or serve as inputs in chemical industries. Biomass is the only renewable energy source that can be used as a substitute for fossil fuel in the making of liquid or gaseous fuels. But large-scale production of biomass could lead to many serious environmental problems, and the potential of biomass is limited by the available quantity of productive land and fresh water. Ted Trainer, an Australian eco-socialist, estimates that meeting the current U.S. demand for oil and gas would require that the equivalent of nine times all U.S. crop land or eight times all currently forested U.S. land be fully devoted to production of biomass. Trainer concludes that “there is no possibility that more than a quite small fraction of liquid fuel and gas demand could be met by biomass sources.”⁵

If world oil production and the production of other fossil fuels reach their peak and start to decline in the coming years, then the global capitalist economy will face an unprecedented crisis that it will find difficult to overcome.

The rapid depletion of fossil fuels is only one among many serious environmental problems the world is confronting today. The capitalist economic system is based on production for profit and capital accumulation. In a global capitalist economy, the competition between individual capitalists, corporations, and capitalist states forces each of them constantly to pursue accumulation of capital on increasingly larger scales.

Therefore, under capitalism, there is a tendency for material production and consumption to expand incessantly. After centuries of relentless accumulation, the world’s nonrenewable resources are being rapidly depleted and the earth’s ecological system is now on the verge of collapse. The survival of the human civilization is at stake.⁶

Some argue that because of technological progress, the advanced capitalist countries have become “dematerialized” (decreasing the throughput of materials and energy per unit of output) as economic growth relies more upon services than traditional industrial sectors, thus making economic growth less detrimental to the environment. In fact, many of the modern services sectors (such as transportation and telecommunication) are highly energy and resource intensive.

Despite such claims regarding dematerialization, the advanced capitalist countries are ecologically much more wasteful than the periphery, with per capita consumption of energy and resources and a per capita ecological footprint far higher than the world average. According to the *Living Planet Report*, North America has a per capita ecological footprint of 9.4 global hectares, more than four times the world average (2.2 global hectares). The supposedly environmentally friendly European Union has a per capita ecological footprint of 4.8 global hectares, or more than twice the world average. Cuba, the only country that remains committed to socialist goals among the historical socialist states, is the only country that has accomplished a high level of human development (with a human development index greater than 0.8) while having a per capita ecological footprint smaller

than the world average.⁷

Claims of the advanced capitalist economies to dematerialization in the wider, more meaningful sense of declining overall environmental impact are in fact refuted by the Jevons Paradox, which says that increased efficiency in the throughput of energy and materials normally leads to an increase in the scale of operations, thereby enlarging the overall ecological footprint. This has been a normal pattern throughout the history of capitalism.⁸

Moreover, part of what is referred to as dematerialization arises from the relocation of industrial capital from the advanced capitalist countries to the periphery in pursuit of cheap labor and low environmental standards. The dramatic rise of Chinese capitalism partly results from this global capital relocation. Although the advanced capitalist countries may have become slightly “dematerialized” in this sense, the capitalists and the so-called middle classes in China, India, Russia, and much of the periphery are emulating and reproducing the very wasteful capitalist “consumerist” life style on a massively enlarged scale. Global capitalism as a whole continues to move relentlessly toward global environmental catastrophe.

The Demise of Neoliberalism and the Age of Transition

On February 1, Immanuel Wallerstein, the leading world system theorist, in his biweekly commentaries pronounced the year 2008 to be the year of the “Demise of the Neoliberal Globalization.” Wallerstein begins by pointing out that throughout the history of the capitalist world-system, the ideas of free market capitalism with minimal government intervention and the ideas of state regulated capitalism with some social protection have been in fashion in alternating cycles.

In response to the worldwide profit stagnation in the 1970s, neoliberalism became politically dominant in the advanced capitalist countries, in the periphery, and eventually in the former socialist bloc. However, neoliberalism failed to deliver its promise of economic growth, and as the global inequalities surged, much of the world population suffered from declines in real incomes. After the mid-1990s, neoliberalism met with growing resistance throughout the world and many governments have been under pressure to restore some state regulation and social protection.

Confronted with economic crisis, the Bush administration has simultaneously pursued a further widening of inequality at home and unilateral imperialism abroad. These policies have by now failed decisively. As the United States can no longer finance its economy and imperialist adventure with increasingly larger foreign debt, the U.S. dollar, Wallerstein believes, faces the prospect of a free fall and will cease to be the world’s reserve currency.

Wallerstein concludes: “The political balance is swinging back....The real question is not whether this phase is over but whether the swing back will be able, as in the past, to restore a state of relative equilibrium in the world-system. Or has too much damage been done? And are we now in for more violent chaos in the world-economy and therefore in the world-system as a whole?”⁹

Following Wallerstein’s arguments, in the coming years we are likely to witness a major realignment of global political and economic forces. There will be an upsurge in the global class struggle over the direction of the global social transformation. If we are in one of the normal cycles of the capitalist world-system, then toward the end of the current period of instability and crisis, we probably will observe a return to the dominance of Keynesian or state capitalist policies and institutions throughout the world.

However, too much damage has been done. After centuries of global capitalist accumulation, the global environment is on the verge of collapse and there is no more ecological space for another major expansion of global capitalism. The choice is stark—either humanity will permit capitalism to destroy the environment and therefore the material basis of human civilization, or it will destroy capitalism first. The struggle for ecological sustainability must join forces with the struggles of the oppressed and exploited to rebuild the global economy on the basis of production for human needs in accordance with democratic and socialist principles.

In this sense, we have entered into a new age of transition. Toward the end of this transition, one way or the other we will be in a fundamentally different world and it is up to us to decide what kind of world it turns out to be.

Notes

1. The net foreign debt equals the cumulative sum of the current accounts deficits. If we assume that the U.S. current account deficit remains at 6 percent of GDP, the U.S. nominal GDP growth rate continues at 5 percent a year, and there is no change in the exchange rate, then theoretically the U.S. net foreign debt to GDP ratio will keep rising up to 120 percent.
2. Martin Wolf, “China Changes the Whole World,” *Financial Times*, January 23, 2008.
3. The Germany Energy Watch Group, “Crude Oil—The Supply Outlook,” EWG-Series no. 3 (October 2007), <http://www.energywatchgroup.org>.
4. The Association for the Study of Peak Oil and Gas, Newsletter No. 86 (February 2008); The Germany Energy Watch Group, “Coal: Resources and Future Production,” EWG-Series No. 1 (March 2007), <http://www.energywatchgroup.org>.
5. Ted Trainer, *Renewable Energy Cannot Sustain A Consumer Society* (Dordrecht, Netherlands: Springer, 2007), 73–92.
6. On the potential destructiveness of capitalist accumulation on the global environment, see John Bellamy Foster, “The Ecology of Destruction,” *Monthly Review* 58, no. 8 (February 2008): 1–14.
7. World Wildlife Fund, Zoological Society of London, and Global Footprint Network, *Living Planet Report* (2006), http://www.panda.org/downloads/living_planet_report.pdf.
8. John Bellamy Foster, *Ecology Against Capitalism* (New York: Monthly Review Press, 2002), 94–95.
9. Immanuel Wallerstein, “2008: The Demise of Neoliberal Globalization,” *Commentary* no. 226 (February 1, 2008), <http://www.binghamton.edu/fbc/226en.htm>.

The Subprime Crisis

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IN THE SUMMER OF 2007 many leading banks in the us and Europe were hit by a collapse in the value of mortgage-backed securities which they had themselves been responsible for packaging. [*] To the surprise of many, the poisonous securities turned out to constitute a major portion of their ultimate asset base. The defaults fostered a credit crunch as all financial institutions hoarded cash and required ever widening premiums before lending to one another. The Wall Street investment banks and brokerages haemorrhaged \$175 billion of capital in the period July 2007 to March 2008, and Bear Stearns, the fifth largest, was ‘rescued’ in March, at a fire-sale price, by JP Morgan Chase with the help of \$29 billion of guarantees from the Federal Reserve. Many of the rest only survived by selling huge chunks of preferred stock, with guaranteed premium rates of return, to a string of ‘sovereign funds’, owned by the governments of Abu Dhabi, Singapore, South Korea and China, among others.

By the end of January 2008, \$75 billion of new capital had been injected into the banks, but it was not enough. In the uk the sharply rising cost of liquidity destroyed the business model of a large mortgage house, leading to the first bank run in the uk for 150 years and obliging the British Chancellor first to extend nearly £60 billion in loans and guarantees to its depositors and then to take the concern, Northern Rock, into public ownership. In late January Société Générale, famous for its skill at financial engineering—indeed the winner that month of the coveted ‘Derivatives Bank of the Year Award’ from *Risk* magazine—reported that a 31-year-old rogue trader had lost the bank over \$7 billion. The SocGen management began unwinding the terrible positions taken by this trader on 21 January, contributing to a share rout on the exchanges and, it seems, to an emergency decision by the Federal Reserve the next day to drop its interest rate by 75 basis points.

The management of risk—especially systemic risk—in the financial world was evidently deeply flawed. An important part of the problem was that core financial institutions had used a shadowy secondary banking system to hide much of their exposure. Citigroup, Merrill Lynch, hsbc, Barclays Capital and Deutsche Bank had taken on a lot of debt and lent other people’s money against desperately poor collateral. Prior to the us deregulation and uk privatizations of the 1990s, us investment banks would have been barred by the Glass–Steagall Act of 1933 from dabbling in retail finance, and Northern Rock would have remained a solid, and very boring, building society.

The trigger for the credit crunch was rising defaults among us holders of subprime mortgages in the last quarter of 2006 and early 2007, as interest rates were inched up to protect the falling dollar. This led to the failure of several large mortgage brokers in February–March 2007, but the true scope of the problem only began to register in the late summer. Interestingly, the first bank to report a problem was Deutsche Bank, which was forced to bail out two property-based funds in July. In October the us Treasury encouraged three of Wall Street’s largest banks—Merrill Lynch, Morgan Stanley and Bank of America—to set up a \$70 billion fund to establish a clear value for threatened assets. This did not work. Analysts complained: ‘The path they have taken of skimming off the

cream from the top doesn't resolve the fact that there is poison at the bottom'. [1]

At the end of 2007, with the credit crisis still as bad as ever, the world's central banks tried to pump vast amounts of liquidity into the global financial system, but the impact was temporary, and the banks remained unwilling to lend to one another. Lawrence Summers, the former us Treasury Secretary, warned of a looming 'major credit crunch'—as if six months' paralysis had been a mere bagatelle; this danger stemmed from the 'impaired' asset base of major banks if more capital was not injected. [2] The subprime debacle and the drying up of credit, themselves the consequences of deteriorating conditions, were hastening the slide to recession in the us and global economy. On 10 February us Treasury Secretary Henry Paulson confirmed that credit problems were still 'serious and persisting', with more expected. [3] On 29 February two senior investment bankers—David Greenlaw (Morgan Stanley) and Jan Hatzius (Goldman Sachs)—and two economists—Anil K. Kashyap (Chicago) and Hyun Song Shin (Princeton)—published a study entitled 'Leveraged Losses' which cautiously estimated that losses from the subprime crisis were likely to total around \$400 billion and cause a drop in gdp of between 1 and 1.5 per cent. [4] You might think the title mainly referred to the plight of millions of mortgaged homeowners but, as we will see, the destructive logic of over-leveraged assets was also at work in scores of financial concerns.

The us President and Congress swiftly agreed a stimulus package of \$150 billion, and on 11 March the world's central banks clubbed together to offer the banks \$200 billion on easy conditions. But these supposed masters of the universe seemed caught in celestial machinery they did not control. On 16 March the us Federal Reserve intervened to avert the collapse of Bear Stearns and arrange for its purchase by JP Morgan Chase at a small fraction of its earlier price. The remaining investment banks were offered, for the first time, direct loans at low rates, against the flimsiest collateral and in confidence.

The credit crunch came as the climax of a long period of gravity-defying global imbalances and asset bubbles. Fear of recession had prompted the us Federal Reserve to keep interest rates low in 2001–06, and this in turn set the scene for cheap and easy loans. The world's financiers and business leaders looked to us householders, the 'consumers of last resort', to keep the global boom going. Robert Brenner gave an arresting account of the structural flaws and systemic turbulence in the global economy in nlr in 1998. In a substantial Afterword to *The Economics of Global Turbulence* in 2006, he stressed that a contrived 'consumption-led' boom in 2002–06 had failed to overcome weak profitability and investment. While labour productivity rose in these years, real employee compensation did not. The maintenance of the boom was made a little easier by cheap Chinese imports, but the vital ingredient in consumer buoyancy was a build-up of personal debt. Brenner characterized the demand-stimulating policies of the Fed and us Treasury as 'market Keynesianism'. [5] While Andrew Glyn and Giovanni Arrighi offered extra considerations, they too recognized that the bubble economics of 1995–2007 was not under control and that finance had escaped the reach of the regulators. [6]

According to the Federal Reserve's *Flow of Funds* data, total debt in the us economy rose from 255.3 per cent of gdp in 1997 to 352.6 per cent of gdp in 2007. Debt growth was strongest in the household and financial sectors. Household debt grew from 66.1 per cent of gdp to 99.9 per cent of gdp over the decade to 2007. But the most rapid growth was in the debt taken on by banks and other financial entities which grew from 63.8 per cent of gdp in 1997 to 113.8 per cent of gdp in 2007. [7] A succession of asset bubbles fuelled this growth in debt.

Notwithstanding his famous remark about 'irrational exuberance' in 1996, Alan Greenspan, the

Federal Reserve Chairman, took no stern measures to dampen the share bubble of the late 1990s. Robert Rubin and Lawrence Summers at the Treasury did even less, with Summers insisting that ballooning share prices should be viewed as an increase in us saving. [8] In the early 2000s Washington found compelling reasons to pursue a cheaper money policy—it wished both to devise a ‘soft landing’ from the share bubble and to demonstrate that the us powerhouse was unscathed by terrorism. It became a national security priority to inflate the purchasing power of us consumers. In the aftermath of 9/11 Americans had a patriotic duty to take on more debt in order to keep consumption rising, and banks and regulators to make this possible.

Banks were drawn to consumer debt because of a decline in their traditional role as custodians of savings and deposits, as this was increasingly assumed by pension funds and mutual funds, and also by a drop in the share of their earnings coming from traditional corporate finance. Between 1997 and 2007, the share of total financial sector assets accounted for by the assets of depository institutions plummeted from 56.3 per cent to just 23.7 per cent, while the share of pension funds and mutual funds rose from 21 per cent to 37.8 per cent. Freed by deregulation, the banks found new business by converting consumer debt into tradeable securities and then selling those securities to the funds (or other banks). In order to finance this operation the banks themselves took on more debt, blithely assuming that the return on the securities would be comfortably above their cost of borrowing, and that they would anyway soon sell on the securities to someone else, in what was known as the ‘originate and distribute’ model. It was difficult for anybody to know what was going on, or how justified these assumptions might be, because much of the action was registered only on the banks’ ‘invisible balance sheet’ in a ‘shadow banking system’. [9] Jane D’Arista argues that these trends also conspired to undermine traditional policy tools, since the latter, especially interest rate changes and great dollops of extra liquidity, work in and through their impact on banks as depository institutions. [10]

In what follows I interpret the credit crunch as a crisis of financialization—otherwise put, as a crisis of that venturesome ‘new world’ of leverage, deregulation and ‘financial innovation’ which Alan Greenspan celebrates in his recent memoir. I show how the pursuit of a market in almost everything led to a banker’s nightmare in which key assets could not be valued. I urge that attention be paid to the ideas of Fischer Black, the improbable inventor of structured finance, who warned against ‘loading up on risk’ when declining to become a founder member of Long Term Capital Management. I evoke both the New Deal response to financial failure and the rise of consumer finance in the postwar world, before considering, in conclusion, what can be done today.

I. Inside the shadow banking system

The very low us interest rates of 2001–06 were hugely lucrative to the banks, allowing them to take on more debt, improve the terms of their business and expand its volume. They sponsored hedge funds and private equity buyouts, packaged their own mortgage-related financial instruments, arranged bond insurance, and furnished lines of credit to their own structured investment vehicles (sivs) and ‘conduits’. These bets were usually leveraged by extra helpings of debt, with some institutions—the investment banks and hedge funds—borrowing to buy assets worth as much as thirty times their capital. This is how the protagonists of the 2007–08 crisis became heavily leveraged concerns—often, as we will see, indebted to one another. The banks’ embarrassment in changed conditions has at least one element in common with the plight of the heavily mortgaged house buyers. In both cases borrowers were squeezed by rising costs and weakened revenue to sell

the underlying assets in a falling market. First the home buyers faced higher interest rates in 2006–07, then the banks and their special conduits ran into an even sharper jump in their borrowing costs in August 2007. Sophisticated and lavishly paid financial professionals should at least have spotted the problem, but they seem to have been deceived by their own legerdemain.

As a *Financial Times* report put it at the close of 2007:

While investors are scrutinizing some of the industry's best-known names, a spectre will be silently haunting events: the state of the little known, so-called 'shadow' banking system. A plethora of opaque institutions and vehicles have sprung up in American and European markets this decade, and they have come to play an important role in providing credit across the system. [11]

This 'hidden' system had expanded rapidly in the 1990s and 2000s as a consequence of deregulation, which allowed many financial institutions to take on banking functions and loosened the rules that govern borrowing and lending. Following the collapse of Enron it was revealed that several leading banks had helped the company fool investors and regulators by devising a multitude of off-balance sheet special purpose entities. To the surprise of many, the subsequent legislation did not introduce an outright ban but allowed, under rule 46-R of the Sarbanes–Oxley Act, the holding of vehicles off-balance sheet so long as the bulk of the rewards and risks lie with others. [12] While other investors had some exposure, the banks, as owners of the sivs, have learnt the hard way that structured finance products can generate less controllable losses than simple assets, whose value can never dip below zero.

Fantasy valuations

Martin Wolf has compared the high bank profits of 2006 with long-run equity returns. While the latter run at about 7 per cent, the return earned by us, German, French and Italian banks in 2006 was around 12 per cent, and uk banks returned 20 per cent. [13] These high rates of return reflect leverage, 'thin' capitalization and risk-taking. The miracle of banking has always lain in the fact that bankers' liquid assets are much less than their outstanding loans. This stems from the credit-creating function of banks. The central banks, as lenders of last resort, are there to insure against bank runs, as the Bank of England reluctantly proved when, with help from the uk Treasury, it bailed out Northern Rock, and as the us Federal Reserve showed when it subsidized the sale of Bear Stearns.

The central banks supposedly control their risks by establishing strict asset qualifications and capital/loan ratios. Level 1 capital for uk banks was only 4 per cent of total outstanding liabilities at the close of 2007. The us banks claim to be better capitalized, with 8 to 9 per cent of Level 1 capital, though Citigroup had dropped to 7.3 per cent at that time—they are meant to stay above 8 per cent. These are not generous levels of capitalization but were still deceptive in that they hid problems created by the lending spree off-balance sheet—with leverage rendered invisible and liabilities rated as assets. This became apparent as the banks were forced to recognize the collapse of the secondary, 'hidden', banking system constituted by off-balance sheet sivs, conduits and bank-sponsored hedge funds. The 'slow motion' collapse reflected reporting periods and rules of disclosure. The sivs held scores of billions of dollars of credit derivatives, at model prices, reflecting great optimism or even sheer fantasy. Within specified time limits, however, the banks' accountants are obliged to 'mark to market', that is, set a market price on them. The best assets—'Level 1' assets—are those which can be valued simply by consulting a Bloomberg screen, where

their price at a given moment will appear. ‘Level 2’ asset values are based on a model which relates them to an index of similar traded assets. ‘Level 3’ asset values are based simply on models, with no directly traded element—a form of guesswork, or, in troubled conditions, a wish and a prayer.

By August 2007, mortgage-based securities were difficult to sell and those based on subprime mortgages could scarcely be given away. They had never qualified for Level 1, but now they did not make Level 2 either. On 8 November *The Economist* noted: ‘Among Wall Street firms, the soaring amounts of Level 3 securities now exceed their shareholder equity.’ [14] In the case of Citigroup, its collateralized debt obligations (cdos) alone were worth more than the equity value of the bank, forcing it, in subsequent weeks, not just to search for new investors, but to offer the latter preferred shares or ‘convertibles’ that greatly diluted the holdings of their existing shareholders—a convertible is a bond in so far as it has a prior claim on the company’s revenues but converts to a share above a given strike price. [15] By April 2008 the imf was estimating that total losses were likely to come to \$945 billion: ‘Global banks are likely to shoulder roughly half of aggregate potential losses, totalling from \$440 billion to \$510 billion, with insurance companies, pension funds, money-market funds, hedge funds and other institutional investors accounting for the balance.’ [16] However these funds, especially insurance and pension funds, also have large shareholding stakes in the banks, so will suffer heavy indirect losses. Indeed, most of their losses are ‘collateral damage’ since their direct holdings of subprime cdos were minimal.

Low interest rates tempted many homeowners to go deeper into hock by re-mortgaging. As Robert Brenner showed, the asset bubbles—first technology shares and then houses—helped to maintain the mirage of a buoyant economy and consumption growth, but only at the cost of growing personal and corporate indebtedness. [17] Non-financial corporations—especially the auto companies—had long offered consumer credit since this was the only way to maintain sales volume; now homeowners were encouraged to treat their houses like ATMs. By 2003, some 18 per cent of the disposable income of us consumers was required to service debt; yet neither the Federal Reserve nor the Securities and Exchange Commission (sec) moved to crack down on the securitized mortgage bonanza. Those who felt wealthy could build a McMansion while the majority, with their flat earnings, still aspired to the comfortable lifestyle portrayed in tv and magazine ads. Low teaser rates led millions of the poor to believe they could own a home. By 2007, weak housing and consumer debt were both hovering around the \$1 trillion mark. For some time finance houses had teamed up with retailers to shower so-called gold and platinum cards on all and sundry, with the hope of ratcheting up consumer debt and subsequently charging an annual 18 or 20 per cent on money for which the banks themselves were paying 3 or 4 per cent. These high rates of return whetted the banks’ appetite for dubious lending.

By February 2008, after more than a year of wilting prices, the number of us homeowners with negative equity rose to 8.8 million or one-tenth of the total. [18] Because houses seem such good collateral, the total home mortgage debt was around \$11 trillion, of which a little over a tenth was either ‘subprime’ or almost equally doubtful ‘Alt A’. Credit-card debt rose to just short of \$1,000 billion, with automobile debt a little lower at around \$700 billion. In these cases the asset backing the loan is really the earnings capacity of the borrower, not the refrigerator or the car.

Contagion?

How bad could it get? Very bad, some believe. Nouriel Roubini of the Stern School of Business (nyu) has come up with a total of possible losses for the us economy that runs to several trillion

dollars. Martin Wolf describes it as a recipe for ‘the mother of all meltdowns’: the bursting of the housing bubble could wipe out between \$4 trillion and \$6 trillion in household wealth; subprime mortgage losses he puts at \$250–300 billion; then there will be consumer credit defaults, the downgrading of bond insurers, a meltdown in the commercial property market, the bankruptcy of a large bank, the collapse of several leveraged buy-outs, a wave of corporate defaults (‘a “fat tail” of companies has low profitability and heavy debt’), the crumbling of the ‘shadow financial system’, a collapse of stock prices, a cascade of hedge-fund failures, and a severe credit crunch. After all this one scarcely needs to add ‘a vicious circle of losses . . . contraction . . . and fire sales’. [19]

Wolf insists that this is a possible scenario—indeed, the ‘bankruptcy of a large bank’ prediction came true within less than a month—and that global linkage will be quite strong: Wall Street sneezes, a debilitated us economy catches a nasty virus, and the world comes down with flu. Of course some of these disasters may be milder than feared, and the authorities would try to prevent each element in the catastrophe; but according to Roubini the regulators do not have the right instruments to avert much of the damage. Indeed some of the problems of today stem from past attempts to put off the inevitable recognition of losses. If losses are not recognized and subordinated shareholdings expropriated, then it will remain unclear where new capital injections need to be made and stagnation may ensue, as it did in Japan in the 1990s. [20]

Chain of irresponsibility

How on earth could such risks build up? The source of the problems which surfaced in 2007—though some had warned about them years earlier—did not lie only in the us deficits or the Fed’s easy money policy. It also lay in an institutional complex and a string of disastrous incentives and agency problems riddling an over-extended system of financial intermediation. To start with, take the incentives relating to those notorious ‘subprime’ cdos. New subprime mortgages rose from \$160 billion in 2001 to \$600 billion in 2006—by which time they constituted one-fifth of mortgage originations. The salesmen responsible for this surge received a generous commission for each new loan, paid upfront but expressed as a proportion of the redemption payments to be made over several years. Brokers happily signed up ‘ninjas’—no income, no job and no assets—by the hundred thousand. This behaviour was directly encouraged by their incentive structure, while legislation dating back to the 1960s had relaxed credit standards for the low paid and jobless without reckoning with the likely consequences. The Bush administration’s vision of the ‘ownership society’ somehow latched onto codicils of Johnson’s ‘Great Society’ to encourage the poor to take on housing debt at the pinnacle of a property bubble. The quality of the arrangements made for poorer mortgagees was manifestly inadequate—they had no insurance provision—and also avoided the real problem, which is the true extent of poverty in the United States and the folly of imagining that it can be banished by waving the magic wand of debt creation. [21] Indeed the subprime borrowers were lured into inherently bad deals by those low ‘teaser rates’ that bore no relation to the large payments required of them down the line.

The bad mortgage bets were to be hugely compounded by the investment banks that purchased the mortgage debt for resale, supposedly according to the ‘originate and distribute’ model—take on debt, repackage it, and sell it on. As a report in the *Wall Street Journal* explained:

Upfront commissions and fees are well established on Wall Street. Investment banks get paid when billion-dollar mergers are signed. Firms that create complex new securities are paid a percentage off the top. Rating services assess the risk of a new bond in return

for fees off the front end. [\[22\]](#)

Just to complete the picture, one should add that such fees are not only garnered by those in investment banks who construct and sell asset-backed securities. On the day his employer announced a write-down of over \$8 billion, a managing director at an investment bank explained that the bank's own senior risk-assessment officer had received a bonus of \$21 million in the previous year for his part in the great cdo bonanza. What was more, this executive still did not report directly to the board.

