Capitalism's Crisis and our Response

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Week after week, we see the global economy contracting at a pace worse than predicted by the gloomiest analysts. We are now, it is clear, in no ordinary recession but are headed for a global depression that could last for many years.
What I would like to do here today is first, to briefly discuss the origins and dynamics of this crisis; and, second, to explore a strategy for the global left that would respond to the current crisis in the context of the challenges coming from the technocratic capitalist center and the populist capitalist right.

The fundamental crisis: overaccumulation

Orthodox economics has long ceased to be of any help in understanding the crisis. Non-orthodox economics, on the other hand, provides extraordinarily powerful insights into the causes and dynamics of the current crisis. From the progressive perspective, what we are seeing is the intensification of one of the central crises or "contradictions" of global capitalism: the crisis of overproduction, also known as overaccumulation or overcapacity. This is the tendency for capitalism to build up, in the context of heightened inter-capitalist competition, tremendous productive capacity that outruns the population's capacity to consume owing to income inequalities that limit popular purchasing power. The result is an erosion of profitability, leading to an economic downspin.

To understand the current collapse, we must go back in time to the so-called Golden Age of Contemporary Capitalism, the period from 1945 to 1975. This was a period of rapid growth both in the center economies and in the underdeveloped economies — one that was partly triggered by the massive reconstruction of Europe and East Asia after the devastation of the Second World War, and partly by the new socioeconomic arrangements and instruments based on a historic class compromise between Capital and Labor that were institutionalized under the new Keynesian state

But this period of high growth came to an end in the mid-1970s, when the center economies were seized by stagflation, meaning the coexistence of low growth with high inflation, which was not supposed to happen under neoclassical economics.

Stagflation, however, was but a symptom of a deeper cause: the reconstruction of Germany and Japan and the rapid growth of industrializing economies like Brazil, Taiwan, and South Korea added tremendous new productive capacity and increased global competition, while income inequality within countries and between countries limited the growth of purchasing power and demand, thus eroding profitability. This was aggravated by the massive oil price rises of the seventies.

The most painful expression of the crisis of overproduction was global recession of the early 1980s, which was the most serious to overtake the international economy since the Great Depression, that is, before the current crisis.

Capitalism tried three escape routes from the conundrum of overproduction: neoliberal restructuring, globalization, and financialization

Escape Route # 1: Neoliberal Restructuring

Neoliberal restructuring took the form of Reaganism and Thatcherism in the North and Structural Adjustment in the South. The aim was to invigorate capital accumulation, and this was to be done by 1) removing state constraints on the growth, use, and flow of capital and wealth; and 2) redistributing income from the poor and middle classes to the rich on the theory that the rich would then be motivated to invest and reignite economic growth.

The problem with this formula was that in redistributing income to the rich, you were gutting the incomes of the poor and middle classes, thus restricting demand, while not necessarily inducing the rich to invest more in production. In fact, it could be more profitable to invest in speculation. Moreover, this strategy, in the long run, aggravated the basic problem, in that investment in production would add to already installed productive capacity.

In fact, neoliberal restructuring, which was generalized in the North and south during the eighties and nineties, had a poor record in terms of growth: Global growth averaged 1.1 percent in the 1990s and 1.4 percent in the ‘80s, compared with 3.5 percent in the 1960s and 2.4 percent in the ‘70s, when state interventionist policies were dominant. Neoliberal restructuring could not shake off stagnation.

Escape Route # 2: Globalization

The second escape route global capital took to counter stagnation was “extensive accumulation” or globalization, or the rapid integration of semi-capitalist, non-capitalist, or pre-capitalist areas into the global market economy. Rosa Luxemburg, who was not only a great radical but a great economist, saw this long ago in her classic “The Accumulation of Capital” as necessary to shore up the rate of profit in the metropolitan economies.

How? By gaining access to cheap labor, by gaining new, albeit limited, markets, by gaining new sources of cheap agricultural and raw material products, and by bringing into being new areas for investment in infrastructure. Integration is accomplished via trade liberalization, removing barriers to the mobility of global capital, and abolishing barriers to foreign investment.

China is, of course, the most prominent case of a non-capitalist area to be integrated into the global capitalist economy over the last 25 years.
By the middle of the first decade of the 21st century, roughly 40-50 percent of the profits of US corporations came from their operations and sales abroad, especially in China.