Returns on risk

The subprime mortgage meltdown perfectly illustrates the perils of financialization and what I have called 'grey capital'—great clouds of institutionalized savings, including private pension money, entrusted to financial industry insiders. I have previously explained how the growth machine of the 1990s and 2003–06 widened inequalities and was based on unsustainable mountains of debt. [\[23\]](#) At a certain point the burden of debt repayment would extinguish the prospects of more credit. Lulled by success, the banks faced a 'Minsky moment', in which the new risks and instabilities of a financialized capitalism would storm through the markets. [\[24\]](#)

The banks themselves borrowed to buy up subprime lenders, some even with convictions for 'predatory lending', because this gave them access to just what they craved—rubbishy assets. They had supposedly discovered how to limit their own exposure, while raking in the charges, by repackaging poor debts as cdos and selling them on to their clients. Risky debt was potentially far more profitable than good debt because the latter is expensive to acquire and can never be worth more than par, while the value of the former was heavily discounted, and optimism about repayment prospects and the ingenuity of 'structured finance' led to high resale prices. [\[25\]](#)

With direct access to subprime mortgages, the banks and hedge funds had enlarged scope for bundling them together as cdos, in ways that supposedly spread and insured the risk. Thousands of mortgages would be consolidated into one instrument and the resulting pool of debt subdivided into ten tranches, each representing a claim on the income accruing to the underlying mortgages; the lowest tranche represented the first to default, the second the next poorest-paying assets and so on up to the senior levels which were least likely to default. The bottom tranche of the cdo, designated the 'equity', was both vulnerable and valuable, and the mezzanine portion also attracted a good return. The senior ones—the top 70–75 per cent—were more difficult to sell because the reward and (it was thought) risk were quite low. The different tranches' vulnerability to default was hedged by taking out insurance, at rates varying according to the perceived level of default risk. Note that a feature of the securitizing and tranching process is that the holders of a tranche would not know which specific mortgages they held until the default rate within a specified period became clear. Depending on the precise wording of the bundled security, the different classes of holder could also find themselves, if there was a default spike, bundled together in awkward and unexpected ways.

The generally buoyant conditions of 2003–06, with low default rates and low interest rates, meant that cdo insurance was cheap. The purchaser was assured by those assembling the cdo that it came with a secure hedge and that the whole package had a 'triple A' grade from the ratings agencies. The complexity of the cdo with its accompanying insurance made the entire credit-derivative product difficult to value. Unsold portions could be 'sold' at model prices to sivs or conduits, set up with the bank's own credit. These prices reflected trust in the banks and the ratings agencies that had

produced and evaluated the products. At the height of the cdo boom the ratings agencies were deriving half their income from such fees. [26] The sivs were off-balance sheet, so that the bank's stake in them was an asset, while the liabilities stowed away did not show up. Institutional investors could be persuaded to buy the sivs' supposedly high-quality, short-term commercial paper, allowing the vehicles to acquire longer-term, lower-quality assets, and generating a profit on the spread between the two. The latter included large amounts of mortgages, credit-card debt, student loans and other receivables. Like cdos, the sivs are tranching with the bank holding the equity. For about five years those dealing in sivs and conduits did very well by exploiting the spread between the return from the commercial paper they sold to investors and that from the sivs' asset base of securitized receivables, but this disappeared in August 2007, and the banks were left holding a very distressed baby. [27]

Market ignorance?

While the party lasted the big banks could not get enough mortgages to feed their cdo assembly lines. The banks' frenzy to acquire subprime mortgages became so intense that they encouraged brokers to skimp on the credit checks required by standard 'due diligence'. In return for immunity from prosecution, Clayton Holdings, a company that 'vetted home loans for many investment banks', is reported to have delivered documents to Andrew Cuomo, New York's attorney general, showing that its clients—the banks—had allowed it to wave through many 'exceptions' to the normal lending conditions and then conceal the high number involved. The report itemizes serial irresponsibility. [28]

The complexity of the cdos and cdss—credit default swaps, the financial instruments which insure bond holders—generates new risks: documentation risk, operational risk, ratings risk, counter-party risk, liquidity risk and linkage risk among them. At the height of the cdo/cds surge thousands of mortgage bonds were being packaged and rated every week. Sometimes the back-office paperwork lagged, skipped stages or was out of sequence, leading to unexpected complications. On 15 November 2007 it was reported that an Ohio judge had dismissed fourteen foreclosures brought on behalf of investors in pooled mortgages, on the grounds that they had failed to prove their ownership of the properties they were trying to seize. [29]

Traditional subprime lenders had tended to cover particular localities about which they built up detailed information. They also had teams who would assess potential borrowers according to quite complex criteria, and collection agents who would retain contact with the mortgage holder. But the large mortgage brokers and investment banks had a different *modus operandi*. In the days of J. P. Morgan, the banks rated 'trust' even more highly than collateral. But then they were dealing with a relatively restricted number of wealthy individuals and businesses. The ballooning of individual debt offered a vast market but with little scope for personal knowledge and judgment. Fair Isaac and other personal credit-rating agencies believed that the creditworthiness of any customer could be distilled into a single three-digit number, reflecting the statistical probability of default. [30] Borrowers and brokers learnt how to manipulate the scores. As the growth of negative equity raised defaults, this algorithm became quite unreliable. In normal times those who hold a mortgage on their house will be greatly concerned to maintain payments, but for the almost 9 million or more with negative equity, the attraction of simply walking away is great. As soon as they believe that the property is worth less than their debt, they have an inducement to put the keys in the post, surrendering the asset and escaping the debt. [31]

The mortgage issuers should have ignored the Fair Isaac scores and taken due note of market risk. After all, default rates correlate more strongly with the trade cycle than anything else. But this factor was ignored, as were the signs from deteriorating credit tests. In a market that had been rising for years there was still money to be made by assuming it would last a little while longer—long enough to ‘distribute’. And many believed that business cycles were becoming so mild, and counter-cyclical action by the monetary authorities so strong and effective, that consumer defaults were dwindling.

The investment banks were playing a fast-moving game of ‘pass the parcel’. According to breathless ‘flat world’ accounts of globalization, loans could be bought one day, packaged overnight in India, and sold on to institutional investors the next day. The sooner the sale, the better the risk profile. But by 2006 the supply of cdos exceeded demand. Many public-sector and ‘defined benefit’ pension funds declined to buy the cdos, because they suspected them or were not sure how they worked. But those with mutual funds and ‘401(k)’ retirement plans were often less well served by their fund managers. There was also demand from other financial institutions—especially hedge funds—who liked the fact that the cdos came with impressive credit ratings and could indirectly be used to bolster their asset base. Several of the major banks themselves developed a taste for the decorative qualities of their fool’s gold. Even if they knew defaults must be in prospect, they believed they could hedge against them or invest only in well-protected tranches. Furthermore, the money-management arms of the banks had some scope for palming off the well-rated derivatives on the less wary of their institutional clients. Thus in January 2008 the secretary of the municipality of Springfield, ma, complained that Merrill Lynch, manager of the authority’s fund, had sold it cdos for a total price of \$13.9 million on the understanding that they were safe assets. By November 2007 they were only worth \$1.2 million. Fearful of the consequences for its reputation, Merrill Lynch repurchased the assets at the sale price. [\[32\]](#)

Tremors

A protracted sequence of reporting periods attached to the various financial services and products delayed the impact of the subprime crisis. The earthquake did not bring down everything at once. The default rate jumped in the second half of 2006. By February 2007 it became clear that defaults were running at a level that was likely to take down Countrywide, one of the largest mortgage brokers in the us; in a move prompted by the Fed, Bank of America offered to rescue Countrywide and guarantee its business, but the deal dragged on for months. In early March 2007 the New York Stock Exchange suspended New Century Financial, a company which had taken on insurance obligations for submerged tranches of mortgage debt for most of the big banks.

The cdo tranches in the sivs and conduits were now dubbed ‘toxic waste’ by insiders. In the context of a credit crunch and mortgage-default rise this colourful phrase had a very exact meaning. The cdo tranches turned from being steady earners into a source of loss as their return fell below the interest that had been promised to investors in the conduits’ commercial paper. As beneficial owners of the sivs and conduits, the banks had to find a way of meeting their obligations to the holders of the commercial paper which had been issued in their name. Sale of the securitized mortgages and other receivables was imperative, but no one wanted to buy them. ‘Leveraged assets’ become a curse when the asset value turns negative.

In the epoch of financialization households have been encouraged to comport themselves as businesses—for example taking out a second mortgage because their home has risen in value. But

many householders remain cautious as they realize that they want to go on living in their home. Financial intermediaries, to a far greater extent than households, actively adjust their balance sheets in response to changes in asset prices. Exception made of their flashy headquarters, the banks get no use-value from the assets on their balance sheet and are obliged to chase a monetary return. Greenlaw, Hatzius and their co-authors contrast the pattern of response from households and financial concerns:

financial intermediaries react in a very different way to the fluctuations in net worth as compared to households or non-financial firms . . . households tend not to adjust their balance sheets drastically to changes in asset prices. In general, leverage falls when total assets rise . . . However, the picture for financial intermediaries is very different. There is a positive relationship between changes in leverage and changes in balance-sheet size. Far from being passive, financial intermediaries adjust their balance sheets actively. [33]

This behaviour by financial intermediaries, the authors believe, made a critical contribution to the mortgage bubble: ‘With regard to the subprime mortgage market in the United States . . . when balance sheets are expanding fast enough, even borrowers who do not have the means to repay are granted credit—so intense is the urge to employ surplus capital. The seeds of the subsequent downturn in the credit cycle are thus sown.’ But once contraction sets in, balance-sheet pressure runs powerfully in the opposite direction and the banks are obliged to hoard cash. The super-leveraged conduits and sivs aggravated the pattern, as they had been set up with access to automatic lines of credit from the parent institution. Greenlaw and co explain:

As credit lines were tapped, the balance-sheet constraint at the banks must have begun to bind, making them reluctant to lend . . . The fact that bank balance sheets did not contract is indicative of this involuntary expansion of credit. One of the consequences . . . was that banks sought other ways to curtail lending. Their natural response was to cut off, or curtail, lending that was discretionary. The seizing up of the interbank credit market can be seen as the conjunction of the desired contraction of the balance sheets and the ‘involuntary’ lending due to the tapping of credit lines by distressed entities. [34]

Balance-sheet pressures were ramped up as accounting deadlines kicked in. The banks’ auditors wanted their clients to accept large write-downs on these assets. But to do so was to make deep inroads on their capital base, and, for the weaker, this raised the spectre of collapse. While grappling with conduit-related balance-sheet pressure they also had to keep a weather eye out for other threats, notably those arising from flaky insurance.

Bond insurance

A string of bankruptcies among the heavily leveraged would test the market for credit default swaps (cdss). Municipal bond insurers, known as ‘monolines’, enjoyed ‘triple A’ rating because of this conservative specialization. Pension funds and other institutions were heavily invested in the monolines, with holdings amounting to \$800 billion at the close of 2007. However, some years back the monolines diversified and took on insurance for corporate as well as municipal bonds, still claiming that their ‘bond only’ insurance remit was of limited risk. [35] The meagre capitalization

of the large bond insurers weakened their credibility, notwithstanding their past ratings. The search for more exciting returns had drawn them into branches of corporate and financial insurance that overstretched their capital base. An institutional investor complained that Ambac, a monoline with equity capital of less than \$5 billion, insured the debt of California, the world's sixth largest economy. [36] If the monolines lost their coveted triple A ratings, this would sharply raise their cost of capital. They escaped downgrades by means of discreet capital injections arranged by several of their clients, including the banks. Shareholders suffered dilution but the prospect of collapse was staved off. It is possible that the Federal Reserve helped to promote this outcome, as it undoubtedly did with the buy-out of Bear Stearns. The saving of Bear Stearns and Countrywide by means of takeovers was a win both for their bondholders and for those concerns that had insured their bonds. [37] Indeed, when a company teeters towards bankruptcy, bondholders and shareholders can have quite different interests; a 'rescue' at fire-sale prices can punish shareholders but leave bondholders relatively unscathed.

We have seen that the securitization boom helped to make up for a stagnation or decline in the banks' fees from corporate lending and underwriting—*ipos*, rights issues etc.—in 2001 and after. Indeed, the banks, helped by their role in packaging and selling all manner of 'credit derivatives' including mortgage-backed *cdos*, achieved remarkably good profits right up to the actual outbreak of the credit crisis. This was true of both the historic investment banks and the commercial banks, albeit that, in the aftermath of deregulation, this distinction was breaking down. A residual contrast was that the investment banks are 'prime brokers' and engage in large amounts of proprietary trading, risking their own money but in ways that are often difficult to fathom. Where commercial banking operations loom large in a financial group, as they do at JP Morgan Chase, the balance sheet tends to be stronger—hence its ability to absorb Bear Stearns. However, credit derivatives had appeal to both types of financial concern, helping to blur the distinctions between them.

Cassandras and others

Warren Buffett warned in 2002 that derivatives were 'financial weapons of mass destruction'. In a letter to the shareholders of Berkshire Hathaway, he conceded that Berkshire's main business, re-insurance, was itself conceptually close to the use of derivatives, the latter being calibrated bets on a pattern of future events not unlike those made by an insurer. He pointed out that there are widely shared risks in the derivatives world and that 'there is no central bank assigned to the job of preventing the dominoes from toppling in insurance or derivatives'. He also observed:

Many people argue that derivatives reduce systemic problems, in that participants who can't bear certain risks are able to transfer them to stronger hands . . . on a micro level, what they say is often true. Indeed at Berkshire, I sometimes engage in large-scale derivatives transactions in order to facilitate certain investment strategies. Charlie [Munger] and I believe, however, that the macro picture is dangerous and getting more so. Large amounts of risk, particularly credit risk, have become concentrated in the hands of relatively few derivatives dealers, who in addition trade extensively with one another. The troubles of one could quickly infect the others. On top of that, these dealers are owed huge amounts by non-dealer counterparties. Some of these counterparties . . . are linked in ways that could cause them contemporaneously to run into a problem because of a single event . . . Linkage, when it suddenly surfaces, can trigger serious systemic problems. [38]

Buffett complained that the way banks account for their holdings of derivatives was completely impenetrable and made a mockery of the disclosure requirements placed on them. The derivatives revolution, on this reading, was the most decisive step towards deregulation. Buffett was also clear that the banks were riddled with principal–agent problems:

I can assure you that the marking errors [i.e. the errors made in ‘marking to market’] in the derivatives business have not been symmetrical. Almost invariably, they have favoured either the trader who was eyeing a multi-million dollar bonus or the ceo who wanted to report impressive ‘earnings’ (or both).

Alan Greenspan, whose job it was to monitor such problems, preferred to remain a cheer-leader for the financial services industry. Addressing the Futures Industry Association in March 1999, he insisted that any new regulations on derivative products ‘would be a major mistake’: ‘Regulatory risk-measurement schemes’, he added, ‘are simpler and much less accurate than banks’ [own] risk-measurement models.’ [39] His view chimed well with the repeal of Glass–Steagall that year and the passage of the Futures Modernization Act, sponsored by Congressmen Gramm, Leach and Bliley and signed into law by President Clinton in 2000. When Greenspan came to write his memoirs he explained: ‘I was aware that the loosening of mortgage credit terms for subprime borrowers increased financial risk . . . But I believed then, as now, that the benefits of broadened home ownership are worth the risk.’ [40] By the time this was published the mirage of ‘broader home ownership’ was beginning to melt away, menacing his ‘brave new world’ of rising productivity and low unemployment and inflation.

Some of Greenspan’s colleagues, however, were alarmed by his cavalier approach to swelling debt. Ned Gramlich, a Federal Reserve governor, queried the chairman’s approach in 2000 and later drew up a detailed indictment asking why super-sophisticated mortgage products were being foisted on the poor. [41] Others in touch with the Federal Reserve system were also concerned. In 2004 the Fed published a paper by Michael Gibson outlining how vulnerable cdos were to the business climate; they could come unstuck very quickly if a recessionary breeze unsettled the interlinked flow of payments. [42] The us regulators seemed to ignore the broad issues of linkage and correlation risk. No doubt they were loath publicly to draw attention to the risks courted by the banks, their sivs and their insurers, or the linkage between them. Investors large and small had no viable way of tackling linkage or default correlation risk—insurance costing 400 basis points would wipe out any profit in holding these assets. As we have seen, many public-sector pension funds did shun the cdos and cdss, which is one reason why the investment banks were caught with so much inventory on their hands. The managers of these funds are inclined to be cautious and to pay attention to the warnings of informed commentators.

Two men were well placed to anticipate these problems, yet failed to do so: Robert Rubin and Henry Paulson. Rubin was a respected director at Citi and could have ensured a much smaller exposure to the risky instruments. He was at the forefront of the financial revolution in the 1980s, when he recruited the ace risk-evaluators to Goldman Sachs, where he then worked. Henry Paulson as Goldman chief ensured that the bank would emerge almost unscathed from the subprime debacle. Yet at the Treasury he took no public or effective steps to avert the catastrophe. Were there aspects of the problem that simply eluded these super-intelligent and deeply informed financiers? Or were they blinded by faith in the market, or in the ability of the financial community to regulate itself?

II. The fog of financialization

The subprime debacle and its sequels train a spotlight on financialization. When properly embedded in structures of social control, finance can help to allocate capital, facilitate investment and smooth demand. But if it is unaccountable and unregulated it becomes sovereign in the re-allocation process, and can grab the lion's share of the gains it makes possible, including anticipated gains before they have been realized. The problem is aggravated as financial intermediaries proliferate and take advantage of asymmetries in access to information and power imbalances. Such distortions multiply as 'financialization' takes hold. It is boosted as the logic of finance becomes ubiquitous, feeding on a commodification of every aspect of life and the life-course—student loans, baby bonds, mortgages, home equity release, credit-card debt, health insurance, individualized pension funds. [43] Financialization also encourages corporations to privilege financial functions and to see themselves as chance collections of assets which, as circumstances change, must be continually broken up and reconfigured. While the individual is encouraged to think of him or herself as a two-legged cost and profit centre, the corporation is simply an accidental assemblage to be continually shuffled in response to fleeting market signals.

Resort to 'leverage' in the financialized world supposedly enables individuals and corporations to get rid of 'unrewarded risk' and maximize outcomes. While the word 'debt' has a negative ring to it, the word 'leverage' is positive; indeed it is now often used as a verb, as we leverage our assets in order to reach for the stars. Forgetting that Archimedes' lever had a purchase point, the financial engineers aspire to move the world without securing the land on which they stand. In their philosophy, all that is fixed melts into air. This gives them some insight into capitalist motion but no sense of its limits. In contemporary capitalist conditions, especially a grey capitalism riddled with defective links between principals and agents, financialization becomes hugely destructive.

Two processes that took hold in the 1950s and 1960s nourished financialization—new principles of consumer credit, and the rise of institutional finance and fund management. In the postwar period, American retailers and manufacturers constructed a new world of revolving credit and 'option accounts', eventually culminating in the credit card. [44] Fostering consumer credit soon became critical to the success of a wide range of businesses. The Commercial Credit Corporation (ccc) offered its services to retailers who lacked sufficient expertise—or capital—to set up their own lending operation. General Electric offered finance to purchasers of its wide range of consumer durables, laying the basis for the emergence of the mighty GE Capital, responsible for 42 per cent of group profits in 2000. General Motors expanded the General Motors Acceptance Corporation (gmac) as of the late 1960s, a finance arm which accounted for nearly all group profits by the close of the century. Louis Hyman concludes: 'Rather than forced down on consumers and retailers by banks, credit practices trickled *up* to financial institutions as retailers responded to the limits on their capital.' [45] Diners Club, American Express and Visa picked up and developed such already established lending practices.

The powerful trend towards financialization was also evident in the rise of institutional investment—pension funds, insurance, mutual funds and college endowments. Indeed it was often they who supplied the capital needed to finance the new credit arrangements, with different financial intermediaries taking generous fees as both fund managers and lenders. In the 19th and early 20th centuries, cooperatives, housing associations and insurance companies organized on a genuinely 'mutual' basis—i.e. owned by their members, not private shareholders—managed to bring down the costs of intermediation by cutting out the commercial middlemen. But the consumer revolution of

the 1950s and 1960s was driven by large-scale commercial retailers and their banks. In later decades many genuine mutuals were marginalized or broken up, with members receiving a modest pay-off in the event of privatization.

Theoretical models

The financial surge was accompanied by a revolution in finance theory that was pioneered as much by those advising institutional investors as by economics departments, since most of the latter took no interest in the world of everyday finance. The global turmoil and computing advances of the mid-1970s gave great scope to a new theory of financial economics and a practice of financial engineering. Its principles and methods were incubated by economists and financial professionals, who were both intrigued by the novel credit conditions and ideologically hostile to the well-ordered world of the postwar boom, with its government regulation, managerialism, hierarchy of leading corporations and increasingly influential fund managers. Fischer Black (1938–95), who straddled the world of finance and academia, was the most theoretically fertile and ambitious member of the emerging school. On the one hand Black was co-inventor of one of the financial world's most intensively used instruments—the Black–Scholes options-pricing formula—and on the other he sought to arrive at a new equilibrium model.

In the mid-1960s Fischer Black was asked by the Investment Company Institute (ici), a fund managers' consortium, to prepare evidence which it could submit to forthcoming Congressional hearings, showing that fund managers were doing a good job for their clients—pension funds, college endowments and investors in mutual funds. In conjunction with two academics also working on the problem, Michael Jensen at Chicago and William Sharpe at Seattle, Black commenced a collaboration that was to redefine the 'capital asset pricing model', underlie the Black–Scholes options-pricing mechanism, and earn his other collaborators, Myron Scholes and Robert C. Merton, the Nobel Prize for Economics in 1997. [46] However, to the disappointment of his commercial sponsors, Black and his associates, after analysing decades of share price movements, found no evidence that fund managers added anything to the value of their assets. (The ici omitted this embarrassing conclusion from the published report.) [47]

The 'financial engineers' pinpointed the contribution to share performance made by a particular management by separating it from share price movements which simply reflected overall shifts in the stock market or industrial sector. On average, they found, half of share-price movement is not company- or sector-specific but reflects overall market trends; sector trends accounted for 10 per cent of price changes. The logic of this approach led to a host of share indices, such that investors could bet on their movements to screen out risk and secure reward. This was the origin of risk arbitrage, or the exploitation of asset mis-pricing in the wake of such market events as a hostile take-over bid. [48] Black urged that the prudent investor should be thoroughly diversified and intolerant of 'unrewarded risk'. These watchwords of financialized investment have unexpected dimensions. For Black, diversification should extend through time as well as within the universe of assets currently available. The same nominal asset in three days, or three years, was not, in fact, the same asset because, as the Greek philosopher pointed out long ago, you cannot step in the same river twice.

But Black's stress on longitudinal diversification also supported 'dynamic hedging', in which the portfolio is continually reassessed and recomposed. Aversion to unrewarded risk can prompt either a reasonable attempt to remove this—e.g. currency, inflation or interest-rate risk, which can be done

by hedging—or a continuous search for risks that carry a reward. This idea often informs the ‘leverage with everything’ approach. Leveraging the assets in a portfolio allows greater diversification; while remaining invested in one set of assets, the investor can mortgage them and establish a claim over another set, perhaps by buying an option or taking out a short position. Such procedures may also minimize tax.

Black’s respect for ‘strong economic forces’ working themselves out through an inescapable overall equilibrium made him a critic of both monetarists and Keynesians. Monetary policy was always impotent in the face of changes in what people want. Black favoured ‘uncontrolled banking’—including the waiving of all deposit ratios. In ‘Banking and Interest Rates in a World Without Money’ he invoked the advantages of a passive banking system—quoting James Tobin to the effect that in such a world, ‘the real economy would call the tune for the financial sector, with no feedback in the other direction.’ [49]

Black expressed various views concerning the ‘efficient market hypothesis’, according to which market prices reflect all available information at a given point in time. He did, however, formulate a version he could accept in the following terms:

We might define an efficient market as one in which price is within a factor of 2 of value, i.e. the price is more than half of value and less than twice value . . . By this definition, I think almost all markets are efficient almost all of the time. ‘Almost all’ means at least 90 per cent. [50]

Many would regard such wide parameters as a very loose concept of efficiency. But Black liked approximations—the Black–Scholes model itself does not aim at great exactness. For Black the market price oscillated around the efficient price, just as Marxist economists hold that market price oscillates around value. Indeed the idea that price and value reflect ‘socially necessary labour time’ itself implies a remarkable approximation to efficiency. [51]

Black remains a contradictory and enigmatic figure. He took further than anyone else a model of equilibrium that treats human beings as bearers of ‘human capital’ who must maximize their returns. Perry Mehrling explains how he experimented with diet, sex and drugs in pursuit of this idea. He was the prophet of leverage because he believed that only the indebted had the single-minded focus on performance that equilibrium demanded (disconcertingly, this concept functions rather like accumulation in a Marxist account). In the pursuit of diversification he alternated spells in academia with work on Wall Street. But when approached by the Chicago Board with the idea of basing the derivatives market on his option-pricing formula he declined to become involved and observed: ‘Options are an exciting way to gamble, and the Chicago Board Options Exchange wants to act as the gambling house, and take its cut. There’s nothing wrong with that; but if we are to permit this form of gambling, it seems logical to tax it as heavily as the government taxes betting on horse races.’ [52]

Risks and uncertainties

The quantitative finance pioneered by Black always wanted to know the worst-case scenario—how much would be lost in the case of a protracted collapse of the market? The banks that were knocked for six by the credit crunch all used elaborate measures for their Value at Risk (VaR). These have proved to be beset by flaws—they do not cope with the unexpected, and prompt replication or

reinforcement of untoward events. Years of low volatility led to reduced VaR scores. Feeding bad news into these systems prompted sell signals that aggravated the dangers which the measure had initially highlighted. [53] The 1987 crash had revealed a similar problem with computerized programme trades.

The afflicted patient is often not the best judge. Regulators with access to a better-constructed VaR could act more rationally than those gripped by a tidal cash ebb. It would not be difficult to bring the visible balance sheet closer to the real balance sheet by requiring published, board-approved levels of VaR and proper disclosure of all liabilities pertaining to associated enterprises. sec filings show that the VaR implied by trading activity at the major investment banks doubled between May 2006 and November 2007. [54] In recent years, as we have seen, Wall Street banks have felt obliged to take greater risks with their own resources because of a contraction in their revenues from corporate finance—itself a reflection of low investment in the us economy. They not only sponsor hedge funds but increasingly come to resemble them as they use their position as prime brokers to leverage up their bets and pursue arbitrage.

The Austrian free-market critique of socialism had insisted on the irrationality of ‘administered prices’, as administrators could never know the host of local possibilities that might unsettle any given set of comparative prices. The practitioners of quantitative finance believed that the Black–Scholes–Merton options valuation model had established a new path to valuation, enabling financial products to be assigned valid prices. The prestige of this device set a precedent for pricing ‘over the counter’—direct, institution to institution—sales of derivative products. As MacKenzie explains:

Many of the instruments traded in this market are highly specialized, and sometimes no liquid market, or easily observable market price, exists for them. However, both the vendors of them (most usually investment banks) and at least the more sophisticated purchasers of them can often calculate theoretical prices, and thus have a benchmark ‘fair’ price. [55]

The theoretical model persuaded the purchasers of cdos that they had paid the right price, notwithstanding the absence of a market, just as it seemingly reassured the banks that they had no skin in the game.

In ‘grey’ capitalist conditions, the concepts and techniques of the financial engineers begin to undermine and corrupt the market mechanism. Part of the problem is that these techniques are often used to game less well-informed players, escape tax or promote a constant reshuffling of assets. As the current crisis shows, they can even deceive the deceivers. To some extent the fault lies in the abuse of financial techniques, rather than in the techniques themselves. The finance houses’ short-term horizon, their lack of commitment to working collectives, and their susceptibility to insider abuse, are all typical of actually existing capitalism. More broadly, today’s institutional investment —‘grey capitalism’—has tolerated or spawned financial malpractice often dressed up in the latest jargon of the ‘quants’ and engineers.

Derivatives and deception

A well-regulated stock exchange is a phenomenal source of information for all market participants. It generates second-by-second data concerning the volume and price of trades, and its settlement system registers the identity of buyers and sellers. The analytic feats of the financial economists

were themselves based on such data. Yet the advent of structured finance generated a gigantic volume of direct trades between institutions whose details were only known to the participants. These ‘over-the-counter’ transactions exceeded stock-exchange transactions by the turn of the millennium, and led the exchanges to skimp on procedure in order to remain competitive. Here we have both the cause of the credit crunch and the ultimate irony of the Western crusade to marketize the globe. A great wave of securitization aimed to turn even the most unpromising cash prospect, or intimate personal ambition, into a tradeable. It succeeded in submerging the world’s main capital markets in a deluge of non-performing and unpriced securities. The fog of grey capital descended on the financial districts, shrouding the great banks and clouding the view of investors and regulators alike.

In order to grasp today’s capitalism we need financial analysis, but the phenomenon of financialization sucks oxygen from the atmosphere. It privatizes information that should be public, just as it commercializes everyday life and promotes a pattern of ‘uncreative destruction’ in which enterprises and work teams are continually broken up and re-assembled to take advantage of transient arbitrage gains. In addition to helping financial institutions game their own customers, the techniques of financialization allow big capital—large corporations and wealthy individuals—to escape tax and skim the holdings of small shareholders. Note that most pension funds and charitable endowments, but not us mutual funds, are limited by fiduciary rules from much exposure to hedge funds or exotic derivatives. A further corollary of proliferating financialization is that the regulations governing credit creation were first loosened and then almost entirely ignored. Reckless credit expansion has long been the primrose path to financial crisis and collapse. [56]

The post-1972 take-off of financialization coincided with advances in computing capacity and the discovery of new mathematical techniques for valuing options and constructing derivatives. To begin with, these techniques were used mainly to reduce uncertainty and hedge currency risk. But before long it became clear that derivative swaps could be used to bamboozle tax authorities and shareholders. Financial engineering could convert one type of income stream into another, or an asset into income or the other way round—reducing or avoiding tax. Derivatives could also be used to refine the techniques of fund management and strategies for merger and acquisition. The more responsible pension funds avoid hyper-trading programmes and stick with long-term investment strategies. But they do use derivatives to hedge their positions. While several financial products serve no useful purpose, we should not expect a generalized rejection of all options and derivatives. Instead it will be necessary to distinguish, as the IRS already tries to do, between derivative contracts that really do seek to hedge risks and those whose only rationale is to cheat the tax authority and confuse the unwitting shareholder. There are already calls for proper regulation and registration of these instruments and of the ‘shadow banking system’ as a whole. More and better regulation is indeed needed, but will regulation be enough? It is worth recalling that financialization was born in a quite heavily regulated world, with some of its techniques designed to frustrate and defeat the regulators, just as others aimed at releasing ‘value’.

Lessons of the 1930s

The 1920s share bubble, and the bank runs of 1929 and after, prompted a wave of regulation, including the passage of Glass–Steagall in 1933—repealed by Clinton in 1999. For a long period, roughly 1929 to 1972, the scope for financialization was limited, first because of the sharp financial contraction of the Great Depression and then because of the extensive coordination of the Bretton

Woods system and postwar economy more generally. [\[57\]](#)

The centrality of banks, and the role of property bonds in the current crisis, bear an eerie resemblance to the onset of the Great Crash. Joseph Schumpeter stressed how the tumbling of property prices in Florida precipitated the collapse of a speculative bubble centred on property bonds. For Schumpeter the stock-market falls were secondary to the impact on the banks, which in turn reflected the bursting of a credit bubble. He pointed out that the 1929 crash exhibited the classic features of the onset of a ‘Juglar cycle’. Named for the economic historian Clément Juglar, this cycle began with a devastating financial crisis and credit famine, which then took its dreadful toll on industry and agriculture. Schumpeter was already aware of the particular role of housing investment in economic turbulence: ‘Nothing is so likely to produce cumulative depressive processes as such commitments made by a vast number of households to an overhead financed to a considerable extent by commercial banks.’ [\[58\]](#)

This time around, speculative financial instruments based on property mortgages have also collapsed—with Florida again an epicentre. Despite many unknowns it is reasonable to suppose that usgdp will stagnate rather than suffer anything like the crushing decline of the 1930s. Nevertheless, the loss in potential output could be large: Greenlaw and his colleagues estimate a conservative 1–1.5 per cent of gdp, as we have seen. So far both politicians and regulators have sought to tackle the crisis by prompting the banks to come up with their own solutions, rather than by devising new instruments of regulation. The Brown government havered for six months before taking Northern Rock into public ownership. In the United States neither the Fed nor the Treasury have shown a clear determination to expose losses and recapitalize the affected institutions. Even Herbert Hoover established the Reconstruction Finance Corporation, a public agency designed to resuscitate threatened assets, which eventually made a huge contribution to reviving the us economy.

The New Deal response to the crisis also comprised, in addition to Glass–Steagall, the setting up of the Home-Owners Loan Corporation (holc) in 1933, the introduction of the Securities and Exchange Commission in 1934, the passage of the Social Security Act in 1935, and the establishment of a Federal National Mortgage Association, now more familiarly known as Fannie Mae, in 1938. While the holc was supposed to head off mounting foreclosures, Fannie Mae was designed to secure and subsidize prime residential mortgages. The holc bought mortgages in default from the banks and offered the borrowers lower repayment terms. Within two years the holc had received 1.9 million applications from distressed homeowners and successfully re-negotiated one million mortgages. It closed in 1951 after the last 1936 mortgage was paid off. [\[59\]](#)

While the holc was dealing with subprime borrowers, Fannie Mae made it easier and cheaper for prime borrowers to get a mortgage, using its Federal guarantee and tax-free status to organize a secondary mortgage market that underwrote any residential mortgage up to a certain value. The guarantee and tax exemption enabled Fannie Mae to borrow at cheap rates which were passed on to the individual borrowers. This partial decommodification of the residential mortgage market subsequently proved a great success. In 1968 Fannie Mae was semi-privatized and allowed to raise capital from investors, but kept its Federal guarantee and remained exempt from taxation. These subsidies enabled it to finance the process whereby, over the subsequent forty years, over 50 million householders acquired ownership of their homes. However the semi-privatization can now be seen as a huge mistake, since it allowed the two government-sponsored enterprises to take on inordinate amounts of debt in a bid to promote securitization and boost earnings. [\[60\]](#) The more general problem here—also seen in the privatization of so many British building societies—is the hostility

to even partially decommodified social forms and an infatuation with the corporate model.

III. Meltdown

By August 2007 the malaise caused by the collapse of mortgage-backed instruments had spread to the whole cdo section, and it was this that created the ‘credit crunch’. The penny now dropped that these amazingly complex financial instruments constituted an important part of the assets of a whole string of financial institutions. Hedge funds had also fancied them, being neither squeamish about their quality, nor quizzical about structured finance. They knew there was no active market in derivatives, but believed in their model value and in the insurance they carried. In some cases, including those worst hit, the hedge funds were themselves spin-offs from an investment bank, which would extend them credit to make margin calls.

Part of the problem with cdos is that the salaries paid to bank employees and financial lawyers match a wholesale operation dealing with thousands of mortgages, but not retail inspection of each lowly mortgage. [\[61\]](#) Shortage of deliverable items and practical restrictions on settling cds contracts, meanwhile, has in some cases led to so-called protocols and cash payments worth less than the hedged amount. In another paper for the Federal Reserve, dated October 2007, Michael Gibson first stressed the benefits of credit derivatives of all types, and then itemized the multiple risks stemming from their complex or intricate sequencing and coordination. [\[62\]](#)

The collapse of cdo valuations, and the doubts about cds coverage, reflected mutual distrust among those holding the securities rather than simple incomprehension. The credit crunch was a product of the banks’ justified doubts concerning one another, as well as the quality of the underlying assets. The banks knew how to assess the problems of the cdos, because they had helped package them. Their in-house Finance PhDs had enough information to know—whatever the complexity—just how dubious these assets were, despite their aaa grades. They were aware that fear of contamination would take its toll on securities, including some that, in the fullness of time, might be okay; likewise that the insurance wrappers around these products might disintegrate just when really needed. The credit crunch has taken a toll on all mortgage securities and on the very concept of the cdo and cds. It will prompt great caution. But it will not wipe out all derivative trades since these are too useful to the financial system, and too widely diffused within it, to be simply abandoned. The nominal total of cdss is no less than \$48 trillion, or three times the size of usgdp (though many overlap and cancel one another out, making the real total much smaller). cdo issuance over the last five years was \$1.6 trillion, while outstanding financial securities total \$10.8 trillion.

The Federal Reserve has offered greater liquidity to the banks but it is very likely that their problem is solvency not liquidity. The paper by Greenlaw and his co-authors explains:

Liquidity injections by the central bank are an invitation to the financial intermediaries to expand their balance sheets by borrowing from the central bank for on-lending to other parties. However a leveraged institution suffering a shortage of capital will be unwilling to take up such an invitation. Recognition of this reluctance is the key to understanding the protracted turmoil we have witnessed in the inter-bank market. [\[63\]](#)

These authors admit that us-style low interest rates help the banks by allowing them to roll over their existing loans at more favourable rates, but they do not lead to new loans.

If the major banks are forced to reduce the book value of their cdos by 50 cents on the dollar, this

will wipe out the equity value of their businesses and make them technically bankrupt. Banks which face this danger include Citigroup, Merrill Lynch, Lehman Brothers and Morgan Stanley, but there are likely to be surprises too. Of course no major bank will be allowed to fail. Instead the authorities will devise rescues, buy-outs and mergers. Rather than the stern treatment meted out to Enron and Worldcom, we shall see ‘socialism for bankers’ as public money is mobilized to prop up finance houses that are too big to fail. The Bear Stearns rescue was hard on shareholders but not bondholders or counterparties. JP Morgan, the purchaser, is the beneficiary of a Federal Reserve guarantee covering \$29 billion of assets held by Bear. In the weeks following this rescue the Fed lent a broadly similar sum, in confidence, to several other banks, with Level 3 securities as collateral. The main alternative to the injection of public funds would be further input from sovereign wealth funds.

Altogether, at the beginning of 2008, there was as much as \$900 billion in vulnerable cdo bundles including quantities of subprime, Alt A and better debt. These assets do have value but it is difficult to know exactly what this is, because they can only be sold at an absurd discount. Some will make a killing by acquiring undervalued ‘distressed assets’, but how to tell good bets from dead losses? In an attempt to rebalance portfolios some banks have resorted to barter, swapping credit derivatives to achieve a supposedly more advantageous mix.

The losses chalked up by the banks hit their shareholders and some juniors in the stricken sector. Financial stocks have dropped on average by a quarter or more, with some doing much worse. However the senior executives who brought these great losses on their shareholders have still been awarded handsome pay-offs by tame boards of directors. The ceos of two Wall Street banks left their jobs in 2007 clutching lavish rewards for failure: \$160 million for Stanley O’Neal at Merrill and \$90 million for Charles Prince at Citigroup. At Bear Stearns the rescue left shareholders with \$10 a share compared with \$170 a year earlier. One-third of the bank’s shares were held by its employees, many of whom will also lose their jobs. Board members lost heavily on their holdings, but will remain very rich men since during the great cdo bonanza—in which their bank was a lead player—they had earned fees and bonuses of tens, or even hundreds, of millions.

Senior- and medium-level bankers continued to receive lavish compensation despite the dire results. Morgan Stanley announced a \$9.4 billion loss in the last quarter of 2007 but still increased the size of its bonus pool by 18 per cent, arguing that the losses had been concentrated in structured finance and should not blight the rewards of those who continued to be profitable. Employee compensation generally runs at 50 per cent of an investment bank’s revenue. In 2007 this rose sharply and in some cases came close to 100 per cent. [\[64\]](#)

The banks’ shareholders have undergone severe losses. The largest shareholder in Citigroup is the Saudi investor Prince Alwaleed, whose booming oil assets offset his banking losses. But there are certainly swathes of pension funds and small investors who will feel the pain. They may not have held much in cdos but, since they have to invest in the whole market in the interests of diversification, they do have stakes in many financial corporations. One report claimed that pension funds lost \$110 billion in the first month of 2008 alone. [\[65\]](#) In 2007 116 funds filed lawsuits against their managers, for losses ranging from 28 to 84 per cent on supposedly safe investments. State Street, with \$2 trillion of pension funds under management, has already put aside \$618 million to cover legal claims. [\[66\]](#)

The most direct victims of the crisis have been two to three million us mortgage holders—or their tenants—who have lost, or will lose, their homes. Younger women, African Americans and other

minorities were over-represented. The credit crunch deepens a recession which shrinks wages and the job market, and will make student loans more difficult and expensive to obtain. It is holding up countless municipal improvements—including the building of social housing. In the longer run there may be some benefit, since it has exposed how insurers and ratings agencies combined to overcharge municipalities for their bond insurance. And the crisis afflicts many outside the us, with the highly financialized uk economy already taking a heavy hit. [67] The looming danger is some mixture of a protracted recession, like Japan in the 1990s, until bank losses are purged from the system, and a wider dislocation like that of the 1997–98 Asian crisis. Because this is a convulsion brought on by ‘Anglo-Saxon’ finance-driven capitalism it will have a character of its own. Japan did not have hollowed-out industries, a negative savings rate, or an infestation of untested, unpriceable structured finance.

Treasury gambits

Henry Paulson has, from the inception of the crisis, put the main emphasis on urging the banks, bond insurers and other financial concerns to come up with their own solutions. But this has had little impact. Thus the super-siv, which he endorsed in September 2007, had to be abandoned in January 2008. On 28 January Hugo Dixon enquired in the *Wall Street Journal*, ‘Is Anybody in Charge?’ [68] Within days Paulson was assuring Charlie Rose, the tv interviewer, that he was working on a new and comprehensive regulatory template, to cover mortgage origination, securitization, bank asset ratios, off-balance-sheet entities, disclosure and the construction and sale of derivatives. When it was published in March it became clear that he had not abandoned his faith that the financial community should regulate itself—or at least appear to do so. The plan laid some disclosure requirements on the investment banks and hedge funds, but there were to be no regulatory powers. The credit crunch has created emergencies in which the Treasury and Fed have had to intervene, but so far as possible this has been dressed up as self-help and auto-regulation. Hence even the takeover of Bear Stearns by JP Morgan only proceeded, as we have seen, because the Fed assumed \$29 billion of risk from the former, an arrangement cleared with the Treasury Secretary. The fire sale of Bear Stearns dealt harshly with an outriding and unloved bank, which had itself declined to join the rescue of Itcm in 1998. It left unanswered the capital-adequacy doubts that dogged other Wall Street concerns.

The Federal Reserve has cut short-term interest rates sharply, supposedly as a way to stimulate the us economy. But its overriding concern is with the well-being, or even survival, of core financial institutions. The banks are always slow to pass on lower rates to customers. [69] With banks able to borrow on the flimsiest collateral at 2.25 per cent interest, they continued to charge over 6 per cent for even the most solid mortgage prospect.

That there is much in life beyond the ken of quantitative finance is no revelation, but that its practitioners so badly miscalculated the odds is strange. Thus Matthew Rothman, a Chicago PhD and head of quantitative equity strategies at Lehman Brothers Holdings, declared after a few bad days in August 2007: ‘Wednesday is the type of day people will remember in Quant Land for a very long time. Events that models only predicted would happen once in 10,000 years happened every day for three days.’ [70] In fact Benoît Mandelbrot had long been sceptical, while Nassim Nicholas Taleb, himself a trader, warned that quantitative finance has a blind spot when it comes to ‘fat tails’ and ‘black swan events’. [71] Fischer Black wrote an article on ‘The Holes in Black–Scholes’ and another on how to exploit them. [72] One hole in Black–Scholes is that it assumes a normal

distribution and will be wrong-footed by a fat tail. With financial data there is often a problem of a sample size that is not large enough to capture their variance over a significant time period. In a long-term perspective the information available to someone basing themselves on today's financial data is very limited; by excluding the future, it is impossible to estimate whether the tail is fat or not. While Fischer Black knew that time could play havoc with the theorems of finance theory, the general run of quantitative economists naively believe in a simple numerical discount rate which can be used to calculate the net present value of a future stream of income or payments. This flattening process—also brought on by 'mark to market' and 'fair value' accounting—robs the future of its most unsettling characteristics: it is at once unpredictable and carries the past within it.

Financialization encourages households to behave like businesses, businesses to behave like banks, and banks to behave like hedge funds. But what, then, is the fate of the hedge funds? How can we know when they are successful? The relative frequency of 'Taleb distributions' in financial markets makes it very difficult for even expert institutional or individual investors to assess the performance of hedge funds. In such markets there is, in any one year, a high probability of making a good return and a low probability of huge losses. But over twenty years the low probability rises to levels where perhaps one in ten, or even one in five, such funds will be wiped out. The hedge-fund manager is paid 2 per cent of fund value each year and 20 per cent of the annual capital gain. Even managers of funds that are wiped out after twenty years will walk away very rich. The credit crunch has already taken down several famous hedge funds and inspired radical doubts concerning the hedge-fund formula. Martin Wolf cites a study which shows how difficult it is to devise incentives that are truly aligned with the interests of investors:

Obvious possibilities include rewarding managers on the basis of final returns, forcing them to hold a sizeable equity stake, or levying penalties for under-performance. None of these solutions solves the problem of distinguishing luck from skill. The first also encourages managers to take sizeable risks when they are close to the return at which payouts begin. Managers can evade the effects of the second alternative by taking positions in derivatives, which may be hard to police. Finally, even under the apparently attractive final alternative it appears that any claw-back contract harsh enough to keep unskilled managers away will also discourage skilled ones. [73]

There remains the question: when—and to what extent—will the financial crisis become a crisis for the real economy? After six months of financial near-paralysis, the us economy was still growing and the New York Stock Exchange was seemingly in denial. There were signs of a slackening pace but these were aggravated, rather than caused, by the credit crunch. After all it was the housing bust which prompted the crunch, not the other way round. A leitmotif of writing about the us economy in 2001 and after was the low level of domestic investment and the decline in loans made to non-financial concerns by banks. Instead financial institutions lent to, and traded with, one another. Greenlaw, Hatzius and their colleagues have explained how the balance-sheet-levered 'financial accelerator' communicates shocks from one interconnected financial sector to another, intensifying the losses. [74] For a while, what was left of the real economy could limp along since it was not dependent on financial credit, but what of the 'fat tail' of heavily leveraged corporations? They might only comprise 5 per cent of the total, but their failure could still set off a new round of write-downs. The April 2008 imf report politely raised the issue of bankruptcy when it stated that its estimate of \$945 billion of losses 'suggests potential added stress on bank capital and further write downs . . . combined with losses to non-bank financial institutions . . . the danger is that there may

be further reverberations back to the banking system as the de-leveraging continues'. [75]

IV. Tackling the credit crunch

The collapse of the mortgage bubble and the damage it has done to both the financial system and real economy reveal the failure of Anglo-Saxon capitalism with its deregulation, privatization and belief in the alchemy of financialization. While parts of the shadow banking system serve no useful purpose and could simply be suppressed, other functions are potentially useful and could be discharged by a responsible public body. The banks are closing their sivs, but the law which allows them to hide liabilities off-balance sheet remains.

The us and British authorities have both mobilized huge resources to rescue the banks from their own folly, and the bailout may be far from over. For both households and financial concerns, the burden of debt remains, and can bring them down. The banks will need support if they are to 'de-leverage' by reorganizing their business and restoring solvency. The use of public resources to achieve this should carry a price if it is not to encourage a repetition of such behaviour—'moral hazard', as the economists call it. Financial corporations that benefit from public intervention—as did JP Morgan—could also be obliged to issue preferred stock to a public holding fund. In the us this might be the state-level Social Security trust fund network. Alternatively a new social fund regional network could be established in this way. Since all have benefited from the low interest rates, all could be required to contribute. The power to impose a capital levy could also be deployed to prevent new bubbles. If the proceeds were redistributed from those who spend their dividends to a future-oriented fund that re-invested its income, it would help to contain inflationary pressures.

Another area that requires reform is accountancy, dominated by just four large companies, and accounting standards, where the 'mark-to-market' approach has been 'pro-cyclical'—encouraging the boom–bust cycle. A public audit agency, and a diversified set of accounting standards, could tackle the problems of an industry where auditors are too often in cahoots with the auditee. [76] There is likewise a case for only allowing expert publicly owned bodies to function as hedge funds, and converting 'private equity' into 'public equity' concerns. Another model that might be considered is the Reconstruction Finance Corporation, a public body that operated in the years 1932 to 1946. It invested a total of some \$39.5 billion—in contemporary terms nearly \$4 trillion—to combat recession and, after 1940, to organize war production. It created a swathe of new productive facilities, acquiring an equity stake in return. This enterprise was hastily liquidated in 1946 because it had succeeded too well. It was portrayed as an un-American institution and several of its best managers were hounded as Soviet spies. [77]

A further example of a bailout mechanism is the Resolution Trust Corporation set up by the us Congress in 1989. This body used Federal money to rescue the stricken Savings and Loan concerns. The rtc assumed ownership of all assets, selling these off once the market had recovered. In this way the rtc accomplished a huge Federal injection of funds but was eventually self-liquidating—the rtc worked, but its successes became an opaque way of subsidizing the banking sector. [78] It would have been better if both rfc and rtc had remained as public bodies helping to diversify the economic landscape and maintain levels of investment and security. Recapitalization expenditures should be seen as part of the capital budget, not as current expenditures.

Jean-Charles Rochet points to the success of the Norwegian approach to its banking crisis in 1988–92. Three of the country's largest banks were taken into public ownership and their shareholders

expropriated. The banks were so successfully rehabilitated that when they were eventually sold back to the private sector the government made a significant profit. [79] At least some of this was channelled to the country's two public pension funds, one of which is dedicated to investment in the local economy.

More generally, the old Anglo-American formula of the National Debt is inappropriate in a world beset not by individual 'risk' but by large-scale 'common shocks' like climate change, ageing and market turmoil, as has been recognized even by some of the most conservative and cautious states as they build up 'future funds' and sovereign wealth funds. The incoming Labour government in Australia has announced that it will continue to build the country's 'future fund'. Norway, Singapore, South Korea and China are other examples. The Norwegian finance minister insists that his country's government pension fund, with assets of \$350 billion, pursues an 'ethical' agenda and a 'high degree of transparency in all aspects of its operation'. It has 'long-term investment horizons', avoids 'leverage' and adds liquidity to the market. The fund rigorously eschews 'political posturing or politicized investment decisions':

We promote the ethical foundation by exercising ownership rights and excluding companies from the fund. In cases where it is possible to encourage a company to put in place systems that reduce the risk of ethical infringements, the use of ownership rights is the preferred option. [80]

Nowadays many public-sector and social funds prefer 'engagement'—putting down motions at agms on such issues as dangerous industrial processes, denial of worker rights and exorbitant executive pay—rather than simply boycotting the stock. One should be careful not to exaggerate what is achievable by such means, still less pose them as an alternative to popular campaigns, legislation and trade-union action. This is still state capitalism, and is usually far removed from real accountability. But in the shifting and treacherous sands of financialized capital markets, the sovereign wealth funds have been a factor of stability. Given this potential there is every reason to argue that they should be financed by regular capital levies, with the added advantage that such levies can, as Schumpeter pointed out, counteract bubble economics. [81]

The national scale of regulation that emerged in the 1930s, and was globally coordinated by the Bretton Woods system, now needs to be revised and extended at international level. Indeed Keynes and Dexter White always meant the imf and World Bank to have greater powers—for example to prevent one country from running a lengthy period of surpluses. In the context of the current crisis these institutions, each with a new head, will certainly try to get in on the act. The clauses of Basel II that allow banks to use their own valuation models need to be struck down.