The problem with this escape route from stagnation is that it exacerbates the problem of overproduction because it adds to productive capacity. A tremendous amount of manufacturing capacity has been added in China over the last 25 years, and this has had a depressing effect on prices and profits. Not surprisingly, by around 1997, the profits of US corporations stopped growing. According to one calculation, the profit rate of the Fortune 500 went from 7.15 in 1960-69 to 5.30 in 1980-90 to 2.29 in 1990-99 to 1.32 in 2000-2002. By the end of the 1990s, with excess capacity in almost every industry, the gap between productive capacity and sales was the largest since the Great Depression. From this perspective, that of overproduction, globalization was not, contrary to the interpretations of many of those who celebrated it and those who criticized it, a higher stage of capitalism but as a desperate effort by capital to escape the conundrum of overproduction. There was nothing progressive about globalization.

Escape Route # 3: Financialization

Given the limited gains in countering the depressive impact of overproduction via neoliberal restructuring and globalization, the third escape route — financialization — became very critical for maintaining and raising profitability.

With investment in industry and agriculture yielding low profits owing to overcapacity, large amounts of surplus funds were circulating in or were being invested and reinvested in the financial sector — that is, the financial sector was turning on itself.

The result was an increased bifurcation between a hyperactive financial economy and a stagnant real economy. As one financial executive noted in the pages of the Financial Times, “there has been an increasing disconnect between the real and financial economies in the last few years. The real economy has grown … but nothing like that of the financial economy — until it imploded.” What this observer did not tell us was that the disconnect between the real and the financial economy is not accidental — that the financial economy exploded precisely to make up for the stagnation owing to overproduction of the real economy
One indicator of the super-profitability of the financial sector is that while profits in the US manufacturing sector came to one percent of US gross domestic product (GDP), profits in the financial sector came to two percent. Another was the fact that 40 percent of the total profits of US financial and non-financial corporations was accounted for by the financial sector although it was responsible for only five percent of US gross domestic product (and even that was likely to be an overestimate.

The problem with investing in financial sector operations is that it is tantamount to squeezing value out of already created value. It may create profit, yes, but it does not create new value — only industry, agricultural, trade, and services create new value. Because profit is not based on value that is created, investment operations become very volatile and prices of stocks, bonds, and other forms of investment can depart very radically from their real value — for instance, the stock of Internet startups may keep rising to heights unknown, driven mainly by upwardly spiraling financial valuations.

Profits then depend on taking advantage of upward price departures from the value of commodities, then selling before reality enforces a “correction,” that is a crash back to real values. The radical rise of prices of an asset far beyond real values is what is called the formation of a bubble.

Profitability being dependent on speculative coups, it is not surprising that the finance sector lurches from one bubble to another, or from one speculative mania to another.

Because it is driven by speculative mania, finance driven capitalism has experienced about 100 financial crises since capital markets were deregulated and liberalized in the 1980s, the most serious before the current crisis being the Asian Financial Crisis of 1997.

Dynamics of the Subprime Implosion

I will not go in detail into the dynamics of the current crisis, which stemmed from the collapse of the US housing market, also known as the Subprime Implosion. Some key dimensions of it, like Alan Greenspan’s encouraging the housing bubble by cutting the prime rate to a 45-year-low of 1 per cent in June 2003 and keeping it there for over a year to counter the recessionary effects of the bursting of the technology bubble of the earlu 1990’s, were already mentioned yesterday. Let me just highlight a few other points.

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 — most of it Asian and Chinese in origin — that flooded the US 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.

How did problematic mortgages become such a massive problem? The reason is that these assets were then “securitized” — that is converted into spectral commodities called “collateralized debt obligations” (CDOs) that enabled speculation on the odds that the mortgage would not be paid. These assets were then bundled with other assets and traded 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. These institutions in turn offloaded these securities onto other banks and foreign financial institutions.

The idea was to make a sale quickly, get your money upfront and make a tidy profit, while foisting the risk on the suckers down the line — the hundreds of thousands of institutions and individual investors that bought the mortgage-tied securities. This was called “spreading the risk,” and it was actually seen as a good thing because it lightened the balance sheet of financial institutions, enabling them to engage in other lending activities.

When the interest rates were raised on the subprime loans, adjustable mortgage, and other housing loans, the game was up. There are about four million subprime mortgages which will likely go into default in the next two years, and five million more defaults from adjustable rate mortgages and other “flexible loans” that were geared to snag the most reluctant potential homebuyer will occur over the next several years. But securities whose value run into as much as $2 trillion had already been injected, like virus, into the global financial system. Global capitalism’s gigantic circulatory system was fatally infected. And, as with a plague, we don’t know who and how many are fatally infected until they keel over because the whole financial system has become so non-transparent owing to lack of regulation.

Collapse of the Real Economy

We are now at that juncture where instead of performing their primordial task of lending to facilitate productive activity, the banks are holding on to their cash or buying up rivals to strengthen their financial base. Not surprisingly, with global capitalism's circulatory system seizing up, it was only a matter of time before the real economy would contract, as it has with frightening speed in the last few weeks. Woolworth, a retail icon, has folded in Britain, the US auto industry is on emergency care, BMW's profits went down by nearly 90 per cent, and even mighty Toyota has suffered an unprecedented decline in its profits. With American consumer demand plummeting, China and East Asia have seen their goods rotting on the docks, bringing about a sharp contraction of their economies and massive layoffs.