John Eatwell and Lance Taylor have for some time been urging the case for a 'World Financial Authority'. [82] Their warning that the international financial system was likely to be dangerously volatile has been borne out by events. In associated work Jane D'Arista has urged the case for what she calls a 'macro-prudential framework', which would insure pension deposits rather than financial institutions. [83] Elsewhere she has written of the need for a new reserve system which takes account of the spread of financial functions and insists on appropriate reserves being held by all entities that undertake them. D'Arista argues, in terms that might apply to any central bank or to an international authority:

Creating a reserve system that extends the Fed's influence over the financial system as a whole requires that reserves be issued to and held by financial institutions as liabilities

to the central bank. Shifting reserves to the liability side of financial institutions' balance sheets would permit the monetary authority to create or extinguish reserves for both bank and non-bank financial firms. [84]

Joseph Stiglitz has also identified critical weaknesses of the current global financial regime. [85] The time has come to re-examine the helpful checklist of proposals made by Walden Bello and others following the Asian crisis of 1997–98. [86] It is now widely recognized that offshore financial centres allow wealthy corporations and individuals to make a mockery of taxation and national regulation. The German government's demand to obtain disclosure from Liechtenstein signals a new approach. The broader concern must be to embed financial institutions also at the level of states and regions.

The solution to the huge problems outlined above is not to abandon money or finance but to embed them in a properly regulated system; to progressively transform the very nature of the corporations and banks in terms of both ownership and functioning; and to create a global network of social funds, financed in the way envisaged by Meidner, and a global system of financial regulation. The 'shadow' banking system must be brought under control and new principles observed by all those who offer derivatives for sale. The latter are a product of human ingenuity and should not be feared as an alien force. But their workings do need to be rendered visible and responsible. George Soros calls for 'a clearing house or exchange with a sound capital structure and strict margin requirements to which all existing and future contracts would have to be submitted.' [87] Perhaps a global network of publicly owned Derivatives Boards should be established with a monopoly on derivatives trading.

The actual and potential costs of the credit crunch are already huge, but they must be seen as part of a wider distemper of financialized capitalism, with its yawning inequalities, stagnant wages and loss of social protection. Global imbalances make China, Japan and Germany the world's leading exporters of capital, as the world's poor struggle to deal with rising food and energy prices. This is shaping up to be the worst crisis to hit global capitalism since the interwar years. The prestige of capitalist institutions has already suffered a damaging blow and will suffer further as the crisis hurts those in the real economy. But only practical, radical and transformative actions to tackle the wrenching consequences of the crisis can ward off stiff doses of capitalist medicine, which for many will be worse than the financialized malady they will be designed to cure.

[*] This article is dedicated to the memory of Andrew Glyn (1943–2007) whose wisdom, generosity and criticism are sorely missed. I would like to thank Yally Avrahampour, Jane D'Arista, Duncan Foley, Max Gasner, John Grahl, Geoffrey Ingham and Julia Ott for helpful comments and suggestions.

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A Systemic Crisis, Both Global and Long-Lasting

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1. How do you assess the changes in the financial system over the last 25 years? How should we assess the current crisis in the light of those changes of the financial system, and how should we assess those changes in the light of the crisis?

The transformations of the financial system should be analysed on the basis of two fundamental tendencies which have been operating since the beginning of the 1980s.

The first is the tendency of the rate of exploitation to rise: almost everywhere in the world, the proportion of the wealth produced which comes back to the wage-workers has decreased, and the emerging economies are no exception here. Even the IMF and the European Commission are now registering this fact. This decrease of the wage-share has allowed a spectacular recovery of the average rate of profit from the mid 1980s.

But, and this is the second tendency, the rate of accumulation has continued to fluctuate around a level lower than that before the crisis. In other words, the drain on wages has not been used to invest more.

The "Schmidt theorem" stated by the German Chancellor Helmut Schmidt at the beginning of the 80s - the profits of today are the investments of tomorrow and the jobs of the day after tomorrow - has not operated.

The growing mass of surplus value which has not been accumulated has mainly be distributed in the form of financial revenues, and that is where the source of the process of financialisation is to be found. The difference between the rate of profit and the rate of investment is a good indicator of the degree of financialisation.

We can also see that the rise of unemployment and casualisation goes together with the growth of the financial sphere. There too, the reason is simple: finance has succeeded in grabbing the greater part of gains from increased productivity, to the disadvantage of the wage-workers, by keeping wages down and by not reducing sufficiently, or even by increasing, work hours.

The relations between productive capital and financial capital have thus been profoundly modified, and the demands of super-profitability come to bear, through a feedback effect, on the conditions of exploitation.

For all that, we should not take a "financialist" view of contemporary capitalism, one which would see an autonomous tendency to financialisation plaguing the normal functioning of "good"

industrial capitalism. That would be artificially to separate off the role of finance and the class struggle over value-added.

We must articulate the analysis of the phenomena correctly: when the rate of profit rises thanks to a wage slowdown, without recreating the conditions for profitable accumulation, finance takes up a functional role in reproduction by providing market outlets alternative to the economic demand from wage earners.

This approach is confirmed by taking into account globalisation. In the progressive constitution of a world market, finance plays a role of abolishing, as far as can be done, the marking-off from each other of spaces of valorisation. The great strength of finance capital is that it ignores geographical or sectoral frontiers, because it has gained the means of moving very rapidly from one economic zone to another or from one sector to another: capital movements can now be deployed on a considerably expanded scale.

The function of finance here is to sharpen the laws of competition by making the displacements of capital more fluid.

Paraphrasing what Marx said about labour, we could say that globalised finance is the process of concrete abstraction which subjects each individual capital to a law of value whose field of operation expands ceaselessly. The principal feature of contemporary capitalism is thus not an opposition between financial capital and productive capital, but the hyper-competition between capitals generated by financialisation.

2. Marxists habitually consider the rate of profit to be a key index of the health of capitalism. But, on some estimates, the increase in the rate of exploitation has brought about a substantial recovery of the rate of profit since the 1980s. Do you agree with this assessment?

The analysis of the current crisis should indeed start with a study of the development of the rate of profit.

After the generalised recessions of 1974-5 and 1980-82, a new phase opened in the functioning of capitalism, one which one could for convenience call neo-liberal. The beginning of the 1980s was a real turning point. A fundamental tendency towards increasing the rate of exploitation was unleashed, and that has led to a continuous rise in the rate of profit.

For a Marxist used to thinking about the tendency of the rate of profit to fall, this about-turn may be disconcerting. One can of course evade this difficulty by trying to show that if the rate of profit is correctly measured, then it will after all have a tendency to fall. But such efforts are not theoretically well-founded, and, though I do not have the time to discuss this in detail here, I believe that the traditional argument about a falling tendency of the rate of profit is erroneous.

It is more enlightening to focus on the fundamental characteristic of the neoliberal phase, more or less unprecedented in the history of capitalism: the recovery of the rate of profit has not led to a simultaneous rise of the rate of accumulation. The rate of accumulation, taking an average over the various fluctuations, and excepting the "new economy" episode in the USA, has remained at a relatively low level.

If we analyse this starting from the Marxist schemas of reproduction, we see a problem of realisation, since neither wage-earners' economic demand, nor accumulated surplus-value, are rising at the same rate as the social product. The solution to this problem is based on the recycling of the non-accumulated surplus-value through the financialisation of the economy.

This quick sketch thus leads us back to two essential points. First, that financialisation is not an autonomous factor, but the logical complement of the reduction of the wage-share and of the scarcity of sufficiently profitable openings for investment. Second, that the increase in social inequalities (within each country, and between zones of the world economy) is an essential trait of contemporary capitalism.

3. Financial crises sometimes lead to crises in production and trade, but not always. The current financial crisis comes at a time when rates of profit are generally high. Do you think that it will nevertheless lead to a serious crisis in production and trade, and how?

The current crisis is not just a financial crisis, because it puts into question the mode of growth in the USA and the configuration of the world economy.

In the USA, growth was based on a push from consumption, sustained by a continuous decline in the savings rate of households. It was in a way growth on credit, which presupposed an inflow of capital from the rest of the world to finance the trade deficit which resulted from the lack of domestic savings.

Add to that the budget deficit, explained in large part by the costs of intervention in Iraq.

That model of growth is thus based on a double imbalance, internal and external. Finance plays an essential role in managing both imbalances. Internally, it is finance which has made possible the growth of debt, especially on the mortgage market. Externally, finance has the function of maintaining the balance of payments.

The current crisis puts that regime of accumulation into question. Household debt is now blocked, and capital inflows are no longer guaranteed. Consequently, the financial crisis will probably lead to a recession in the USA, or at least to a long-lasting slowdown of growth.

Will that slowdown be transmitted to the rest of the world economy? There is talk these days about "decoupling", meaning that the growth of the emerging economies could keep up world demand sufficiently that the impact of the US slowdown will be limited. But that does not take into account the interweaving of the world economy, which also involves the relations between Europe and the USA and between China and the rest of Asia.

Dependence on exports to the USA cannot be measured simply by the percentage which they make up in the total exports of China. That would be to underestimate the criss-cross relations between China and other countries of Asia.

In Europe too, economic growth will slow down, for three reasons: the very high rate of exchange of the Euro in relation to the dollar; prices of imported primary materials; and government economic policies unfavourable to growth and employment.

Finally, the crisis may possibly encourage more internally-centred economic growth in China, reducing its contribution to world trade.

4. The financial sector feeds more and more on individual incomes rather than on business transactions. What are the implications of this fact for the impact of the crisis on working-class households?

The big question is, which social layers will bear the costs of the crisis? The answer differs in the

different zones of the world economy. We can sketch the main outlines.

In the USA, obviously the mortgage crisis is plunging a large number of households into poverty. In numerous developing countries, the rise of food prices has already sharply increased the number of people affected by malnutrition or even famine. They are paying the price for neoliberal agricultural policies which have focused on exports and destroyed traditional agriculture.

In Europe, the restrictive monetary policy of the European Central Bank aims to make wage-earners' purchasing power bear the impact of the rise in primary-product prices.

The implacable code of capitalism insists that it be the working people who thus have to pick up the pieces for the vagaries of the system. To absorb the losses, it will be necessary to clean up the economy on the backs of the working class, by braking growth, by raising interest rates, and by using the current world-economy disturbances as a pretext once again to push down the wages of the majority.

According to the latest report of the ILO [International Labour Organisation], the financial turmoil could lead to a five-million increase in the number of unemployed in the world in 2008, a year "full of contrasts and uncertainties", as the ILO director general prudently puts it.

If these tendencies sharpen, they can only worsen the recessionary effects of the crisis by curbing demand. Conversely, this fact shows that the outcome of the crisis is an eminently social question.

Everywhere in the world, a transition to a less chaotic mode of growth would necessitate a different, more egalitarian, distribution of income, which would allow a reduction of the flows of liquid assets which are at the root of the recurrent financial crisis, a reduction of the intensity of international trade (and thus, by the way, of carbon dioxide emissions), and a better response to social needs.

The case of the USA is almost caricatural in its extraordinary degree of inequality in the distribution of income. Over the last 15 years, only the top 10 or 20% of the population have profited from the economic growth, and they have thrown themselves into a frenzy of consumption. To establish a stabilised mode of growth, a radical redistribution of income is necessary. There too, we come up against the social question.

5. How do you see the current situation of capitalism? Is it still stuck in a "global turbulence" originating in the 1970s? Or has it developed a new model of generalised expansion?

In terms of Ernest Mandel's theory of long waves, we face an ambivalent configuration.

On the one hand, we could say capitalism has been successful, since it has re-established a high rate of profit, and the current phase could thus be characterised as one of expansion.

But if we take the rate of accumulation ("the law and the Prophets" of capital, according to Marx) as criterion, we could on the contrary say that capitalism is stuck in a phase of recession and diminished dynamism. Add to that two economic elements : the specific instability created by the weight of finance, with a countless series of crises, and the fundamental imbalance which the trade deficit of the USA introduces into the current configuration of the world economy.

This fundamental imbalance is the symptom of a systemic crisis which is also without precedent in the history of capitalism, and is situated at a more profound level, putting into question the essential mainsprings of this mode of production.

The source of this crisis is the growing gap which exists between the social needs of humanity and

the capitalist mode of satisfying those needs. Social demand goes for commodities which are not susceptible of being produced with the maximum of profit. The gap grows in two main dimensions.

The first, in the developed countries, is the displacement of demand from manufactured goods (in the production of which productivity is high) towards services with which smaller productivity gains, and thus smaller perspectives of profit, are associated.

No new economic outlet has taken up on a sufficient scale the role which the car industry played in the preceding, "Fordist", phase.

The second dimension is geo-economic, and results from globalisation. Globalisation tends to create a world market, or in other words an expanded space of valorisation. The lower levels of productivity of the less advanced sectors are directly confronted with profitability demands set according to the performance of the most competitive countries or businesses. A "crowding-out" effect results, so that a certain number of lines of production and thus of social needs which they could satisfy are no longer admissible because of the criteria of hyper-profitability which they face.

In these conditions, the reproduction of the system goes through a double movement: extension of the domain of commodities, and refusal to respond to non-profitable needs.

Contemporary capitalism is thus a "pure capitalism", in the sense that it has brought together the conditions which it itself demands for an optimal functioning from its point of view. Rather than an improvement in social welfare, pure and perfect competition, free from regulations, rigidities and other distortions, brings to light a total absence of legitimacy, since social regression is explicitly the main desideratum for the success of the system.

6. Since the 1970s at least, the prevalent view among Marxists has been that the USA is in the process of losing its hegemonic position. Do you think that the USA's hegemony is really in decline? Or will be in the near future? If it is, will this decline generate imbalances and crises in the system?

The hegemony of the USA has had this paradoxical feature, that it has rested, for two decades, on the import and not on the export of capital, contrary to all the classic definitions of imperialism.

No other country would have been able to run such a trade deficit without incurring a currency crisis; and it is indeed its position as the dominant power which has allowed the USA, recently, to let the dollar's exchange-rate decline.

We could talk about an "imperial decline of the dollar" in the sense that, in that recent period, the strength of the USA has been measured by the weakness of its currency. Besides the fact that the dollar functioned as world money, there were in this situation some more objective determinations: the stability of the financial investments offered, notably Treasury bonds, and relatively good financial performance.

But the permanent inflow of capital could also be explained, from the middle of the 1990s, by the acceleration of productivity gains in the USA. This phenomenon seemed to mark the reaffirmation of the supremacy of the USA in the productive sphere itself, as a dynamic site of innovation and thus of profitability. It was at the foundation of the "new economy" and the stock market boom which accompanied it. That is why the question of knowing whether the productivity leap constituted the material base of a new phase of expansion, or a high-tech cycle, is absolutely decisive.

In the first case, the foundations of US hegemony would be renewed on the basis of an objective productive advance. In hindsight, the facts now seem to confirm the thesis of a high-tech cycle.

Hourly labour productivity in the USA has in fact slowed down in recent years, and has slipped back to a rate of growth below 2%, comparable to the rate during the three decades preceding the "new economy". Thus the "new economy" appears as an interlude, provisionally reviving the rhythm of the phase of expansion which ended in 1967.

7. Do you think that the talk in recent years of the rise of the "BRIC" countries (Brazil, Russia, India, China), and perhaps also of other countries such as South Korea, Mexico, or South Africa - is just superficial journalism? Or that it reflects a real change in the capitalist relation of forces on a world scale?

The rise of the emerging economies manifestly represents a major inflection in the configuration of the world economy. We can pick it out objectively in the relative rates of growth of the different regions of the world.

But the most spectacular change is in the inversion of capital flows, or in other words, the fact that the emerging economies have become net creditors. The recent bailing-out of the banks of the richest countries by the sovereign wealth funds of countries of the South is the most spectacular manifestation.

We could talk here of a "boomerang effect" of globalisation which puts into question the classical notion of imperialism, not to speak of the mainstream theories. Of course, there are still immense zones of "classical" dependency.

This new configuration generates uncertainties as to his medium-term sustainability. In fact it is based on the trade surpluses achieved by the emerging economies, swollen for some of them by the rise of primary-product prices. The main counterpart of those surpluses is found in the trade deficit of the USA, which needs a regular inflow of capital.

But with the recession and the fall in interest rates, and the continual depreciation of the dollar, there is less motive for capital to place itself in the USA. Today, it is the central banks of the emerging economies that finance the US deficit, and that is a matter of a purely political choice which has no reason to be sustained for ever. Objectively, the central banks would do better to hold their assets in euros rather than dollars, or at least in a better balanced mix of the two.

If we now look at the productive aspect, the counterpart of the surpluses of the emerging economies is found in an extraversion in their economies which implies a holding-down of internal demand and, for the majority of the population, an advance in purchasing power much lower than the growth in the economy. This schema is not sustainable, and it is inevitably going to lead to social struggles which may open onto a more internally-centred mode of growth, a bit like in South Korea, and thus a reduction of surpluses.

But that is a mid-term perspective which is not an immediate solution to the crisis. That is why the world economy has entered, for an indeterminate time to come, a period of deepening of trade wars and of inter-capitalist contradictions, full of threats.

8. Do you think that the current economic disturbances will develop in such a way as to generate crises in the "BRIC" countries? How do you assess the probability that the enormous inflow of capital to the USA from Asia and the oil-exporting countries will dry up, and that a disastrous decline of the dollar will result? In the course of the current disturbances? Or in the coming

years?

The dollar has already hit a historic minimum, and, since its fate today depends on the attitude of the central banks of the countries in trade surplus, it can hardly go lower. Thus no further depreciation of the dollar, to adjust the USA's balance of payments, can be counted on.

A dose of recession will doubtless be necessary, but also, above all, a serious slowdown of growth. From this point of view, the main result of the subprime crisis is surely to have put a definitive end to the mode of growth in the USA established in the Reagan era.

Moreover, rather than just engaging in an exercise in forecasting, it is more stimulating to reflect about the coordinates of a more balanced configuration of the world economy. The way to deflate the sphere of globalised exchanges and to reduce global imbalances is basically the same everywhere: namely, to re-focus economic activity on internal demand, or in other words on the satisfaction of social needs.

But that path implies a radical calling into question of the current tendencies of today's "pure capitalism", and even a recession will not be enough to set such a reorientation in motion. Spontaneous reactions in defence of the social interests of capitalism will push in the contrary direction, because it is difficult for the possessing classes to forgo the large and disproportionate sums that they extort from the wage-earners of the whole world.

Suppose that this year produces a very uneven slowing-down of the world economy, and it does not transform itself into a generalised recession. Even in that case, 2008 will demonstrate how unsustainable the fragile balance of the world economy is, and how it is now on the brink of breakdown.

As we have seen, the USA will have difficulty in continuing to make the rest of the world finance its profound trade deficit, or in hoping to reduce it by an endless slide of the dollar, without that setting off new tensions with China and Europe. The structural dysfunctions of the European Union will also be exposed in all their clarity. And the mode of the growth of the emerging economies, totally reliant on exports, will also show its limits.

Thus 2008 will allow us to understand the social content of the current configuration of the world economy: its imbalances are based on the profoundly inegalitarian character of the social arrangements which underlie it. Over and above the obvious differences which exist between the USA, China, and Europe, these three great poles have a fundamental trait in common, which is the regular reduction of the share of wealth produced which goes back to those who produce it. It is that tendency which creates the super-indebtedness and the deficit in the USA, unemployment in Europe, and the export priority and overaccumulation in China.

The other lesson that we can draw from this story is that the legitimacy of capitalism today is profoundly weakened. The successes which it marks up are directly proportional to the social regression which it manages to impose, without compensation or counterpart. Even if the relation of forces is in its favour, one thing at least should be clear: projects aiming to regulate, discipline, or humanise such a system are in the current context tantamount to pure utopia, in the bad sense of the term.

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Global Instability and Challenges to the Dollar: Assessing the Current Financial Crisis

David McNally

Source : New Socialist – Canada

(<http://www.newsocialist.org/index.php?id=1636>)

WE ARE LIVING through financial turmoil so serious at the moment that the International Monetary Fund calls it “the largest financial crisis in the United States since the Great Depression.” Already, commercial banks have collapsed in both Britain and Germany, as has the fifth-largest investment bank on Wall Street. A series of hedge funds have gone under or are teetering on the brink of ruin. It is a near certainty that more financial institutions will fail before the crisis burns out.

It is clear that the Left needs serious analysis of just what is happening to world capitalism at the moment. Too often, however, our assessments are stuck in the past, revolving around debates as to whether or not this crisis represents a repeat of 1929 and the Great Depression.

Such debates detract from the hard work of analysis that is needed. Ignoring the inherently dynamic and historical nature of capitalist society and the continual transformations this involves, they take one particular historical moment in the history of capitalism as the norm against which all others will be measured. The end result is a sterile exchange between, on the one hand, those who assume that history tends to repeat itself and, on the other side, those critics who so exaggerate what has changed (particularly the ability of central banks to dampen tendencies to financial instability) that they present a picture of a capitalism whose contradictions have been effectively muted.

The real challenge for Marxist analysis, however, is to grasp both the changes and the enduring economic contradictions within capitalism, in order to understand how capitalist transformation displaces and reorganizes crisis tendencies without eliminating them.

In the absence of such analysis, much of the radical commentary on offer tends to focus on the blatant deceit and corruption of financial players who have contributed to the market upheaval. This has its purposes. But it runs the risk of downplaying the structural features of late capitalism that breed financial meltdowns – and in so doing of suggesting that the Left should focus on issues like financial regulation rather than class struggle against capital.

Trying to make sense of this crisis is one important step toward developing both an analysis of late capitalism and some of the tasks that confront the Left. To be sure, any assessment of unfolding events will necessarily be partial and incomplete. Nonetheless, it is possible to offer some crucial guidelines for making sense of this crisis.

A Banking Crisis, Not a Liquidity Crisis

It is critical to recognize at the outset that, contrary to the claims of central banks, this is not a liquidity crisis, i.e. financial turmoil caused by insufficient supplies of money flowing through the financial system. Instead, we are dealing with an insolvency crisis caused by the fact that many financial institutions are effectively broke. The result is a trauma in the banking sector.

This trauma persists because a myriad of lending institutions hold billions of dollars in massively depreciated paper that nobody is interested in buying from them. There is a host of exotic names for this paper – Collateralized Debt Obligations (CDOs), Asset Backed Commercial Paper (ABCP) and so on – but essentially it is an array of debt obligations, or titles to payment of interest and principal on a vast array of loans. Until the crisis broke, investors had been treating such paper as a stock of assets that could at any time be sold, i.e. as liquid wealth. Yet, the value of a debt rests in the first instance on the capacity of the borrower to pay. If the borrower cannot pay, the alternative is for the creditor to seize the asset. But if the asset itself is losing value, then it may not cover the loan – and there might not be anyone out there who wants to buy it. In short, it may not be convertible to cash.

And that is precisely what is happening on a larger and more complex scale today. Economic reality is demonstrating that much of this paper – tied in the first instance to tens of millions of US mortgages – is worth billions of dollars less than what was paid for it. So, much of it is being written off or written down (revalued at amounts that involve enormous losses). It is as if you once had \$1000 in the bank, against which you had borrowed many times that amount (say, ten times that amount or \$10,000), and you have now learned that you only have \$500. Once your creditors discover that, they will scramble to collect in the knowledge that there's no way you will ever pay off all that you owe. But your \$500 will be gone pretty fast. And since you owe \$10,000, a lot of your creditors won't be able to collect. And they won't be able to sell off your debts to anyone else either.

Fictitious Capital in the Current Crisis

To their holders debts, no matter what their exotic names, are forms of *fictitious capital*, to use Marx's term. Rather than consisting of actual assets – such as machines, equipment, factories, buildings or stocks of commodities – that have been produced by past labour, fictitious capitals are paper titles to future wealth. So, if I purchase someone's mortgage, I have bought a claim to their future mortgage payments. But this claim only becomes real when they have met all the payments required. Until such time, my "capital" in the form of someone's mortgage remains largely fictitious, or unreal. Stocks, bonds and a whole host of complex financial instruments all qualify as fictitious capitals, where money has been paid for future returns that may or may not materialize.

When capitalism is in a boom or prosperity phase, capitalists rarely worry about the idea that future returns might not materialize. Banks, corporations and investors frenetically buy and sell paper claims to wealth, often with manic get-rich-quick expectations. These are the moments when *asset bubbles* develop, i.e. ridiculously inflated prices for things like shares of dotcom companies or real estate in Tokyo or San Francisco. So over-confident are investors about the solidity of their fictitious capitals that they use them as means of payment between financial institutions and investors as if they were hard cash.

Bubbles burst, however. And when they first start to lose air an investor panic sets in. All of a sudden, those holding commercial paper realize it is not as good as cash. Indeed, as its value plummets, buyers are hard to find and the values of fictitious capitals start to collapse. At such moments, institutions and individual investors begin panic selling. And they start to call in their loans to other companies or investors. Over night, cash and cash alone becomes king.

"A monetary crisis," writes Marx, "occurs only where an ongoing chain of payments has been developed along with an artificial system for settling them. Whenever there is a general

disturbance . . . money suddenly and immediately changes over from its merely nominal shape, money of account, into hard cash...” [1]

And at such moments, capitalists start to trust only those who have great stacks of cash in reserve. Those whose assets consist overwhelmingly of dubious debt paper quickly find they are being abandoned. In such circumstances, an institutional “run on a bank” can occur, of the sort that rocked Bear Stearns in mid-March of 2008. In the course of 48 hours, Bear’s holdings of cash and liquid assets plummeted from \$17 billion to \$2 billion as investors pulled their funds from the bank.

So, the root problem is not a lack of liquidity in the system. It’s that there are all kinds of institutions out there that to whom nobody wants to lend, and whose ostensible “assets” nobody wants to buy. Worse, none of the players in the system are entirely certain as to who is holding increasingly worthless paper, or how much of it they have. As a result, the flow of funds between banks and between banks and other lenders (like mortgage companies) keeps seizing up.

This is the reason that injecting cash into the system does not restore confidence. In fact, despite deep cuts to interest rates by central banks, particularly the US Federal Reserve (designed to encourage borrowing) and massive injections of money into the banking system, American banks have continued to tighten lending to consumers, corporations and other banks [2]. The loss of confidence in Bear Stearns thus took place for a fundamental economic reason, not a simply psychological one: Bear’s actual assets, particularly those tied to real estate loans, had been losing massive amounts of value for months. In fact, in June of 2007 two of the bank’s hedge funds, which were deeply invested in sub-prime mortgages, effectively collapsed.

From Housing Bubble to...

And it is there, in the housing sector, that we find a key link between the financial crisis and material assets in the wider economy. For, central to this crisis is the collapse of a manic bubble in US house prices.

For a hundred years after 1895, as Dean Baker has noted, US house prices increased at the rate of inflation. Then, as a result of speculative mania in housing, from 1995 to 2007 they rose 70 per cent more than the cost of everything else. That created an extra \$8 trillion in paper wealth for US homeowners. And, with that ostensible wealth in their sights, American consumers ran to the stores, often after taking out loans against the increased value of their homes. At the same time, banks started to loosen up mortgage lending, often far beyond the real capacity of borrowers to pay, and then turned around and sold the debt to all kinds of investors. As a result, huge amounts of fictitious capital from the US mortgage sector built up throughout the financial system.

That bubble started to burst last summer, with a rise in the number of mortgage holders in default. Many of the mortgages that US buyers had taken out were designed with very low payments in the first year or two. But as they “reset” at higher levels, large numbers of borrowers could not keep up. And it just kept getting worse. US housing prices dropped about 13 per cent last year, and have continued tumbling this year. As the houses on which they have taken mortgages fall in value, the cost of buying them has risen for millions of Americans. Huge numbers are just putting the keys in the mail and sending them back to the mortgage lender. Others, unable to make payments, are suffering foreclosure. In March of this year, foreclosures jumped 57 per cent in the US, while house repossessions by banks more than doubled compared to a year earlier. In May, despite claims that the worst was over, foreclosures rose another 48 percent over a year earlier [3]. Many analysts now expect US house prices to decline by another 10 to 20 per cent over the next year. Some believe

prices will fall for the next five years.

Meanwhile, the meltdown in the value of their paper assets is calamitous for those who bought those mortgages – through a variety of schemes known as mortgage-backed securities. The borrowers cannot pay and the underlying assets are in freefall. The fictitious character of their assets has been thrown into sharp relief. Buyers for these toxic debts cannot be found, unless it is at staggering low prices.

This is why the asset-backed commercial paper (ACPB) market has been frozen in Canada for the last six months. And now the same thing has happened to the \$300 billion auction rate note market in the US. There are simply no buyers of these “assets” to be found.

Yet housing is just part of the problem. Equally dubious junk is now turning up in commercial paper tied to credit card loans, commercial (not just residential) real estate, auction rate notes, leveraged buyout loans and much more. Indeed, growing numbers of analysts are also raising warnings about corporate debt [4].

Not surprisingly, estimates of the total damage of the crisis to the financial system keep rising. Initial predictions had the figure between \$50 and \$100 billion. Then as bank after bank wrote off billions more, estimates in the range of \$400 billion and even \$600 billion emerged. In April, the International Monetary Fund calculated that the meltdown will result in losses of nearly \$1 trillion. One analyst writing in the *Wall Street Journal* suggests the global damage will hit \$1.4 trillion.

Whatever the ultimate figure – and it is likely to be at the higher end of the predictions – it represents a very large hit for the system. It also means that there are huge losses still to be recorded before the financial system recovers. Nouriel Roubini, among that very small minority of economists who saw the sub-prime meltdown coming and one of the few who have consistently warned that its consequences would be extremely serious, has argued that “the worst is still to come” for the US and global economies. Indeed, in May of this year the number of companies at risk of receiving a credit rating downgrade – i.e. as being more financially precarious than before – rose to record levels, indicating that much more turmoil lies ahead [5].

Global Slowdown

Just how deep and prolonged the slowdown in the global economy will be remains to be seen. But in recent years as much as half of all US economic growth has been housing-driven. Borrowing against rising home values, American consumers fed the engine of the world economy, particularly in their enormous purchases of manufactured goods from around the world. During this round of credit-driven growth, US household debt more than doubled, increasing from \$6.4 trillion in 1999 to \$13.8 trillion in 2006.

Between 1980 and 2000 US imports increased 40 per cent, accounting for 19 per cent of world imports and roughly four per cent of world GDP. Now, as the housing bubble bursts, as consumers hold off on big purchases and try to pay down debt, world exports to the US will decline, and global growth will taper off. In fact, imports into the US dropped by over \$6 billion in March, a clear sign that the global slowdown is spreading. Moreover, even a modest move by US consumers to rebuild their savings will knock about 1.5 per cent off US economic growth per annum. And with US consumer confidence now at a 28 year low, it is clear that consumption spending in the US will no longer be driving global growth.

Across the US, construction spending, industrial production, private employment and

manufacturing output are all falling. The US economy is clearly in recession. It remains to be seen just how significant the accompanying global slowdown will be.

The Dollar, World Money and the Current Crisis

Alongside the turmoil in financial markets, the current crisis also poses major challenges to the US dollar as the dominant form of world money today.

World money is necessary to the measuring and allocating of value – prices, profits, wages, etc. – within and between regions and nations. It is also essential as a store of value, as a stable asset in which wealth can be stored. In order to do this efficiently, global money must be effectively “as good as gold” – something that everyone will accept because it is a stable and universally recognized means of payment. This is what it means for money to play the role of a genuinely *universal equivalent*.

For most of the history of capitalism, gold anchored the system of world money, either through an actual gold standard (in which international payments were made in gold) or a gold convertibility standard, under which the leading currency could be converted into gold by the world’s central banks.

Since 1971, however, when US President Nixon broke the dollar’s tie to gold, the US dollar has operated as *inconvertible* world money. This has produced two tendencies: first, a significant long-term decline in the value of the dollar relative to other major currencies; and, secondly, a new volatility in world currency markets, as investors try to avoid holding on to currencies whose value may plummet. In fact, much of the proliferation of those complex financial instruments called derivatives is a product of the new instabilities in prices, currencies and profits that monetary instability creates. But in the absence of any other viable candidates for world money status, the dollar continued its reign.

Indeed, throughout the last decade or more, the status of the dollar seemed to be rising. Despite huge deficits in the US current account – the balance between what economic actors based in the US owe the rest of the world and what the rest of the world owes these US actors – the dollar kept riding high. This led some pundits to argue that current account deficits (i.e. debts to the rest of the world) are irrelevant where the dominant imperial power is concerned. Even as the US economy started to run deficits of \$500 billion per year and more with the rest of the world – deficits that are essentially paid for by printing and shipping off dollars – these commentators insisted that there would be no meaningful consequences for the economy of the United States.

The reality is much more complex. It is true that the world money-issuing state can get away with deficits that would not be tolerated in the case of any other nation-state. But it is not true that it can do so infinitely. Sooner or later, as more and more of the currency floods into world markets to cover these deficits, a point must be reached at which some of those holding dollars become tempted to unload them in favour of other currencies or assets. And at that point, an inevitable decline in the dollar’s value would set in, increasing the pressure on others to dump it as a depreciating financial asset.

Flight from the Dollar?

In fact, precisely this process has been underway for some time now. Beginning in 2001, private investors began to dump dollars. As a result, the greenback has lost 40 per cent of its value relative to other currencies since 2002. And the decline would have been much worse were it not for the fact

that central banks in Asia, particularly China and Japan, stepped into the breach and invested massively in the US.

These Asian central banks have been effectively returning to the US the dollars it ships overseas to pay for its current account deficit. (This is done by making foreign investments in the US, be it in US treasury bills or the stocks of banks and corporations.) Some commentators have held that this process could continue for decades, dubbing it “Bretton Woods II,” after the original Bretton Woods agreement that created the post-World War 2 dollar-gold regime.

But there have always been three inherent flaws in this arrangement. First, this massive recycling of dollars back to the US only fuels speculative bubbles, as US financial institutions try to make profits by finding borrowers for this money, be it investors in dotcom stocks, or low income home buyers. Yet, when these bubbles burst, as has the most recent one in housing, it makes the US national economy a less attractive place for investment (since investments have become highly risky and unprofitable). Secondly, as the Federal Reserve lowers interest rates to prevent the bursting bubble from becoming a full-fledged crisis (as it has been doing in recent months), it makes dollar-denominated assets less and less attractive, since higher interest rates are available elsewhere. Finally, as low US interest rates provoke a flight from the dollar, investors holding the US buck have a greater and greater incentive to get out of it.

And even foreign central banks are doing so, albeit incrementally, under the byword of “diversifying” their holdings – i.e. reducing the percentage of international reserves they keep in dollars. In recent years, China, Russia and South Korea have all reduced the proportion of international reserves they hold in dollars. Russia, for instance, has gone from 30 per cent to 50 per cent of its reserves in currencies other than the dollar. More recently, a number of Middle East oil-exporting states have done the same. So worried are US officials by these moves that, when the United Arab Emirates was musing about dropping its currency peg to the dollar, US officials visited the UAE central bank governor to lobby against the move.

Why does the US government care about countries reducing their dollar holdings? Put simply, the ability to print dollars to pay debts is a huge imperial privilege. It is, in the words of the *Economist* magazine, as if you could “write cheques that were accepted as payment but never cashed” [6]. This privilege, known as *seigniorage*, allows the state that issues world money to appropriate a disproportionate share of global value and surplus value just by virtue of its role in the world monetary system. This has allowed the US great flexibility in financing imperial wars and it has provided an enormous boost to the US national economy, which has paid for goods with paper.

But now private investors and central banks are becoming increasingly reticent about taking ever-growing amounts of these blank cheques. Furthermore, for the first time in several generations they now have a meaningful alternative to the dollar: the euro. And many signs indicate that the euro is starting to play a larger world money role.

When it was first introduced in 1999, for instance, the euro comprised 18 per cent of all global reserves. Today it represents 25 per cent of international reserves. As a means of payment for cross-border operations, the euro now figures in 39 per cent of all such transactions, versus 43 per cent for the dollar. And in international bond markets, 49 per cent of all debt was denominated in euros in 2006, compared to 37 per cent for the dollar.

None of this is meant to suggest that the euro will simply displace the dollar. The European Union economy is not large and dynamic enough for that to happen and the dollar is still the world’s

dominant currency by a considerable measure. But these trends do suggest that the dollar's role is diminishing now that there is a viable alternative. With this in mind, Deutsche Bank predicts that the euro will constitute between 30 and 40 per cent of world reserves by 2010.

What these developments indicate is a genuine contradiction between regionally based accumulation projects. Capitals based primarily in Europe are using the European Union and its central bank to strengthen their global standing relative to American-based capitals. To be sure, capitals share convergent interests. But they are equally divided by divergent ones. Indeed, one of the keys to understanding the patterns of regional rivalry in the age of the new imperialism is to grasp the complex ways in which convergence and divergence of interests interact. The long-term conflict between the world-money capacities of the euro and the dollar figures centrally here. Without a doubt, this is not the territorially-based rivalry that was at the core of early 20th century competition among imperialist powers. But it does nevertheless involve new patterns of competition between regional political-economic projects for the appropriation of larger shares of world value.

And at the moment, the capacities of the American state look to be constrained by a declining global appetite for the dollar among investors. In 2007, for instance foreign residents borrowed \$596 billion in long-term stocks and bonds in the US, down from \$722 billion the year before [7]. This relative decline in the appetite for the dollar poses a real dilemma for the US state. In order to prop up the dollar, and retain the seigniorage privileges that boost its national economy and underwrite the financing of imperial militarism, it would have to raise US interest rates. But interest rate hikes would deepen the recession in the US (making it harder to borrow and pushing many indebted Americans into bankruptcy and default), and they might topple more indebted corporations and banks.

For the moment, the US state has chosen to try to offset the recession by keeping interest rates low. But this only depresses the value of the dollar and weakens its world money status. And this gives the US state less financial means to maneuver on the world stage. As a result, the chairman of the Federal Reserve Bank, Ben Bernanke has taken to talking up the dollar, though so far to mixed results [8].

And so, the US state confronts a dilemma: to prevent a deep slump it must pursue policies that weaken the world standing of the dollar. In the medium to longer term, however, a diminished dollar will create tighter constraints on the financial capacities of US imperial operations. This is a real and abiding contradiction and the US state is not able to wish it away.

Persistent Contradictions

If the current financial crisis illustrates anything, then, it is the persistence of fundamental contradictions of neoliberal capitalism. With an enormous "dollar overhang" sloughing through the world economy, asset bubbles regularly form – in Japanese real estate, in East Asian stock markets, in dot-com, or in US real estate. And each time, central banks intervene to *monetize* debt obligations, i.e. to give legal tender for junk. And the end result is to flood the financial system with money that will flow into yet another speculative bubble, as seems to be happening at the moment in commodities such as oil, gold and foodstuffs. Meanwhile, global dollar surpluses will continue to exert downward pressure on the value of the greenback.

Thus far the US Federal Reserve has offered up \$500 billion in US treasury bonds, effectively as good as cash, for junk on the books of banks and investment houses. The Bank of England is proceeding along the same lines.

But as they flood the system with money, these central banks also prime the pump of their nemesis – inflation. This has prompted the International Monetary Fund to issue a stern warning about rising inflation. As soon as central banks think they have stabilized the financial system, they are likely to heed the warning by turning to anti-inflation policies that will trigger corporate bankruptcies, job losses and declining living standards. Already the European Central Bank has indicated that fighting inflation is its priority and the Bank of Canada surprised observers by failing to lower interest rates in June 2008, citing worries about inflation.

Of course, capitalist classes the world over will try to make sure that working classes and the global poor bear the brunt of the inflationary hardship. And the weakness of the international left is not promising in this regard, despite important and inspiring movements of resistance, particularly in much of Latin America.

Too often, however, sections of the Left imagine that their role is to offer policies that will avert crises of capitalism. In so doing, they gravitate to a kind of Keynesian politics designed to boost demand and consumption.

It is not the job of the Left to save capitalism from itself, however. To be sure, we have an obligation to advocate and agitate for policies to protect the victims of the crisis, policies that cut against the very market logic of neoliberalism. A case in point would be campaigns for publicly-funded social housing programs at a time when, in the US, millions face foreclosure. Equally important are campaigns to raise social assistance rates in order to protect the most vulnerable.

But equally vital is a Left that names the actual contradictions of capitalism, one that addresses the disasters of the neoliberal model and publicizes the inherent conflict between capital accumulation and the satisfaction of human needs. And this requires a Left that speaks openly of *socialism* as the alternative.

We now confront a significant crisis of the neoliberal reorganization of capitalism. And every crisis represents an opportunity – for both the old order and the forces of the new. The Marxist Left is not especially well-equipped in this regard. But we must do what we can so that the forces of authentic change are better prepared when the next crisis breaks, as surely it will. To this end, it is incumbent on us to seek to understand this crisis, to agitate to protect its poorest victims, and to do the patient work of socialist education about real alternatives to the logic of the market.

NOTES

1. Karl Marx, *Capital*, v. 1, trans Ben Fowkes (Harmondsworth: Penguin Books, 1976), p. 236.
2. See *Financial Times*, May 6, 2008, and Tony Jackson, “Lack of trust lurks at the heart of banking troubles,” *Financial Times*, June 2, 2008.
3. “U.S. Foreclosures surge 48% in a year,” *Toronto Star*, June 14, 2008.
4. Sean Farrell, “The next banking crisis?” _ The Independent_, June 3, 2008.
5. Elena Moya, “Credit woes set May record,” *Reuters*, June 7, 2008
6. “The disappearing dollar,” *The Economist*, December 5, 2004.
7. *Wall Street Journal*, June 15, 2008
8. Barrie McKenna, “Bernanke endorses strong dollar,” *Globe and Mail*, June 4, 2008.

From the credit crunch to the spectre of global crisis

Chris Harman

Source : International Socialism – UK

(<http://www.isj.org.uk/index.php?id=421&issue=118>)

*There is a hierarchy of precedents for financial crises. In August, as things began to unravel, the initial comparisons were with the 1998 collapse of Long Term Capital Management. That is, a freak event in which the sins of a few egg-heads temporarily hit confidence. Then, as it became clear that banks were in pain, the comparator became the 1980s and 1990s Savings and Loan crisis that saw bank losses worth 3 percent of US economic output. Now, after a very nasty week in markets, the whispers are that it might even be the big one: the worst crisis since the 1930s.
The Lex Column, Financial Times, 7 March 2008*

THAT WAS the Lex Column of the *Financial Times* as we went to press. It displays the bewilderment afflicting those who are supposed to be providing some direction to the system as they alternate between sheer panic, fake optimism, and simply hoping things will turn out all right.

Blaming the bankers

The easiest explanation for the crisis is to blame the bankers. The crisis “follows a well-trodden path laid down by centuries of financial folly”, says Ken Rogoff, former chief economist at the International Monetary Fund.¹ Raghuram Rajan, another former IMF chief economist, thinks the problem is the vast bonuses bankers receive when they lend and borrow.² Billionaire financier George Soros blames “the financial authorities” for “injecting liquidity...to stimulate the economy”. This “encouraged ever greater credit expansion”.³ Even the French president, Nicolas Sarkozy, has joined the chorus, declaring that “something seems out of control” with the financial system.⁴ He should know, since his half-brother heads the European wing of the Carlisle Group, whose hedge fund has gone bust.

For supporters of capitalism to heap blame on the financial system is not as strange as it may seem. In so far as mainstream neoclassical economists have explanations for the slump of the 1930s, they are in terms of the operations of the money markets. The same is true of most mainstream Keynesian economists, who now believe their chance has arrived to come in out of the cold after three decades. So the *Guardian*'s Larry Elliot argues:

This is a chance, perhaps a once in a lifetime chance, to break the dependency culture by forcing big finance to be more transparent, having a clearly defined separation between commercial and investment banking, and by banning some of the more toxic

products.⁵

Deeper imbalances

Simply blaming the avarice and short-sightedness of bankers does not explain how they found it so easy to get the funds that they gambled so heavily. It also avoids asking what shape the world economy would have been in without such lending.

In their bewilderment, some strongly pro-capitalist commentators are raising such questions. For instance, Martin Wolf of the *Financial Times* writes of the crisis originating in “global macroeconomic disorder”, rather than simply “financial fragility” or “mistakes by important central banks”.⁶ Commentators such as Wolf have noted a surplus of “savings” over investment in some of the world’s most important economies. The finger is usually pointed at East Asia. The head of the US Federal Reserve, Ben Bernanke, has cursed this “saving glut in the rest of world” for feeding the upsurge of lending to the US.⁷ But surpluses have also been generated nearer to home: “Investment rates have fallen across virtually all industrial country regions”.⁸ According to one report:

*The real driver of this saving glut has been the corporate sector. Between 2000 and 2004, the switch from corporate dis-saving to net saving across the G6 [France, Germany, the US, Japan, Britain and Italy] economies amounted to over \$1 trillion... The rise in corporate saving has been truly global, spanning the three major regions—North America, Europe, and Japan.*⁹

In other words, “Instead of spending their past profits, [US] businesses are now accumulating them as cash”.¹⁰

Such an excess of saving has an effect noted by John Maynard Keynes in the 1930s—and by Karl Marx 60 years earlier. It creates recessionary pressures. The capitalist economy can only function normally if everything produced is sold. This will only happen if people spend all the income from producing goods—the wages of workers, the profits of the capitalists—on buying those goods. But if the capitalists do not spend all their profits (either on their own consumption or, more importantly, on investment) then a general crisis of overproduction can spread through the system. Firms that cannot sell their goods react by sacking workers and cancelling orders, and this in turn causes further contractions in the market. What begins as an excess of saving over investment ends up as a recession that can turn into a slump.

Keynes and his followers argued that there was a way to stop this happening. The government could intervene to encourage capitalists to spend their savings—by changing tax and interest rates to make it more profitable for firms to invest, by borrowing to undertake investment of its own, or by giving handouts to consumers to encourage them to spend. On occasion such methods have worked in the short term. Government investment or handouts have provided an immediate market for unsold goods, encouraging firms to increase their output and, as a by-product, increasing tax revenues sufficiently to pay for the extra government spending.

But there are inbuilt limits to the long term effectiveness of such methods when faced with a serious recession. Government borrowing must eventually be paid for. Otherwise the value of the currency will decline and inflation will result. If the spending is repaid by taxing profits it reduces the

incentive to invest; if it is repaid by taxing consumers, it cuts into their buying power. The measures Keynes himself recommended to British governments in the 1930s would not have been nearly sufficient to end the mass unemployment of the time,¹¹ while attempts to deal with the crisis of the mid-1970s in this way simply added rising inflation to rising unemployment.

In recent years government borrowing and spending have played a role in absorbing the surpluses created by the gap between saving and investment—particularly in the case of the US arms budget. “Official military expenditures for 2001-5 averaged...42 percent of gross non-residential private investment”, even though “official figures...excluded much that should be included in military spending”.¹² But as important as government spending has been the upsurge of borrowing by US consumers to buy things that they cannot afford out of their wages and salaries. Subprime mortgages have been central to this.

In 2001 Alan Greenspan, then head of the US Federal Reserve, encouraged the financial market to let rip and provide for such borrowing when panic over the 9/11 attacks threatened to exacerbate an already deepening recession.¹³ The Italian Marxist Riccardo Bellofiore has aptly called this reaction “privatised Keynesianism”.¹⁴ It was not just a question of a central banker doing favours for his friends who ran big private banks. As Martin Wolf recognises, “Surplus savings” created “a need to generate high levels of offsetting demand”,¹⁵ and lending to poor people provided it. “US households must spend more than their incomes. If they fail to do so, the economy will plunge into recession unless something changes elsewhere”.¹⁶ “The Fed could have avoided pursuing what seem like excessively expansionary monetary policies only if it had been willing to accept a prolonged recession, possibly a slump”.¹⁷

In other words, only the financial bubble stopped recession occurring earlier. The implication is that there is an underlying crisis of the system as a whole, which will not be resolved simply by regulating financiers. Nor, in the medium term, can the sort of action being taken by the US Federal Reserve and the Bush administration solve the problems. They have cut interest rates and taxes to boost consumption. Martin Wolf, using a metaphor from Keynes, has described this as dropping money “from helicopters”.¹⁸ But the most such measures could do would be to reflate the lending and borrowing bubble until it bursts again in a couple of years time. It may well not even achieve that.

The source of the imbalances

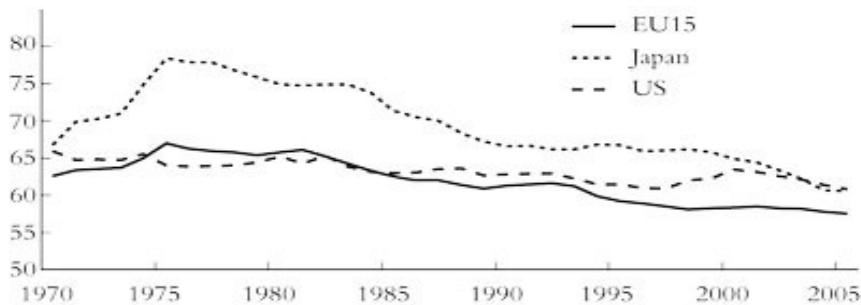
Where does the “saving-investment” gap itself come from? Why have firms failed to invest their past profits on the scale they once did?

Studies of the advanced industrial economies show that there was a big drop in average rates of profit from the end of the 1960s through to the early 1980s.¹⁹ There were recurrent bursts of recovery in the mid to late 1980s and 1990s. But by 2000 profit rates had still not risen back to the levels that had sustained capitalism’s longest boom during the quarter century after the Second World War, a time now often called “the golden age of capitalism”. The highest point they reached in the US, around 1997, was only marginally above the level that had seen the onset of the first major post-war recession in 1973-4.

As I have argued in this journal in the past, the partial recovery that did occur was based on three

things. The lower rate of profit caused a slowdown in investment, which did not rise as rapidly in relation to new profit as previously. Some firms went bust, particularly during and after the recession of the early 1990s, allowing the remainder to benefit at their expense. Most importantly, there was a general increase in the share of output going to capital as opposed to labour—in Marx’s terms an increase in the rate of exploitation (figure 1).²⁰

Figure 1: Wage share of national income (percent) *Source: OECD*



The increased rate of exploitation is not confined to the advanced industrial countries. It is also a feature of the “newly industrialising” countries of East Asia. In China, for instance, real wages have not nearly kept up with rising output, while big sections of the peasantry have probably suffered falling living standards over the last decade.²¹ As in the industrial countries, much of the saving in recent years has come from enterprises,²² although people still have to save an average of about 16 percent of their income if they are going to be able to pay bills for healthcare or to provide for their old age.

The worldwide increase in the rate of exploitation cuts the proportion of total output that workers can afford to buy as consumption goods. The economy is therefore dependent on investment if all the goods produced are to be sold, and the failure of capital to invest creates a potentially recessionary situation that may be hidden by financial and other bubbles.

Such bubbles arise because profits are not invested productively and instead flow, via the financial system, from one speculative venture to another. Each venture seems for a time to offer above average profits—the stock exchange and property booms of the late 1980s, the dotcom boom of the late 1990s, the subprime mortgage boom of 2002-6. Although none of these are directly productive, they can, for a period, provide a boost to spending (through outlay on office buildings, spending by those managing the speculation, the conspicuous consumption needed to attract speculative funds, and so on). That leads to a short term increase in real economic output.

As the economists Boyer and Aglietta have explained, the US boom of the second half of the 1990s rested on “a growth regime whereby overall demand and supply are driven by asset price expectations, which create the possibility of a self-fulfilling virtuous circle. In the global economy, high expectations of profits trigger an increase in asset prices which foster a boost in consumer demand, which in turn validates the profit expectations... One is left with the impression that the wealth-induced growth regime rests upon the expectation of an endless asset price appreciation”.²³

This is what is happening today. The most logical explanation seems to be the continuing low long term profitability. The Marxist economist Robert Brenner has used official US statistics to produce figures that show manufacturing profit rates in 2000-5 at levels lower than in either the early 1970s

or the 1990s (although higher than in the late 1970s and 1980s). His calculations for all non-financial corporations show them as about a third lower in 2000-6 than in the 1950s and 1960s, and about 18 percent lower than in the early 1970s.²⁴

Some commentators hold a different view on trends in long term profit rates. They believe that profit rates have been completely restored by increasing exploitation. This is held to be particularly true in the US, where increased productivity over the past seven years has been accompanied by stagnating wages and the loss of one in six manufacturing jobs. Martin Wolf asserts that “on average, US companies are in decent shape”.²⁵ The OECD *World Outlook* asserts that “the non-financial corporate sector is healthy”.²⁶ The French Marxist Michel Husson was already accepting eight years ago that there were “high levels of profitability”.²⁷ Today he writes of “a spectacular re-establishment of the average rate of profit since the mid-1980s”.²⁸ Another leading Marxist economist Fred Moseley wrote recently, “The rate of profit appears to be more or less fully restored” without “a deep depression characterised by widespread bankruptcies that would result in a significant devaluation of capital”, which is what Marx thought “would usually be required”.²⁹

There are, however, reasons to believe that Brenner’s account of profitability is the correct one. In recent years companies have tended to exaggerate their profits in order to boost their standing on stock exchanges, to deter takeover bids and to increase the value of “stock options” given to their top managers. So in the last boom in the US, that of the late 1990s, declared profits were up to 50 percent higher than actual profits.³⁰ There are signs that the same thing has been happening over the past four or five years, with corporations concealing their level of indebtedness, while including in their declared profits proceeds from the financial bubble that have turned out to be fictional.

The mainstream economist Andrew Smithers has drawn attention to the way the profitability figures provided by companies give an exaggerated picture of what is really happening. He points out that the US’s official figures shown in the “Flow of Funds” accounts involve adjustments that have the effect of “massively boosting US net worth by the addition of ‘statistical discontinuities’ and rising property values”.³¹ In fact, the Flow of Funds accounts showed increases in “real estate worth” alone accounting for \$757 billion out of the \$1,239 billion increase in “net worth” of the whole of the non-farm, non-financial corporate sector in 2005 (while “discontinuities” accounted for another \$506 billion).³² According to Samuel DiPiazza, chief executive of PwC, one of the US’s four big accounting firms, many industrial concerns in the US have looked to finance to augment their profits in recent years and have “invested in the asset-backed and mortgage-backed securities”.³³

In other words, much of the apparent profitability of US corporations has depended upon the way the bubble increased the paper value of their financial and real estate assets well above their underlying real value.

Fred Moseley notes the way in which corporations have been hiding their level of debt by “the increasing transfer of debt from the books of non-financial corporate businesses to ‘special purpose vehicles’”.³⁴ But hidden debt of this sort suggests that profitability on investments made in the past has not been as high as claimed, and that Brenner’s account of relatively low profit rates would seem to be correct.

Finally, even if average profitability had risen as much as is sometimes claimed, it would not necessarily have been enough to raise the level of investment. Martin Wolf added a rider to his assertion that on average companies were in “good shape”, to the effect that there is a “fat tail” of

companies with low profitability and heavy debt.³⁵ In other words, even if some companies have profits high enough to undertake large scale productive investment, there are many others that do not (among them are such giants as General Motors and Ford). This would leave investment in the economy at a low level, leading to a repeated tendency to recession.

What happens next?

The present financial crisis is a symptom of the same underlying problem that has plagued world capitalism since the mid-1970s. Increased exploitation has been able to stop a further downward plunge in the rate of profit, and even to restore it somewhat. But it has not been able to bring it back to a level that will persuade capital to invest sufficiently to avoid recurrent recessions. And the omens this time round look serious.

This is recognised even by many of those who see it as caused by runaway finance. They see that only the most drastic remedies can put a check on it, but that such remedies could precipitate a deep recession. Soros, for instance, argues that “credit expansion must now be followed by a period of contraction because some of the new credit instruments and practices are unsound and unsustainable”,³⁶ but then worries that the outcome might be not just a US recession but a world slump.

The spread of recession increases the problems of the financial sector and spreads them to part of the productive sector. It makes it impossible for all sorts of very big borrowers to recover enough of what they have lent to repay what they owe. Nouriel Roubini of New York University’s Stern School of Business sees “a rising probability of a ‘catastrophic’ financial and economic outcome” with “a vicious circle where a deep recession makes the financial losses more severe and where, in turn, large and growing financial losses and a financial meltdown make the recession even more severe”.³⁷

Such fears explain the behaviour of the US Federal Reserve and the Bush government. They are afraid of the crisis deepening, and so are pouring money into the system with a series of interest rate reductions and with the first tax cuts that have benefited anyone apart from the very rich. It is an approach that has led the *Wall Street Journal* to accuse Bernanke of being a “Keynesian”.³⁸

Such a policy really amounts to trying to overcome the collapse of one bubble by inflating another one. But that is likely to add to inflationary pressures at a time when food prices worldwide are soaring and oil prices are at a record level. It also risks provoking a loss of faith in the value of the dollar when it is already falling in value against currencies such as the euro. The fact that the US authorities are prepared to take such a risk, with the potential damage to US global hegemony it entails, is a sign of how seriously they take the situation.

Yet the approach shows signs of failing. It faces all the problems that have beset mainstream Keynesian attempts to deal with crises in the past. The tax cuts are not on anything like the same scale as the private loans that people are now under enormous pressure to repay, while the cuts in interest rates are not feeding through. As Wolfgang Müncher argues:

*The US Federal Reserve has cut short term rates by a cumulative 225 base point, yet borrowing costs for US consumers and companies have gone up. While the European Central Bank has stoically kept short term interest rates at 4 percent, rates charged to consumers and companies have increased.*³⁹

To have more than a short term effect, the US government would have to be putting enough money into people's pockets not only to absorb the worldwide surplus of saving over investment, but also to reassure them that they do not need to save it in order to protect themselves against the impact of a slump. Giving banks or people the incentive to use their money is not the same as making sure they do so. That is why mainstream economists are quoting Keynes's adage that you "can't push on a string".

It is also why some mainstream commentators are convinced that the US government will be forced to go much further. So George Magnus, chief economic adviser to the UBS financial services company, argues that the cost of nationalising Northern Rock is "pretty small beer compared with the kind of activities which I think are going to take place in the United States...a bailout for homeowners in the United States is as close to a surefire thing as I can imagine. The losses on mortgages are so high and the stories and estimates which...people make about repossessions and delinquencies in the housing market are so high that, especially in a presidential election year, I think it's just inevitable that there will be very strong action".⁴⁰

But then Magnus holds that this crisis is much more serious than the collapse of the Long Term Capital Management hedge fund in 1998, the Stock Exchange Crash of 1987 or the Mexican crisis of 1995. "This is different: (a) because it's big; (b) because it's widespread; and (c) because it is about solvencies, not just about liquidity. And solvency requires a totally different policy approach than just a liquidity problem." Crises of liquidity occur when firms are profitable but lack the cash to pay their immediate bills; crises of solvency occur when they are operating at a loss.

Müncher sees this as a "hugely contagious solvency crisis" and suspects that "we will ultimately end up with some combination of regulatory relief, fiscal bailouts, nationalisations and many, many bankruptcies of financial institutions that are not too big to fail".⁴¹

Two nightmares haunt defenders of the system. One is the great slump of 1929-33. This is not completely off key. There are similarities between what happened in the 1920s and what has happened in recent years. In both cases profit rates were stopped from falling from previously fairly low levels by increased exploitation, creating underlying imbalances between production and consumption that were bridged, for a period, by speculation, unproductive use of resources, and lending to finance consumption.⁴² Then, as now, it only required the bubble to deflate for the underlying imbalance to make itself felt.

There is, however, one important difference. The level of government spending, especially military spending, in the US is much higher today. As noted earlier, this has played a role alongside private borrowing in maintaining demand in recent years. Short of the US state going bankrupt this government spending provides a floor below which the American economy will not sink. Weaker capitalisms may not, however, be so fortunate.

The second, slightly less frightening, scenario is what happened to Japan in the early 1990s. The collapse of a boom based on a real estate bubble resulted in a long period of near stagnation that has not yet come to an end 16 years later. The losses incurred by the Japanese banks were around the same level as those incurred so far in the US (losses that could well double in the months ahead). Nevertheless, most mainstream commentators are keen to stress that the US today is different—in particular that the Federal Reserve is not making the supposed "mistakes" made by Japan's central bankers. But that rests on the assumption that the root of both crises lay purely in finance, and not in tendencies in the productive sector of the economy as well. In fact problems of profitability in the

productive sector played a big role in Japan⁴³ and, as we have seen, they are central to what is happening now.

Japanese capitalism has, of course, survived, despite growing so slowly. But a similar prolonged period of stagnation like that would have a traumatic effect on the US, deepening the so far unfocused bitterness to be found within its working class and shaking US global hegemony still further. It is not really so surprising that, faced with such a possibility, those who run the US state are ignoring the neoliberal credo they preach to the rest of the world.

The political impact

Economic crises in the modern world always have a political impact. This is because the biggest capitalist concerns still operate from national bases, despite all the hype about globalisation. Each relies on its own national state to defend its interests around the world against those of rival multinationals based in other national states. This is especially true at times of crisis.

Because crisis affects the various sections of global capitalism in different ways, governments and central banks react with policies that move in different directions. So over the past eight months the US Federal Reserve has been pouring money into the economy and making big cuts in interest rates; the British government, the Bank of England and the European Central Bank have been trying to restrain public expenditure and keep interest rates high; the Chinese state has been trying to slow down its economy for fear of inflation (and popular unrest) getting out of hand.

If the crisis gets more severe, the disagreements could get quite nasty, with each state trying to exert pressure on others to get its way. In the past the US state could usually use its influence on the European and Japanese governments to get them to accept some of the pain involved in solving its problems. The most famous case was the “Plaza Agreement” 23 years ago, in which the Europeans and Japanese agreed to take action together to reduce the international value of the US currency. One reason the US could get its way was that the other states were dependent on US financial and military power.

The US will try to exert similar pressures now, but it will do so from a weaker position. The most rapidly growing national economy is no longer that of Japan, but that of China—and China is nothing like as dependent on the US economically, financially or militarily as Japan was (and still is).⁴⁴ The US government can be expected to try to counter its current economic weaknesses through the use of the other tools at its disposal. This means the US showing it has the military power to determine what happens in wide areas of the world and upping the ideological barrage against those other major powers that might stand in its way. Expect more crocodile tears about the horrors in Darfur from those who have created horrors on an even greater scale in Iraq, Afghanistan, Congo-Zaire and Somalia. And expect them to create more such horrors.

It is not only internationally that financial crisis is finding political expression. Different capitals within particular countries are differentially affected by the crisis—it has hit Lloyds and Barclays to a different degree to Northern Rock—and they are attracted to different ways of trying to resolve it. Those who look to serve the interests of capital pull in different directions, develop different perspectives and denounce each other when things go wrong. In the process capitalist hegemony itself can be damaged, particularly in the weaker capitalist states worst hit by the crisis.

We can expect further political ructions in Britain, precisely because the economy has become more

dependent on finance as a source of profits (and a centre of employment) over the past two decades than any other advanced industrial state.⁴⁵ Wolfgang Müncher even holds that “the UK economy is about to undergo a downturn at least as large as that of the US—maybe even worse, because of an even more inflated housing market and because the financial sector constitutes a larger share of gross domestic product”.⁴⁶

Mervyn King, the governor of the Bank of England, has reacted to these problems by calling for “a genuine reduction in our standard of living compared to where it would otherwise have been”.⁴⁷ New Labour, of course, is intent on trying to achieve that through continuing its cuts in real public sector wages for at least another two years, even as food and energy prices soar and those who took advantage of cut rate mortgage deals in recent years face a massive escalation of housing costs.

The inevitable bitterness can have a big ideological fallout. Any recession exposes the claims that are always made during booms, however short lived, about the wonders of capitalism. Martin Wolf, a staunch defender of the system, fears that “the combination of the fragility of the financial system with the huge rewards it generates for insiders will destroy something even more important—the political legitimacy of the market economy itself—across the globe”.⁴⁸

Such worries over “legitimacy” explain the New Labour government’s attempts to avoid nationalising Northern Rock, even after it became clear that this was the only way to stop a collapse that would further damage the rest of the financial system. Nationalisation as such is not necessarily inimical to capitalism. It was a characteristic feature even of some of the most right wing regimes in the period from the early 1930s to the mid-1970s. Nor is it some peculiar aberration in the present period. Governments, including those often called “neoliberal”, have repeatedly taken over the running of parts of endangered national banking systems to capitalist applause in the past two decades (Chile in the early 1980s, the US in the late 1980s, Japan in the 1990s).

However, such actions stand in clear contradiction to the way neoliberal ideology is used to try to legitimise the current phase of capitalism. That ideology portrays the market as a mechanism of superb efficacy that must not under any circumstances be interfered with. Every time nationalisation is carried through, even the most thorough capitalist form of nationalisation, it challenges that view. It shows that conscious human action can override the supposedly natural laws of the market—and raises the questing of why that action cannot be in the interests of the mass of people rather than in the interests of capital.

Many more such questions are going to be raised as the effects of the monetary crisis work their way through the system. And they will do so as the different national governments try to pass the burden on to those who labour for capital. No wonder it is not only the bankers who are worried as well as bewildered.

Notes

¹: Quoted in the Independent, 19 January 2008.

²: Quoted By Martin Wolf, Financial Times, 15 January 2008.

³: Financial Times, 22 January 2008.

⁴: Quoted on the Financial Times website, 29 January 2007.

⁵: Guardian, 24 January 2008.

- 6: Financial Times, 22 January 2008.
- 7: Quoted in Godley, Papadimitriou, Hannsgen and Zezza, 2007.
- 8: Terrones and Cardarelli, 2005, p92.
- 9: “Corporates are Driving the Global Saving Glut”, JP Morgan Securities, 24 June 2005.
- 10: Papadimitriou, Shaikh, Dos Santos and Zezza, 2005.
- 11: Harman, 1996.
- 12: Magdoff, 2006, p5. Net physical investment by non-farm, non-financial corporate business in the US in 2006 amounted to \$299 billion, the US military budget \$440 billion.
- 13: For a longer account of the emergence of the subprime crisis, see Lapavitsas, 2008.
- 14: Speech at the Historical Materialism conference, London, November 2007.
- 15: Financial Times, 22 January 2008.
- 16: Martin Wolf, Financial Times, 21 August 2007.
- 17: Martin Wolf, Financial Times, 22 January 2008.
- 18: Martin Wolf, Financial Times, 12 December 2008.
- 19: For detailed analysis, see Harman, 2007a.
- 20: The usual measures of the shares of capital and labour, as in the graph shown here, give only a rough indication of the trend in the rate of exploitation, since, for Marx, surplus value extracted from productive labour also pays for a mass of “unproductive” activities that serve to bolster capitalism (such as the forces of “law and order”, the military and the financial system). For simplicity I use the conventional measures here.
- 21: For more on this, see Charlie Hore’s article in this issue.
- 22: Terrones and Cardarelli, 2005, Box 2.1, p96.
- 23: Aglietta, 2000, p156. The discussion between Aglietta and Boyer was indicative of a situation where their Regulation School’s effort to explain the long term trajectory of capitalism was coming adrift. For a comment on this, see Grahl and Teague, 2000, pp169-170. For an early critique of the Regulation School, see Harman, 1984, pp141-147.
- 24: Handout provided to participants in the Historical Materialism conference, London, November 2007.
- 25: Financial Times. 19 February 2008.
- 26: Quoted by Andrew Smithers, response to “America’s Economy Risks Mother Of All Meltdowns”, economists’ forum, Financial Times website, 20 February 2008.
- 27: Husson, 1999.
- 28: Husson, 2008.
- 29: “Is the US Economy Headed for a Hard Landing?”, www.mtholyoke.edu/~fmoseley/hardlanding.doc
- 30: The Economist, 23 June 2001, quoted in Harman, 2001. For the same phenomenon in the late 1980s, see Harman, 1993.
- 31: Andrew Smithers, response to “America’s Economy Risks Mother Of All Meltdowns”, economists’ forum, Financial Times website, 20 February 2008.
- 32: “Flow of Funds Accounts of the United States, Flows and Outstandings, second quarter 2007”, Federal Reserve statistical release, p106, table R102, www.federalreserve.gov/RELEASES/z1/20070917/ The “discontinuities” figure jumped by \$323 billion between 2005 and 2006-equivalent to nearly a fifth of the increase in net worth for the whole sector.
- 33: Quoted in Financial Times, 6 February 2008.
- 34: “Is the US Economy Headed for a Hard Landing?”, www.mtholyoke.edu/courses/fmoseley/HARDLANDING.doc

- [35:](#) Financial Times, 19 February 2008.
- [36:](#) Financial Times, 22 January 2008.
- [37:](#) Quoted by Martin Wolf, Financial Times, 19 February 2008.
- [38:](#) Wall Street Journal, 18 January, 2008.
- [39:](#) Financial Times, 10 March 2008.
- [40:](#) Interview on the Financial Times website, 25 February 2008.
- [41:](#) Financial Times, 10 March 2008.
- [42:](#) For accounts of the origins of the crisis of 1929-33, see Corey, 1934, and Harman, 1984, chapter two.
- [43:](#) For criticism of views that ignored the fact that the crisis developed in the non_financial sector, see Kincaid, 2001.
- [44:](#) This point was made by Peter Gowan at a public lecture at the London School of Economics in February 2008-and repeated in a comment on the Financial Times online economists forum on 21 February by Robert Wade, who chaired the lecture.
- [45:](#) See Harman, 2007b.
- [46:](#) Financial Times, 24 February 2008.
- [47:](#) Press conference on the Bank of England's February inflation report, quoted in Financial Times, 28 February 2008.
- [48:](#) Financial Times, 15 January 2008.

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Devastating Crisis Unfolds

Bob Brenner

Source : Solidarity Against The Current – USA

(<http://www.solidarity-us.org/node/1297>)

THE CURRENT CRISIS could well turn out to be the most devastating since the Great Depression. It manifests profound, unresolved problems in the real economy that have been — literally — papered over by debt for decades, as well as a shorter term financial crunch of a depth unseen since World War II. The combination of the weakness of underlying capital accumulation and the meltdown of the banking system is what's made the downward slide so intractable for policymakers and its potential for disaster so serious. The plague of foreclosures and abandoned homes — often broken into and stripped clean of everything, including copper wiring — stalks Detroit in particular, and other Midwest cities.

The human disaster this represents for hundreds of thousands of families and their communities may be only the first signal of what such a capitalist crisis means. Historic bull runs of the financial markets in the 1980s, 1990s and 2000s — with their epoch-making transfer of income and wealth to the richest one per cent of the population — have distracted attention from the actual longterm weakening of the advanced capitalist economies. Economic performance in the United States, western Europe and Japan, by virtually every standard indicator — the growth of output, investment, employment and wages — has deteriorated, decade by decade, business cycle by business cycle, since 1973.

The years since the start of the current cycle, which originated in early 2001, have been worst of all. GDP (Gross Domestic Product) growth in the United States has been the slowest for any comparable interval since the end of the 1940s, while the increase of new plant and equipment and the creation of jobs have been one third and two thirds, respectively, below postwar averages. Real hourly wages for production and non supervisory workers, about 80% of the labor force, have stayed roughly flat, languishing at about their level of 1979.

Nor has the economic expansion been significantly stronger in either western Europe or Japan. The declining economic dynamism of the advanced capitalist world is rooted in a major drop in profitability, caused primarily by a chronic tendency to overcapacity in the world manufacturing sector, going back to the late 1960s and early 1970s. By 2000, in the United States, Japan and Germany, the rate of profit in the private economy had yet to make a comeback, rising no higher in the 1990s cycle than in that of the 1970s.

With reduced profitability, firms had smaller profits to add to their plant and equipment, as well as smaller incentives to expand. The perpetuation of reduced profitability since the 1970s led to a steady falloff in investment, as a proportion of GDP, across the advanced capitalist economies, as well as step-by-step reductions in the growth of output, means of production, and employment.

The long slowdown in capital accumulation, as well as corporations' repression of wages to restore their rates of return, along with governments' cuts in social spending to buttress capitalist profits,

have resulted in a slowdown in the growth of investment, consumer and government demand, and thus in the growth of demand as a whole. The weakness in aggregate demand, ultimately the consequence of the reduction in profitability, has long constituted the main barrier to growth in advanced capitalist economies.

To counter the persistent weakness of aggregate demand, governments, led by the United States, have seen little choice but to underwrite ever greater volumes of debt, through ever more varied and baroque channels, to keep the economy turning over. Initially, during the 1970s and 1980s, states were obliged to incur ever larger public deficits to sustain growth. But while keeping the economy relatively stable, these deficits also rendered it increasingly stagnant: In the parlance of that era, governments were getting progressively less bang for their buck, less growth of GDP for any given increase in borrowing.

From Budget-Cutting to Bubblicomics

In the early 1990s, therefore, in both the United States and Europe, led by Bill Clinton, Robert Rubin and Alan Greenspan, governments moving to the right and guided by neoliberal thinking (privatization and slashing of social programs) sought to overcome stagnation by attempting to move to balanced budgets. But although this fact does not loom large in most accounts of the period, this dramatic shift radically backfired.

Because profitability had still failed to recover, the deficit reductions brought about by budget balancing resulted in a huge hit to aggregate demand, with the result that during the first half of the 1990s, both Europe and Japan experienced devastating recessions, the worst of the postwar period, and the U.S. economy experienced the so-called jobless recovery. Since the middle 1990s, the United States has consequently been obliged to resort to more powerful and risky forms of stimulus to counter the tendency to stagnation. In particular, it replaced the public deficits of traditional Keynesianism with the private deficits and asset inflation of what might be called asset price Keynesianism, or simply Bubblicomics.

In the great stock market runup of the 1990s, corporations and wealthy households saw their wealth on paper massively expand. They were therefore enabled to embark upon a record-breaking increase in borrowing and, on this basis, to sustain a powerful expansion of investment and consumption. The so-called New Economy boom was the direct expression of the historic equity price bubble of the years 1995-2000. But since equity prices rose in defiance of falling profit rates and since new investment exacerbated industrial overcapacity, there quickly ensued the stock market crash and recession of 2000-2001, depressing profitability in the non-financial sector to its lowest level since 1980.

Undeterred, Greenspan and the Federal Reserve, aided by the other major Central Banks, countered the new cyclical downturn with another round in the inflation of asset prices, and this has essentially brought us to where we are today. By reducing real short-term interest rates to zero for three years, they facilitated an historically unprecedented explosion of household borrowing, which contributed to and fed on rocketing house prices and household wealth.

According to *The Economist*, the world housing bubble between 2000 and 2005 was the biggest of all time, outrunning even that of 1929. It made possible a steady rise in consumer spending and residential investment, which together drove the expansion. Personal consumption plus housing construction accounted for 90-100% of the growth of U.S. GDP in the first five years of the current

business cycle. During the same interval, the housing sector alone, according to Moody's Economy.com, was responsible for raising the growth of GDP by almost 50% above what it would otherwise been — 2.3% rather than 1.6%.

Thus, along with G. W. Bush's Reaganesque budget deficits, record household deficits succeeded in obscuring just how weak the underlying economic recovery actually was. The rise in debt-supported consumer demand, as well as super-cheap credit more generally, not only revived the American economy but, especially by driving a new surge in imports and the increase of the current account (balance of payments and trade) deficit to record levels, powered what has appeared to be an impressive global economic expansion.

Brutal Corporate Offensive

But if consumers did their part, the same cannot be said for private business, despite the record economic stimulus. Greenspan and the Fed had blown up the housing bubble to give the corporations time to work off their excess capital and resume investing. But instead, focusing on restoring their profit rates, corporations unleashed a brutal offensive against workers. They raised productivity growth, not so much by increasing investment in advanced plant and equipment as by radically cutting back on jobs and compelling the employees who remained to take up the slack. Holding down wages as they squeezed more output per person, they appropriated to themselves in the form of profits an historically unprecedented share of the increase that took place in non-financial GDP.

Non-financial corporations, during this expansion, have raised their profit rates significantly, but still not back to the already reduced levels of the 1990s. Moreover, in view of the degree to which the ascent of the profit rate was achieved simply by way of raising the rate of exploitation — making workers work more and paying them less per hour — there has been reason to doubt how long it could continue. But above all, in improving profitability by holding down job creation, investment and wages, U.S. businesses have held down the growth of aggregate demand and thereby undermined their own incentive to expand.

Simultaneously, instead of increasing investment, productiveness and employment to increase profits, firms have sought to exploit the hyper-low cost of borrowing to improve their own and their shareholders' position by way of financial manipulation — paying off their debts, paying out dividends, and buying their own stocks to drive up their value, particularly in the form of an enormous wave of mergers and acquisitions. In the United States, over the last four or five years, both dividends and stock repurchases as a share of retained earnings have exploded to their highest levels of the postwar epoch. The same sorts of things have been happening throughout the world economy — in Europe, Japan and Korea.

Bursting Bubbles

The bottom line is that, in the United States and across the advanced capitalist world since 2000, we have witnessed the slowest growth in the real economy since World War II and the greatest expansion of the financial or paper economy in U.S. history. You don't need a Marxist to tell you that this can't go on.

Of course, just as the stock market bubble of the 1990s eventually burst, the housing bubble eventually crashed. As a consequence, the film of housing-driven expansion that we viewed during

the cyclical upturn is now running in reverse. Today, house prices have already fallen by 5% from their 2005 peak, but this has only just begun. It is estimated by Moody's that by the time the housing bubble has fully deflated in early 2009, house prices will have fallen by 20% in nominal terms — even more in real terms — by far the greatest decline in postwar U.S. history.

Just as the positive wealth effect of the housing bubble drove the economy forward, the negative effect of the housing crash is driving it backward. With the value of their residences declining, households can no longer treat their houses like ATM machines, and household borrowing is collapsing, and thus households are having to consume less.

The underlying danger is that, no longer able to putatively “save” through their rising housing values, U.S. households will suddenly begin to actually save, driving up the rate of personal savings, now at the lowest level in history, and pulling down consumption. Understanding how the end of the housing bubble would affect consumers' purchasing power, firms cut back on their hiring, with the result that employment growth fell significantly from early in 2007.

Thanks to the mounting housing crisis and the deceleration of employment, already in the second quarter of 2007, real total cash flowing into households, which had increased at an annual rate of about 4.4% in 2005 and 2006, had fallen near zero. In other words, if you add up households' real disposable income, plus their home equity withdrawals, plus their consumer credit borrowing, plus their capital gains realization, you find that the money that households actually had to spend had stopped growing. Well before the financial crisis hit last summer, the expansion was on its last legs.

Vastly complicating the downturn and making it so very dangerous is, of course, the sub-prime debacle which arose as direct extension of the housing bubble. The mechanisms linking unscrupulous mortgage lending on a titanic scale, mass housing foreclosures, the collapse of the market in securities backed up by sub-prime mortgages, and the crisis of the great banks who directly held such huge quantities of these securities, require a separate discussion.

One can simply say by way of conclusion, because banks' losses are so real, already enormous, and likely to grow much greater as the downturn gets worse, that the economy faces the prospect, unprecedented in the postwar period, of a freezing up of credit at the very moment of sliding into recession — and that governments face a problem of unparalleled difficulty in preventing this outcome.

[This statement was written by Robert Brenner, a member of the Against The Current editorial board and author of 'The Economics of Global Turbulence'. References for all data cited here can be found in this book, especially in the Afterword.]

The Sub-Prime Market Crisis

Nomi Prins

Source : Solidarity Against The Current – USA
(<http://www.solidarity-us.org/node/1171>)

IT WASN'T UNTIL I flew to the United Kingdom on Saturday, September 15th, that the globalized nature of the sub-prime contagion really hit home, as it were, for me. On my flight over, I grabbed a copy of the UK Telegraph newspaper, the front page of which looked like something shot at a Great Depression bread line.

Following an announcement that the Bank of England would act as its lender of last resort, on September 13th scared customers queued at the doors of Northern Rock, a Scotland-based lender, in larger numbers than to a Harry Potter book release. They sought to extract their hard-earned cash, \$4 billion worth, on fears that a credit crunch would drive Northern Rock to ransack their accounts to make up for lack of liquidity.

People who never even heard of a credit crunch were talking about it the next day on every street, bus and tube. The ensuing panic caused the bank's shares to fall 35% and "BANKING CRISIS" headlines to adorn mainstream United Kingdom newspapers on September 18th.

If the financial markets weren't so exceedingly globalized, it might have been possible for the impact of the past six years of loose mortgage lending in the United States to remain contained within its borders. Even the sub-prime component that's been getting all the media attention, and wreaking national havoc as the housing market melts above it, should not have spilled overseas. Indeed, the sub-prime percentage of the overall United States mortgage market, at 15%, is three times larger than it is in other countries, like the United Kingdom. (See this [document from the Federal Reserve](#).)

Yet the financial industry's gleeful disregard for the potential risks of excessive lending, aggressively marketed to a public told that housing was a safer investment than stocks, created a virus. Incestuous trading of sub-prime and other esoteric mortgage-backed securities amongst the international banking community transmitted this virus. And as soon as substantial fears of a sub-prime-led meltdown in an already deteriorating housing market were unleashed on mainstream television — notably when investment bank Bear Stearns, announced that sub-prime defaults were destroying its credit hedge funds — the virus became a full-blown global epidemic.

The Dow, having flirted just below highs of 14,000, lost over 1000 points between mid July and mid August. International stock markets plunged in solidarity. The media began covering the sub-prime market crisis with a vengeance, and declines in housing prices, construction, related jobs and consumer confidence accelerated.

Back in the UK, following the run on Northern Rock other top banks such as Alliance Leicester plunged 30%, wiping out \$2.4 billion of the company's value. Bradford and Bingley dropped 15.4%. (The Independent, hardcopy cover, September 18, 2007) It only took two months for the average United Kingdom borrower to be impacted by the U.S. sub-prime calamity. Global contagion was consummated.

Cheap and Mad Money

The United States honors two prized exports, war and debt: We lead the world in exporting debt, Treasury or sub-prime. We also treat our purveyors of the banking system differently stateside. As Federal Reserve Chairman Ben Bernanke was being heralded a savior by the financial industry and its media as a late-to-the-table hero for cutting rates to aid market liquidity for the banking system, the governor of the Bank of England, Mervyn King, was being grilled in front of a Treasury select committee for his crisis remedy – promising to back up all of Northern Rock’s depositors, or take on Northern Rock’s bad loan problems.

Stepping back to the end of August, the U.S. business media, in the guise of CNBC’s Mad Money Jim Cramer, begged for rate cuts to help “the average homeowner.” Jim’s words “they know nothing” regarding their previous sidelined position on rates, echoed around the Internet and even made The Colbert Report.

Jim was speaking for the average American, he said — or was he? In reality, those cuts only helped the institutions that had lent money under risky and often predatory practices to begin with. They didn’t then call their distressed borrowers and pass on their new-found liquidity, or subsequently lower their rates commensurate with the Fed cuts.

In the UK the media skewered King, and the Treasury select committee (equivalent to our Senate Finance Committee) grilled Deputy Bank of England Governor, Sir John Gieve, calling him “asleep at the wheel” for ignoring signs that Northern Rock had detailed problem loans in their July interim result report. Meanwhile, the Fed cut spurred a Wall Street surge last seen in magnitude in 2003 (helping borrowers not at all). The Dow Jones rallied 335 points, or 2.5%.

There can be no doubt whom that additional liquidity helps, nor whether banks are really as stretched as they whine; consider the sign that hung at a Sovereign Bank window on Park and 20th street a week later: “Red Tag Home Equity Sale, .76% interest.” Yes, that’s right, instead of 7.45%, Sovereign in late September was giving money away. In your face credit crunch! — they were saying to prospective customers, this on their supposedly “squeezed” liquidity.

Banks always find a way to get liquidity. It’s just periodically more difficult, as when Bear Stearns’ credit funds plunged and oozed poor returns all over their investors, who publicly headed for the hills. But this time, as in the past, the Fed stepped in. That is their job, the Fed would say, to provide liquidity to the banking system. But, even so, they stop short of reprimanding banks for the practices that led to their own liquidity problems (preying on customers) or suggesting they share the spoils with those customers by resetting their loans.

Rescuing Banks, Not Borrowers

Before forecasting whether the sub-prime crisis will end anytime soon, let’s examine the numbers. The U.S. mortgage market, approximately \$11 trillion in size, encompasses about \$1.5 trillion, or 15% sub-prime loans. (See [This document from the Federal Reserve](#).) Cheap money caused those loans to balloon as a percentage, particularly over the last two years; even as housing prices stagnated. In 2006, \$600 billion new sub-prime loans were originated, compared to \$120 billion in 2001, or only 6.5% of the market.

But the general lending problem, although it’s dubbed the sub-prime problem, is not exclusively about those sub-prime loans, though the lending practice of sticking less credit-worthy (i.e. less

economically, ethnically or racially advantaged) people with higher interest rates is certainly a contributor to the housing market downturn. Banks strategically chose to prey on the least able, charging them the most on a monthly basis, bombarding them with ads, phone campaigns, and the means to borrow beyond their means.

Who couldn't see that train wreck coming? People with less money and stability having to pay comparatively more? Yeah, that was sustainable.

When the inevitable happened and borrowers couldn't make their payments, banks and lending institutions got scared. All their free-market capitalist tendencies to avoid, say, regulation of those types of loans instantly converted to tremendous support for a government bailout via the Federal Reserve — which had previously ignored the housing lending bubble and any discussion of reining in lending practices.

Until mid-August, Ben Bernanke was concerned about inflation. And there has been cost inflation in gas prices, health care costs, tuition and prescription drugs — there still is. That makes the effects of the housing decline worse — real people have to face inflationary increases in basic needs and services, plus drops in home values.

There have been other casualties; the nation's largest lender, Countrywide, announced layoffs of 3500 by the end of the year. Several Wall Street firms are bleeding out sub-prime employees. More than 150 mortgage lenders have closed their doors due to bankruptcy or unsustainable liquidity problems and lack of appropriate reserves. (See [coverage from CNN](#).)

Who's to Blame?

When there is catastrophe, there is blame. Some lenders, like Countrywide, blame the economy — a recession is causing housing prices to drop, not the impossible loans fashioned to maximally extract from the least able borrowers, nor exaggerated appraisals to increase mortgage balances. Developers could be blamed for dumping supply onto an already saturated market. The media could be blamed for perpetuating the post-dot.com and Enron myth that your home can never decline like the stock market can. And yes, even borrowers could be blamed for not being more responsible; they shouldn't have bought what they couldn't afford.

According to the November 2006 Demos "House of Card" report, Americans tapped into their home equity in record volume during the past five years; they cashed in \$1.1 trillion (roughly 10% of the mortgage market) in home equity loans since 2001. Thus Americans have less equity in their homes than in the 1970s or early '80s.

This borrowing frenzy exacerbated the looming crunch for the average American. People paid off credit cards with their homes — thereby swapping five-year debt (albeit at stupidly high interest rates) with longer-term, 30-year debt using their homes as collateral. Their credit cards were used to pay for the basic needs in many cases, but with the thought that rising home equity would remain available to offset them.

The cheap money that banks were offered in 2001 and 2002, enabled by former Fed chairman Alan Greenspan, created advantages and disadvantages — for banks. The advantage was that banks had more to lend, the disadvantage was that they they made less margin — which is why they had to think of ways to increase volume to compensate.

The banks cast a wider net for profits. They lured in more sub-prime borrowers; decreased

requirements for down payments as a percentage of overall loan size for all borrowers; and took advantage of the psychological attractiveness of low rates by pushing adjustable-rate mortgages (ARMs) which start with lower, than reset to higher rates, and interest-only mortgages (IOs) which start with smaller interest payments and subsequently reset to higher payments including interest and principal later.

Banks assumed further that in the event of foreclosure, the rising market would provide a perfect environment for profiting from reselling any foreclosed property. This was the same argument used by hedge funds to pursue institutional investors' money to purchase packaged bunches of sub-prime loans.

The only problem: Exuberant development led to a glut of supply. With that, coupled with resetting loans accompanied by higher monthly payments causing individual cash crunches, the housing market stopped rising, and the idea of selling a default property into a saturated market lost appeal.

Then the loan chickens came home to roost. According to the Demos Report, approximately, \$1.4 trillion ARMs reset in 2006 and 2007 (\$400 billion in 2006 or 5% of outstanding debt, and \$1 trillion in 2007 or 12 %.) On average, affected borrowers will shell out 25% more on monthly payments. Additionally, 20% of the mortgage market since 2005 is comprised of IOs, yet to reset to include principal pay downs.

The other nail in the housing problem coffin is the home appraisal. Appraisal fraud (consisting of appraising homes at higher values than their market worth, to enable lenders to lend, and thus reap interest payments back from, bigger balances) increased seven fold since 1999. (See Demos Report.)

Finally, lack of liquidity in the market is a self-fulfilling prophesy. If people don't have real equity in their homes, they can't borrow more against it, meaning they won't spend that extra money on their homes, or the general economy. This will cause contractions in consumer spending, and consumer confidence (at a four-year low).

People will move less, causing relocation companies strife. They will improve homes less, causing companies like Home Depot anguish. Construction will continue to decline, one of the reasons that mega-developer Lennar is cutting 35% of its workforce. Repercussions will keep reverberating through the real economy.

Silver Linings?

For the real people facing foreclosure, clawing back will be painful. Unfortunately, there's no magic wand that will remove the oncoming pain, but there are ways to reduce its force and create a safer lending environment for the future. For instance, bankruptcy laws should enable people to protect their homes in the event of having to declare bankruptcy.

Congress should address appraisal fraud. They should also enact measures to protect borrowers from excessive rate increases, fees and unforeseen charges. At the end of the day, this will also protect banks and lenders from delinquency and default volatility that hurts their liquidity and profit margins, but will have the more important added benefit of helping the general home-owning population.

For those who never got into the real estate game, the news is slightly brighter on one accord — rent. Rents in the United States will decline. All those developers who promised speculators great

deals that they could transform into rental income are sitting on excess inventory. If one can't sell property, they can rent it. But if a lot of property doesn't sell, then there's a lot more rental inventory for renters to choose from, this makes finding rental property an easier prospect, at cheaper levels.

The other good news for homeowners is that the foreclosure process takes time, five to 18 months. Banks really don't want to take possession of a plethora of unsellable properties (if they were sellable, borrowers could have sold them and rented instead). This means that homeowners facing increased rates or unpayable debt have more negotiation power than the media or lenders would have them think. The problem could be contained for the homeowner as well, since the market will contain supply.

Americans can also take some solace from Wall Street activity, even as housing prices have not yet bottomed out. Three months after Bear Stearns' stock price tanked amidst sub-prime issues, billionaire Warren Buffet is rumored to be making a bid for 20% of the firm. He is obviously less concerned about continued downside to that portfolio, or the firm, not least because of interest rate cut gifts from the Fed and the general resilience and ingenuity of Wall Street.

Why No Outrage ?

Editors of The Monthly Review

Source : Monthly Review – USA

(<http://www.monthlyreview.org/nfte080901.php>)

JUST OVER A YEAR since the beginning of the worst U.S. financial crisis since the Great Depression, and only six months after the federal bailout of Bear Stearns, the seizing up of credit markets continues. The failure of eight U.S. banks this year, including IndyMac, and the recent instability that struck the two government-sponsored mortgage giants, Fannie Mae and Freddie Mac, requiring a special government rescue operation, has had the entire financial world on edge. Mortgage-related losses by themselves “could cause a trillion dollars in credit to vaporize,” according to a special July 28, 2008, *Business Week* report. The downside effects of financial leveraging (the magnification of results associated with borrowed money) mean that each dollar lost by financial institutions could lead to reductions in lending of fifteen dollars or more, creating a shockwave so massive that it could reveal structural weaknesses throughout the economy. Already the economy is reeling, with faltering growth, a deep slump in housing, massive job losses, rapidly rising oil and consumer goods prices, and a falling dollar.

Yet, the good news from the standpoint of capital is that the financial system has been stabilized somewhat (though the crisis is far from over) as a result of repeated government rescue operations, essentially socializing the losses of private investors, on the principle that the financial entities concerned are “too big to fail.” The Federal Reserve Board’s assets in June 2007 consisted almost entirely (92 percent) of Treasury securities. Now these amount to just 54 percent of the Fed’s assets, and have been replaced by, among other things, loans to financial institutions whose shares have been falling. Moreover, as a result of the Bear Stearns rescue and subsequent Fed interventions, the public now bears the risk on a lot of collateralized mortgage obligations, i.e., largely worthless paper assets—a further cost to the taxpayers.

This raises an important question: “Why No Outrage?” This is the title of an article by longtime gold bull James Grant, editor of *Grant’s Interest Rate Observer*, writing in the July 19, 2008, issue of the *Wall Street Journal*. Why is it, Grant asks, that “America’s 21st century financial victims,” the general public, “make no protest against the Federal Reserve’s showering dollars on the people who would seem to need them least?...Have the stewards of other people’s money not made a hash of high finance? Did they not enrich themselves in boom times, only to pass the cup to us, the taxpayers, in the bust?” Why, he asks, is there no populist outburst, in the historic tradition of U.S. society? Further, why, in the context of a 2008 presidential contest, are the candidates of the two major political parties virtually silent on the extent of the robbery taking place, and even on the financial crisis itself? “The American people,” he writes, “are famously slow to anger, but they are outdoing themselves in long suffering today.”

The fact that such questions are being asked in the leading U.S. financial paper by a noted financial analyst should give us reason to pause. Moreover, the answers that Grant gives to his questions are as interesting as the questions themselves: “Possibly, in this time of widespread public participation in the stock market, ‘Wall Street’ is really ‘Main Street.’ Or maybe Wall Street, its old self, owns both major political parties and their candidates. Or, possibly, the \$4.50 gasoline price has absorbed every available erg of populist anger, or—yet another possibility—today’s financial failures are too

complex to stick in everyman's craw."

Grant's own preferred explanation is that the populists really won in the days of the New Deal and later, and now, due to the expansion of the state's role, Wall Street has become so "hand-in-glove with the government" that the space for political opposition within the system has evaporated. To be sure, he writes, "government is...—in theory—by and for the people." But even that, he suggests, is not enough to explain the lack of public angst, which remains largely a mystery.

Although we have long been opposed (and remain so) to views that place monetary policy at the heart of explanations of the course of modern capitalism—a perspective that Grant is identified with—we nevertheless agree with his assessment here that the state and finance are in bed with each other (or have at least closed ranks in the crisis, representing a common ruling-class viewpoint). This also extends to the two major political parties and their candidates. And it includes the media, which ought to be raising a stir. The silence in the context of a general election speaks volumes. We also find ourselves in accord with Grant's conclusion that in the end there seems to be no completely satisfactory explanation for lack of popular protest over a series of *ad hoc* grants showering hundreds of billions of dollars of public money on the masters of finance, collectively the richest group of capitalists on the planet. And that raises the question: Is this outrage present nonetheless, growing underground, unheard and unseen? Will it suddenly burst forth, like some old mole, unforeseen and in ways unimagined? That too, we think, is a possibility.

The July 28 *Business Week*, through Michael Mandel its chief economist, offers this hopeful perspective from a ruling-class standpoint: Nothing will happen until after the election and then the next president will most likely act immediately to initiate a massive bailout of the entire mortgage-based financial system. A new president, *Business Week* presumes, will have sufficient political clout to socialize private losses even more fully at the expense of the taxpayers, without generating a public revolt. The truth is that the last thing that the capitalist class wants is an explosion of outrage and the destabilization of what for them is a good thing indeed...vast profits from speculative bubbles, plus the government's increasing absorption of losses on the downside: all paid for by an acquiescent or oblivious public. It is win-win for capital, and lose-lose for everyone else. In 2006 the richest 1 percent of the U.S. population received their highest share of the nation's adjusted gross income in two decades, and maybe since the 1929 stock market crash, while their average tax rate fell to the lowest level in eighteen years or more (*Wall Street Journal*, July 23, 2008). Needless to say, the object of capital as a whole is to keep this game going as long as it can.

Will The U.S. Nationalize The Banks?

Dan La Botz

Source : Znet, where the Spirit of Resistance lives – USA
(<http://www.zcommunications.org/znet/viewArticle/18956>)

THE POLITICAL CONFLICT over the Bush administration's plan for a bailout of the banks, brought about both by differences with the Democrats and even more intensely with rightwing Republicans, makes it highly unlikely that Congress will be able to pass a bailout plan that can stabilize the financial situation along the lines that Secretary of the Treasury Henry Paulson originally asked for. Paulson wanted a \$700 billion check to clean up the banks' books by taking their bad loans off their hands. Many believe the price tag would ultimately come to a trillion dollars. He simply wanted taxpayers to save the banks. While a minority of rightwing Republicans reject the fundamental basis of the plan, the Democrats would add conditions -- Congressional oversight, better terms for homeowners, limits on executive salaries, and other items -- which would (from the bankers' point of view) weaken the plan and limit its effectiveness.

Even if Congress can quickly arrive at an agreement with the Bush administration and Secretary Paulson about the bailout, the financial situation and the economic situation in general will very likely continue to deteriorate. The underlying problems facing American capitalism -- the failure of the United States in Afghanistan and Iraq, the decline of the United States as a world power, the rising cost of petroleum, the continuing and increasing competition from Europe and Japan, and now the ascendancy of China -- make it very likely that the country's economic power will also deteriorate. Beyond that are structural and systemic weaknesses in the American economy and society as a result of globalization which have caused a deep disjuncture between the vision of the United States as a post-modern, high-tech economy and the reality of a nation with a crumbling infrastructure, a disintegrating public education system, inadequate health insurance, and persistent problems of poverty. And, of course, the economy is in a recession.

Whatever the ultimate bailout plan, the financial situation could well continue to unravel and begin to affect credit and the broader economy, leading to a deep recession or depression. The U.S. Congress, both Democrats and Republicans, might then be forced -- despite their deep aversion to any form of government ownership -- to not only bail out the banks but to *buy them*. The increasingly popular sentiment that the bankers should be made to pay for the crisis opens the door to the notion of nationalization of the banks. What would it mean to have the government own the banks?

Historically the Populists, various labor parties, and the Socialist and Communist left have raised the slogan of nationalization of the banks as part of a process of bringing about socialism. Their argument has been that if the banks were owned by the government, and the government was controlled by the people, we could democratically plan an economy to meet the needs of all.

Nationalization of the banks would form part of a plan of socialization of the economy -- banks and corporations, mines and factories, airlines and railroads -- brought under the control of a combination of citizens, workers and consumers. We would put our children, the elderly and the infirm first, and organize the economy to provide jobs, housing, health care, education, and retirement benefits for all. Bank nationalizations have usually just been a stage in the boom-bust cycles of modern economies, a period when the state lends its strength to finance to see it through hard times, and once finance has recuperated, returns it to its private owners to continue to reap the benefits of wealth plus interest.

When Governments Nationalize the Banks

In recent history governments have nationalized banks when the pressures of internationalized financial markets and international competition have made it difficult for them to control and stabilize their finances and currency. During the last couple of decades, countries as different as Mexico, France, Sweden and Japan carried out partial or more or less complete bank nationalizations to regain control of the financial situation.

Japan's experience more than a decade ago was much like that of the United States in many ways. After a period of great productivity and prosperity in the 1980s, in the early 1990s, Japan's housing bubble burst, leaving Japanese banks holding sheaves of bad loans. The Japanese housing boom collapsed just as China began to become an export competitor.[1] After neglecting the problem for some time the Japanese government intervened, spending \$440 billion dollars of its taxpayers' money to nationalize the weakest banks, infuse capital into the stronger banks, and to protect depositors.[2] Japanese banks were required to create a Business Revitalization Plan, at the center of which was a capital / asset ratio. Some economists and journalists have suggested that Japan's solution -- partial nationalization and partial financial support for private banks -- could provide a model for the United States in the current crisis.

Sweden handled its financial crisis of the early 1990s through a quasi-nationalization. The Swedish Social Democrats -- not the conservatives -- had deregulated the banks in the 1980s. But in the early 1990s Swedish real estate values began to fall and banks were left holding bad loans. Sweden spent \$11.7 billion to rescue its banks but in return received warrants, that is paper granting the government the right to buy stock in the banks whenever it wished. This constituted a quasi-nationalization of the banks restoring public confidence. As part of the Swedish deal, banks had to write down their losses, sell their distressed assets, and later the government sold the shares it held in the banks.[3] The government's temporary control allowed the financial situation to stabilize, and the re-privatized banks reentered the national and global financial markets strengthened, but still subject to the on-going, world wide crisis of capitalism.

Both Mexico and France both nationalized their banks in the 1980s in response to international financial pressures and international competition. In Mexico, the government of President López Portillo raised the banner of the Mexican Revolution as he nationalized the banks in an attempt to regain control of finances and to stop capital flight abroad. In France, the Socialist and Communist parties and the middle class Radical party had adopted in 1972 the Common Program of the Left, which called for the nationalization of the banks. But in France too it was the new international character of finance which led the government to nationalize the banks in large part to get control of the expanding money supply.[4]

Lessons of the Experience

Without going into all the details of the Japanese, French and Mexican cases, we can note some similarities in the experience of nationalization of the banks. First, an important sector of bankers resisted nationalization, and when finally forced by the government to relent, fought for higher compensation for their property than originally offered, and usually won. Second, in none of these cases was bank nationalization complete, with some domestic and foreign banks usually excluded. Third, where banks were more completely nationalized, the bankers opened new financial institutions which tended to engage in banking functions and significantly drained off capital. In general, bank nationalization tended to contribute to the centralization and modernization of the banking industry as a whole. In all cases after a few years the nationalized banks were reprivatized, usually to many of the same financiers who had previously owned them.

The nationalization of banks does not necessarily represent a progressive measure nor is it a logical next step toward socialism. Government ownership of banks, at least partial ownership and sometimes complete ownership, is quite common around the world. Many capitalist nations -- both developed and developing ones -- have nationalized their banks during the twentieth century. A 2002 study of banks found that around a third of all banks were government owned, though such bank ownership was more common in the developing world.[5] In capitalist societies governments engage in the nationalization of banks to reestablish financial stability and improve their economic position in the international market, not to advance the common good.

The Slogan of Nationalization in a More Radical Time

Bank nationalization had a different character in an earlier era. During the 1930s a far more radical left than that of the 1980s had raised the slogan "Nationalize the Banks!" as part of a revolutionary, transitional or radical reformist program aiming at the establishment of socialism in a not too distant future. Socialist parties around the world had since the nineteenth century called for the nationalization of the banks, transportation and communication, industry and mining. The idea was that nationalization formed an integral part of socialization, of banks and industries which would be guided by a national economic plan elaborated democratically either by a kind of parliament or by national representatives of workers councils. For some the Soviet Union's experience -- a nationalized economy which brought about rapid industrialization and victory in World War II -- represented a confirmation of their notions of the value of centralized planning. Only later would the problems of Stalinism or bureaucratic Communism, that is, undemocratic centralized planning managed by a totalitarian dictatorship and forced labor, become clear to all.

In France, liberated at the end of World War II by a combination of Allied invasion and national resistance movement of the Maquis' guerrilla bands, there was a great revulsion against the Third Republic, the Vichy government, the French elite, and capitalism more generally. Socialist and Communist Party influence was great, and it was in this atmosphere and under this pressure that the French government nationalized the largest banks on December 2, 1945. This was a far more popular and democratic nationalization than those of the 1980s and 1990s, but it did not fundamentally change the character of French capitalism. Socialist, Communists and Christian Democrats then joined together in the Three-Party Alliance, and established the Fourth Republic.

During this first bank nationalization, the new French government established a Bank Control Commission with the power to oversee the running of both the nationalized banks and the remaining smaller, private banks. But there was also a National Credit Council appointed by the government played a key role in determining the policy of the banks. It was made up of seven members chosen for their expert financial knowledge (from the nationalized and private banks,

from the foreign trade banks and from the stock exchange), seven representatives of the country's labor unions, including the bank workers, and ten representatives of various economic interests (agriculture, cooperatives, foreign trade, shipping, chambers of commerce, and craft organizations). A cabinet minister presided over the council and the governor of the Bank of France served as vice-president.[6]

France's nationalized banks worked with the government and private industry to fulfill the 470 billion franc Monnet plan for reconstruction and development. The nationalized banks were used in particular to finance other nationalized firms, such as the gas and electric company. Often the nationalized firms were less sound and less profitable than the private corporations, so the nationalized banks became a kind of government subsidy to state industry. Whatever the left parties had envisioned when they supported nationalizing the banks at the end of the war, and some no doubt saw nationalization as a step toward socialism, it became part of the process of reconstructing European capitalism. European social democracy gave up the struggle for socialism and undertook instead the management of capitalism along Keynesian lines. While the social democratic welfare state provided reforms, it could not ultimately escape the vicissitudes of capitalism, and like the American liberal welfare states, had to bend before neoliberal reforms in the 1980s.

The Question of State Capitalism

Nationalization of the banks has usually represented a recurring stage in the experience of modern capitalism, which is to say state capitalism. At its birth, capitalism shared the cradle with the modern state. The two grew up together, two brothers testing their strength against each other, and drawing strength from the tests. As they matured, they transformed capitalism into imperialism, and used their strength to extract wealth from the societies of Asia, Africa and Latin America.

Throughout the world, including in the United States, at every stage of development government provided capitalism with a legal framework, with a domestic market, with government subsidies in the construction of infrastructure, and often with vast grants of land, lucrative contracts, and periodic infusions of capital. Government and finance have a particularly close relationship; they are practically Siamese twins sharing the same nervous and circulatory system. In the United States, the Secretary of the Treasury and the Federal Reserve Bank are the point of connection and each is as much a part of government as of finance. In the modern world, the token of and the tendency toward state capitalism is ever present.

Some have seen nationalization per se as a step toward socialism. In the nineteenth century, some argued that state nationalization of industry by the governments of Bismarck of Germany or Napoleon III of France represented socialism. Karl Marx and Friedrich Engels, the founders of modern socialism, disparaged and ridiculed the idea that the state might hand down socialism from above. Engels wrote :

"But of late, since Bismarck went in for state ownership of industrial establishments, a kind of spurious socialism has arisen, degenerating now, and again, into something of flunkeyism, that without more ado declares all state ownership, even of the Bismarckian sort, to be socialistic. Certainly, if the taking over by the state of the tobacco industry is socialistic, then Napoleon and Metternich must be numbered among the founders of socialism."

Engels pointed out that in Europe in the late nineteenth century various nations had nationalized banks and some industries, but, he insisted, "...the transformation, either into join-stock companies and trusts, or into state ownership, does not do away with the capitalist nature of the productive

forces."[7] Neither does the capitalist state's nationalization of banks represent a step toward socialism.

Rudolf Hilferding, the Austrian-German socialist economist wrote in his book *Finance Capital* published in 1910:

"Finance capital does not want freedom, but domination; it has no regard for the independence of the individual capitalist, but demands his allegiance. It detests the anarchy of competition and wants organization, though of course only in order to resume competition on a still higher level. But in order to achieve, and to maintain and enhance its predominant position, it needs the state which can guarantee its domestic market through a protective tariff policy and facilitate the conquest of foreign markets. It needs a politically powerful state which does not have to take account of the conflicting interests of other states in its commercial policy. It needs also a strong state which will ensure respect for the interests of capital abroad, and use its political power to extort advantageous supply contracts and trade agreements from smaller states; a state which can intervene in every corner of the globe and transform the whole world into a sphere of investment for its own finance capital."[8]

The Russian Bolshevik political leader and intellectual Nicolai I. Bukharin, following Hilferding, would argue in his book *Economics of the Transformation Period* published in 1920 that out of imperialism and war had arisen "a new model of state power, the classical model of the *imperialist* state, which relies on *state capitalist* relations of production." [9]

While many things have changed since 1910, the tendency of financial institutions to seek the protection of the state in a world of intense foreign competition remains. While Hilferding and Bukharin seem to have envisioned something like the literal fusion of the state and finance, what we have seen instead throughout the modern period is an oscillation of periods of quasi-fusion through nationalizations and of quasi-independence during periods of privatization. Whatever the exigencies of the moment, in the face of international competition, diplomatic rivalry, and foreign wars, financial institutions and the state will tend to seek out relationships of mutual benefit to the dominant bloc of finance capital. Nationalization of the banks tended to be a moment in this oscillating relationship, the moment of the salvation of the banks by the state.

The Role of Nationalization in the Program of the Left

Yet the socialist argument that banks controlled by a government of the people could be a step toward socialism does have merit. Left social movements and political parties should raise the idea of nationalization of industries and the banks propagandistically and educationally, but this notion only has socialist implications when linked with the idea of working class control of the state. The slogan "Nationalize the Banks!" as an agitational point makes sense only when there is a mass movement and a working class ascendant which has the power to use nationalization even under capitalism as a tool to weaken private capital. The left has usually called for the expropriation of the banks without compensation, though perhaps in some situations it might be possible to buy them and permanently retire the bankers. The slogan of nationalization becomes most meaningful as part of the program of the left when we make it clear that we mean the socialization of industry under democratic control and when combined with the notion of workers' control of production itself. The goal in the end is the most democratic control of the government and the economy.

The problem for the left today, however, is to organize to build labor and social movements, and to build a political party of the left which could put such a demand as "Nationalize the Banks!" on the

agenda. Today the problem is to keep the government from simply using the taxpayers' money to save the banks and sending them back on their merry way. We have to be part of the struggle to make sure that that doesn't happen.

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2008: The Demise of Neoliberal Globalization

Immanuel Wallerstein

Source : Fernand Braudel Centre – USA

(<http://www.binghamton.edu/fbc/226en.htm>)

THE IDEOLOGY of neoliberal globalization has been on a roll since the early 1980s. It was not in fact a new idea in the history of the modern world-system, although it claimed to be one. It was rather the very old idea that the governments of the world should get out of the way of large, efficient enterprises in their efforts to prevail in the world market. The first policy implication was that governments, all governments, should permit these corporations freely to cross every frontier with their goods and their capital. The second policy implication was that the governments, all governments, should renounce any role as owners themselves of these productive enterprises, privatizing whatever they own. And the third policy implication was that governments, all governments, should minimize, if not eliminate, any and all kinds of social welfare transfer payments to their populations. This old idea had always been cyclically in fashion.

In the 1980s, these ideas were proposed as a counterview to the equally old Keynesian and/or socialist views that had been prevailing in most countries around the world: that economies should be mixed (state plus private enterprises); that governments should protect their citizens from the depredations of foreign-owned quasi-monopolist corporations; and that governments should try to equalize life chances by transferring benefits to their less well-off residents (especially education, health, and lifetime guarantees of income levels), which required of course taxation of better-off residents and corporate enterprises.

The program of neoliberal globalization took advantage of the worldwide profit stagnation that began after a long period of unprecedented global expansion in the post-1945 period up to the beginning of the 1970s, which had encouraged the Keynesian and/or socialist views to dominate policy. The profit stagnation created balance-of-payments problems for a very large number of the world's governments, especially in the global South and the so-called socialist bloc of nations. The neoliberal counteroffensive was led by the right-wing governments of the United States and Great Britain (Reagan and Thatcher) plus the two main intergovernmental financial agencies - the International Monetary Fund and the World Bank, and these jointly created and enforced what came to be called the Washington Consensus. The slogan of this global joint policy was coined by Mrs. Thatcher: TINA, or There is No Alternative. The slogan was intended to convey to all governments that they had to fall in line with the policy recommendations, or they would be punished by slow growth and the refusal of international assistance in any difficulties they might face.

The Washington Consensus promised renewed economic growth to everyone and a way out of the global profit stagnation. Politically, the proponents of neoliberal globalization were highly successful. Government after government - in the global South, in the socialist bloc, and in the strong Western countries - privatized industries, opened their frontiers to trade and financial

transactions, and cut back on the welfare state. Socialist ideas, even Keynesian ideas, were largely discredited in public opinion and renounced by political elites. The most dramatic visible consequence was the fall of the Communist regimes in east-central Europe and the former Soviet Union plus the adoption of a market-friendly policy by still-nominally socialist China.

The only problem with this great political success was that it was not matched by economic success. The profit stagnation in industrial enterprises worldwide continued. The surge upward of the stock markets everywhere was based not on productive profits but largely on speculative financial manipulations. The distribution of income worldwide and within countries became very skewed - a massive increase in the income of the top 10% and especially of the top 1% of the world's populations, but a decline in real income of much of the rest of the world's populations.

Disillusionment with the glories of an unrestrained "market" began to set in by the mid-1990s. This could be seen in many developments: the return to power of more social-welfare-oriented governments in many countries; the turn back to calling for government protectionist policies, especially by labor movements and organizations of rural workers; the worldwide growth of an alterglobalization movement whose slogan was "another world is possible."

This political reaction grew slowly but steadily. Meanwhile, the proponents of neoliberal globalization not only persisted but increased their pressure with the regime of George W. Bush. Bush's government pushed simultaneously more distorted income distribution (via very large tax cuts for the very well-off) and a foreign policy of unilateral macho militarism (the Iraq invasion). It financed this by a fantastic expansion of borrowing (indebtedness) via the sale of U.S. treasury bonds to the controllers of world energy supplies and low-cost production facilities.

It looked good on paper, if all one read were the figures on the stock markets. But it was a super-credit bubble that was bound to burst, and is now bursting. The Iraq invasion (plus Afghanistan plus Pakistan) are proving a great military and political fiasco. The economic solidity of the United States has been discredited, causing a radical fall in the dollar. And the stock markets of the world are trembling as they face the pricking of the bubble.

So what are the policy conclusions that governments and populations are drawing? There seem to be four in the offing. The first is the end of the role of the U.S. dollar as the reserve currency of the world, which renders impossible the continuance of the policy of super-indebtedness of both the government of the United States and its consumers. The second is the return to a high degree of protectionism, both in the global North and the global South. The third is the return of state acquisition of failing enterprises and the implementation of Keynesian measures. The last is the return of more social-welfare redistributive policies.

The political balance is swinging back. Neoliberal globalization will be written about ten years from now as a cyclical swing in the history of the capitalist world-economy. The real question is not whether this phase is over but whether the swing back will be able, as in the past, to restore a state of relative equilibrium in the world-system. Or has too much damage been done? And are we now in for more violent chaos in the world-economy and therefore in the world-system as a whole?

The US Subprime Crisis Goes Global

Eric Toussaint

Source : Counter Punch

(<http://www.counterpunch.org/toussaint01122008.html>)

THE CRISIS THAT SWEPT through the US in August 2007 is not over yet and the international repercussions will be deep and lasting. When the housing bubble burst in August 2007, it shook financial markets worldwide. This housing crisis is closely linked to a private debt crisis in the world's most industrialized countries. Clearly this crisis will be with us for several years. With perhaps worse to come.

All the warning signs were there: the boom in housing construction over several years (buoyed up by lower interest rates decided by the Federal Reserve to stem the crisis of 2001-2002) leading to overproduction and a hike in real estate prices which in turn opened the door to speculation. Purchases of new homes have plummeted since the start of 2007 while the default rate for households with mortgages is rising sharply. The weakest link in the debt chain has finally snapped: lenders specializing in high-interest loans to heavily indebted, low or middle-income households (the subprime mortgage market) have found themselves in trouble as the default rate soars (see box). Unfortunately, it is not enough to replace the broken link for the chain to regain its economic momentum. Other links are also likely to give way.

The mortgage lenders (like the banks) made long-term mortgage loans while borrowing for the short term (either from depositors, or on the inter-bank market at historically low interest rates, or by selling their mortgages to big banks and hedge funds). The "problem" is that they made long-term loans to a sector of the population that was struggling to make repayments while the housing glut caused their property (which was the surety for their loan) to depreciate drastically. As the number of defaults increased, these mortgage lenders began to experience difficulties in repaying the short-term loans they had contracted with other banks. And the banks, to cover themselves, refused to grant them new loans or did so at much higher interest rates. In the United States, 84 mortgage lenders went bankrupt or partially ceased their activity between the beginning of the year and 17 August 2007, as opposed to only 17 for the whole of 2006. In Germany, the IKB bank and the public institute SachsenLB, both of whom had invested heavily in the US mortgage market, suffered immediate effects and were only saved by the skin of their teeth.

But the domino effect does not stop there: the banks that bought up mortgages did so by setting up largely off-balance sheet operating companies called Structured Investment Vehicles (SIV) . These SIVs finance the purchase of mortgage loans by selling commercial papers to other investors. Their profit comes from the difference between the remuneration paid to buyers of their commercial papers and the money gained from high-yield mortgage loans converted into bonds (CDO Collateralized Debt Obligations).

Of course all these complex debt and loan packages do not create real wealth (whereas there is real

wealth in the construction industry and its suppliers): they are largely speculative financial operations. The crisis in this shaky "paper" market, however, leads to the destruction of wealth and human lives (failed construction companies, financial ruin and even suicide, loss of employment, repossession of properties).

When the crisis erupted in August 2007, the investors who habitually bought commercial papers issued by the SIVs stopped buying them because they no longer had confidence in the health and credibility of the SIVs. Consequently the SIVs lacked liquidity for buying mortgage bonds and the crisis worsened. The big banks that had created these SIVs had to honour SIV commitments to avoid them going bankrupt. While SIV operations had until then been below-the-line items (which allowed them to conceal the risks they were taking), big US and European banks were now obliged to show SIV debts on their balance sheets. Among these were Bank of America, Citigroup (the leading worldwide banking group), Wachovia, Morgan Stanley and Merrill Lynch, Deutsche Bank and UBS (Union des Banques Suisses). Between August and October 2007, US banks alone took on at least 280 billion dollars of SIV debts, with serious bottom-line consequences. Several major banks such as Citigroup and Merrill Lynch at first tried to minimize their level of risk exposure, but their losses were so considerable that they could not conceal them for long. Chairmen were ejected, but not without a golden parachute. Merrill Lynch's chairman Stan O'Neal received 160 million dollars as compensation for his untimely departure! On the contrary, the CEO of the bank Goldman Sachs, Lloyd Blankfein, established the record for the highest bonus in 2007: 68 million dollars, for record benefits and for the knack of having bought products that derived from the exploitation of the subprime crisis (which contributed to exacerbate the latter, according to some sources). Effectively, these scandalous sums reward anti-social, if not criminal, behaviours.

Indebtedness of households, defaults on mortgages and much more

In the United States, repossessions of mortgaged homes reached 180,000 in July 2007, over twice as many as in July 2006, and have passed the one million mark since the beginning of the year, that is, 60% more than just a year ago. It is estimated that there will be 2 million repossessions in 2007.

Indebtedness in American households has reached an extraordinarily high level: 140% (in other words household debts amount to almost one and a half times their annual income). Mortgage debts of households represented 95% of their income in 2005 (compared to 63% in 1995). This illustrates the enormous proportion of home-buying in household debts and consequently, the extent of the crisis that started in 2007. It will last many years.

Few economic commentators make the connection between the increasing number of mortgage defaults and the fact that American workers work on average longer hours per week to earn less money. This is the result of creating a more flexible and precarious labour market as part of the employers' offensive. A large section of North American employees have seen a real drop in income over the last few years. The rise in interest rates imposed by the Federal Reserve since June 2004 has finally made mortgage repayments far too heavy in relation to household income. In fact the rise in payment defaults is not restricted to the real estate sector: it now concerns loans and credit cards.

Double standards

The August 2007 crisis had spectacular effects both in the United States and in Europe. *"On Friday 10 August, in Europe and in the United States, an incredible thing happened: in 24 hours banks became too mistrustful of each other to do any mutual lending, forcing the central banks to step in*

massively. In 4 days, up to 14 August 2007, the ECB [European Central Bank] pumped nearly 230 billion euros of liquidities into the market." The US Federal Reserve acted likewise. The dynamic response of the US and European monetary authorities thus prevented multiple bankruptcies. From the 13 December 2007, in a joint action, on a scale never witnessed before, the ECB, the Federal Reserve, the Bank of England, the Bank of Canada and the Swiss National Bank (supported by the Bank of Japan) again pumped enormous liquidities into the interbank market, a sign that the crisis is not over yet.

The response of the US and European political and financial authorities to the liquidity crisis which began in August 2007 is a far cry from the response imposed on the Indonesian authorities by the IMF, supported by these same governments, at the time of the Asian crisis of 1997-1998. In the first case, the US and European authorities saved the banks by placing liquidities at their disposal, whereas in Indonesia, the IMF enforced bankruptcy on dozens of banks by refusing to let either the Indonesian Central Bank or the IMF itself lend them liquidities. This ended in a social disaster and a huge increase in the internal public debt because the debts of the failed private banks were transferred to the Indonesian State. Another glaring difference: to stem the crisis, the US monetary authorities have since August 2007 lowered interest rates (as they did between 2001 and May 2004), whereas the IMF demanded that the Indonesian government increase interest rates, a factor which considerably aggravated the crisis. Double standards for the North and South

International contamination

In September 2007 the US crisis affecting the financial world abroad became even more visible when Northern Rock, a major British bank specializing in mortgages, was suddenly unable to honour its engagements.

This bank was contracting short-term loans on the interbank market and making long-term loans on the real estate market. The breach of confidence among banks led to a sudden rise in the London interbank offered rate (LIBOR). This directly hit Northern Rock, whose borrowing rates increased unexpectedly. An emergency loan from the Bank of England saved Northern Rock from bankruptcy. This breathing space was of short duration however, and Northern Rock is now for sale. It could even be nationalised.

The real estate crisis and the private debt crisis are interconnected

The present crisis is not limited to real estate: it directly affects the debt market. Over recent years the private debt owed by companies has dramatically increased. New financial products have become more widespread, namely the Credit Default Swaps (CDS). CDS are bought to protect against the risk of the non-payment of a debt. The market for CDS has multiplied by a factor of 11 in the last five years. The problem is that these insurance contracts are sold without any regulatory control from the public authorities. The existence of these CDS encourages companies to take increasing risks. Believing that they are protected against non-payment, the lenders give out loans without verifying the borrower's ability to pay. However, if the international economic situation deteriorates, tens or hundreds of borrowers could suddenly become bankrupt, in which case the CDS would become valueless pieces of paper as the insurers would be incapable of honouring their engagements.

The SIVs mentioned previously specialize in selling CDOs (Collateralized debt obligations) that many investors have been trying to get rid of since August 2007. As of mid-December 2007, default

repayments of CDOs had reached a sum of 45 billion dollars . Since August 2007, the issuing of new CDOs has stopped as a result of the severity of the crisis.

For its part, the huge market of commercial papers based on mortgage credit and asset-backed commercial papers, worth 1.200 billion dollars in August 2007, has literally melted: a 30% contraction from the beginning of the crisis to mid-December 2007 . As this market still represents 800 billion dollars, its continued downward trend could have serious consequences for the banks, curtailing their sources of funding on a long term basis.

Finally, during 2006-2007, several companies have endeavoured to buy out other companies by contracting debts: this is what is called Leveraged Buy-Out (LBO). To sum up, over recent years a huge house of cards has been built on accumulated debts. It is now collapsing and the central banks of the most industrialized countries are attempting to patch the breaches and (to) hastily put up some scaffolding to prevent the worst from happening. They might avoid a complete disaster but the damage will be severe in any case.

Several time bombs have been set

In the conclusion to Chapter 5 of *Your Money or Our Life, The Tyranny of Global Finance* (2005), I raised the question of whether the 2001-2002 crisis in the United States would have long-term consequences:

"Twenty years of deregulation and opening up of markets on a planetary scale have eliminated all the safety barriers that might have prevented the cascade effect of crises of the Enron type. All capitalist companies of the Triad and emerging markets have evolved, some with their own variations, on the same lines as in the USA. The planet's private banking and financial institutions (as well as insurance companies) are in a bad way, having adopted ever riskier practices. The big industrial groups have all undergone a high degree of financialisation and they, too, are very vulnerable. The succession of scandals shows just how vacuous are the declarations of the US leaders and their admirers in the four corners of the globe.

A mechanism equivalent to several time-bombs is under way on the scale of all the economies on the planet. To name just a few of those bombs: over indebtedness of companies and households, the derivatives market (which in the words of the billionaire Warren Buffett, are "financial weapons of mass destruction"), the bubble of property speculation (most explosive in the USA and the UK), the crisis of insurance companies and that of pension funds It is time to defuse these bombs and think of another way of doing things, in the USA and elsewhere. Of course, it is not enough to defuse the bombs and dream of another possible world. We have to grapple with the roots of the problems by redistributing wealth on the basis of social justice."

From the 2000-2001 crisis to the crisis in 2007- ...

Before the 2000-1 "New Economy" or "dot-com" speculative bubble burst in the US and elsewhere in the world, economists and politicians eager to praise the benefits of capitalism in its neoliberal stage (supported in this by a whole armada of journalists specializing in financial issues) confidently claimed that no crisis could be expected. On the contrary, they maintained that the United States had found the magic formula for permanent growth without crisis. They had to

change their tune when recession hit the US in 2001 and stockmarket prices kept falling.

With the resumption of growth these same commentators then claimed that capitalism had found the magic formula to dispel risks related to too high a rate of debt emissions by creating (among other measures) Credit Default Swaps (CDSs). There was a staggering number of reassuring statements and papers on risk spreading.

Yet official bodies such as the BIS (Bank for International Settlements), the IMF, or the WB knew that this meant playing with fire. These institutions' reports published before the August crisis include scenarios that do not rule out the possibility of a crisis but the prevailing message they conveyed was that effectively, thanks to the new debt security engineering, risks had been spread and major accidents were unlikely. In its 2007 report published in June, two months before the crisis broke out, the BIS noted: "*The episodes of market turbulences . . . may have reflected market participants' latent nervousness that the balance of risks tends to be skewed towards the downside when times are good. In the near term, however, few market participants appear to be overly concerned about a sudden and widespread deterioration in credit quality.*" The crisis that started in August gave them a rude awakening.

Criticism was heaped on scapegoats. "*The conduct of some mortgage brokers was shameful and called for nation wide regulation of the home lending business*", the US Treasury Secretary Hank Paulson said in the *Financial Times*. Few economists writing in financial papers share Wolfgang Münchau's criticism of the policies pursued by the Washington government and the Federal Reserve: "I believe that the explosive growth in credit derivatives and collateralised debt obligations between 2004 and 2006 was caused by global monetary policy between 2002 and 2004," and further "The channel through which negative real interest rates can translate into a credit bubble will remain open".

In big banks and private financial bodies there was heavy turbulence and a certain amount of in-fighting at board level (cf. Citigroup and Merrill Lynch). On 11 October 2007 the Institute of International Finance (IIF), an international association of some 800 banks and other financial institutions (including the most prestigious banks) sent a long letter to the IMF and to the main central banks in which it diagnosed a deep crisis and asked public bank authorities to more closely supervise the international private finance sector.

The neoliberal European Commissioner for the Internal Market and Services, Charlie McCreevy, has very strong words to denounce "irresponsible lending, blind investing, bad liquidity management, excessive stretching of rating agency brands and defective value at risk modelling. Nobody can be proud of some of the ugliness that this credit crisis has exposed." However, according to the *Financial Times*, "the Commissioner, one of the EU's most prominent exponents of free market thinking, will caution against a rush to regulate, saying rules that enforce transparency in financial markets can sometimes backfire, spreading panic and moral hazard across the system". Of course we cannot expect the European Commission or the Washington government to decide on firm regulations to be applied to the financial corporations that are responsible for the current crisis.

Are the measures adopted by Washington the sought-for solution?

While they momentarily alleviate the impact of the crisis, the measures taken by the US administration (among them a reduction in interest rates in September and October 2007) are not a solution. In a way the reduction of interest rates alleviates the crisis while dragging it on since it merely postpones deadlines. The real estate crisis has indeed started and its consequences will be

felt in the long term. Why? Here are several reasons:

1. The market in mortgage lending in the US represents 10.000 billion dollars (that is, over 72% of the gross domestic product) . The subprime market represents 15 to 20% of this market. Consequently, the crisis of subprime and other segments of the mortgage market can only have severe repercussions.
2. There is real over-production in the US housing industry compared with demand.
3. A great number of building projects are under way. In the months and years ahead hundreds of thousands of new homes will come onto the market. A building firm can hardly abandon a site in progress. In short, these new buildings will be added to what is on offer in an already depressed market. A production slowdown in the building sector will have long-term consequences for the economy at large: layoffs, and fewer orders to building suppliers.
4. For several years, there has been a tendency to "go out and buy" since home owners and shareholders have been feeling rich due to the fact that their assets had substantially increased thanks to the rise in real estate prices and to the recovery of the stock market (after the 2001 slump). Now the opposite effect is underway: the value of real estate property is plummeting and the stock markets are uncertain. Households are likely to respond by buying less, which will make the crisis worse.
5. The major banks, pension funds, insurance companies and hedge funds have numerous bad debts on their books. Since August 2007 institutions such as Citigroup, Morgan Stanley, HSBC, Merrill Lynch and UBS have been trying to minimize their declared losses but have repeatedly had to admit to new losses, which has led to a steady fall in their share value and to the firing of several executive officers. Other institutions will no doubt be affected. It is not impossible (let's be cautious) that financial institutions will find themselves in a similar situation to that of the Japanese banks when the real estate bubble burst in the 1990s. They needed some fifteen years to get back into the black.
6. The steady fall of the US dollar is undoubtedly a good thing for exports to the United States, and allows the US government to pay back its enormous external debt with a devalued currency. But it also has major drawbacks. A weak dollar makes Treasury bonds and stock market investments less attractive to foreigners who normally invest a large part of their capital in the United States. Less capital is likely to flow in (at a time when it is much needed to narrow the deficit) and more capital is likely to flow out.

The Washington government and the board of the central bank are faced with a real dilemma. If they lower interest rates further, the consequences will be equivocal: it would reduce the immediate risk of bankruptcies and make the fall in consumption less dramatic, but it would also make investments in the US much less attractive and reduce the pressure for sounder company and household accounting. If on the other hand they increase interest rates, the consequences would be the exact opposite with investments in the US becoming more attractive but household consumption

falling and companies being faced with increased cash flow problems.

7. The banks and other private financial institutions in need of liquidities sell shares (including their own) on the stock market, causing a strong decrease in stock market capitalisation of the financial sector. Considering the losses that the financial institutions have to finance and the drying up of their usual sources of funding (especially the commercial papers), it is possible that the downward trend continues.

This crisis shows the abject failure of the neoliberal capitalist model. The directors of the private financial institutions are directly responsible for the current crisis. There is little doubt about this, which the business press has acknowledged. The governments of the main industrialised countries, the directors of the main central banks, the directors of the BIS, of the IMF and the World Bank are directly guilty. Many segments of the debt market are made up of edifices that are now crumbling. Those responsible for the crisis and their accomplices will again try to pass the cost of the cleaning up and the rescue operation to the people via the mobilisation of public funds originating mainly from the taxes that they pay. Among the people, those whose savings and future retirement depend on investments from the stock market, of the purchase of CDOs and other financial products will have to tighten the belt too. As long as finance ministers of this world are at the wheels of this neoliberal globalization, it will be the people who will pay the cost of crisis management. The solutions thus lie elsewhere.