Globalization has ensured that economies that went up together in the boom would also go down together, with unparalleled speed, in the bust, the end of which is nowhere to be discerned.

Let me just pause here to say that the reason I have gone into some detail about the causes and dynamics of the crisis is to underline the fact that what we have unfolding before us is not a crisis of the neoliberal variant of capitalism but the crisis of capitalism.

Global Social Democracy: the Capitalist Response

With the collapse of globalization and the deregulated market going haywire, the neoliberal metaphysics that propped up contemporary capitalism has been thoroughly discredited, though it will undoubtedly engage in some rearguard action.

I think that there is a real panic out there among the establishment and real disarray and a sinking feeling that things will get worse before they get better and that the old neoliberal institutions, like the IMF, WTO, and G 20 have become irrelevant, even as Keynesian methods of deficit spending and monetary easing might have very limited effects. Increasingly the more intelligent intellectuals of the establishment are realizing that we are just at the beginning of the global freefall and don't really know when we are going to hit rock bottom and once we reach it, how long the global economy will lie there. Indeed, the best image I can conjure of the global economy is that of a German World War II U-Boat that has been depthcharged in the mid-Atlantic by British destroyers, and it's descending rapidly to the ocean bottom, and once it reaches the bottom, you don't know how the crew is going to get the submarine back up. Will the crew's tortuous maneuvers to get some compressed air into the damaged ballast tanks get it back to the surface, as in Wolfgang Petersen's classic film *Das Boot*, or will the U-boat just stay at the bottom? Will Keynesian methods of reflation work today? The more critical thinkers of capital like Martin Wolf and Paul Krugman are not taking bets on it.

The two things we can be certain of is that one, neoliberal approaches are thoroughly discredited, and two, the facts on the ground will dictate what those who wish to save the system will do, not any predetermined ideological limits. So let us disabuse ourselves of the notion that neoliberal principles will constitute red lines beyond which they will not go.

Let me be more specific. I think that the actions of the new Obama administration in Washington clearly constitute a break with neoliberalism. One important question, of course, is how decisive and definitive the break with neoliberalism will be. Other questions, however, go to the heart of capitalism itself. Will government ownership, intervention, and control be exercised simply to stabilize capitalism, after which control will be given back to the corporate elites? Are we going to see a second round of Keynesian capitalism, where the state and corporate elites along with labor work out a partnership based on industrial policy, growth, and high wages—though with a green dimension this time around? Or will we witness the beginnings of fundamental shifts in the ownership and control of the economy in a more popular direction? There are limits to reform in the system of global capitalism, but at no other time in the last half century have those limits seemed more fluid.

At this point, massive stimulus spending at record-breaking levels—something anathema to neoliberals—has become practice, the only difference among Northern elites being how much stimulus spending it will take to refloat the submarine.. On this, Obama has become the super-Keynesian. Nationalization of the banks—another practice condemned by neoliberalism---is also well in progress, and the questions that divide the elites is how aggressively the government will exercise its control of the majority shares of the stocks and whether it will return the banks to private management once the crisis is over.

Reprivatization is not, contrary to some of the comments here yesterday, is not a predetermined fact. The facts on the ground will determine the answer to these questions, for the task at hand for the state managers of capitalism is not whether or not the solutions are in line with a discredited doctrine but what it will take to save capitalism.

Beyond deficit spending and nationalization, I think that there will increasingly be a debate within the establishment on whether to go on the path of what I call “Global Social Democracy”, or GSD, in order to respond to capitalism’s desperate dual needs for stabilization and legitimacy.

Even before the full unfolding of the financial crisis, partisans of GSD had already been positioning it as alternative to neoliberal globalization in response to the stresses and strains being provoked by the latter. One personality associated with it is British Prime Minister Gordon Brown, who led the initial European response to the financial meltdown via the partial nationalization of the banks. Widely regarded as the godfather of the “Make Poverty History” campaign in the United Kingdom, Brown, while he was still the British chancellor, proposed what he called an “alliance capitalism” between market and state institutions that would reproduce at the global stage what he said Franklin Roosevelt did for the national economy: “securing the benefits of the market while taming its excesses.” This must be a system, continued Brown, that “captures the full benefits of global markets and capital flows, minimizes the risk of disruption, maximizes opportunity for all, and lifts up the most vulnerable - in short, the restoration in the international economy of public purpose and high ideals.”

Joining Brown in articulating the Global Social Democratic discourse has been a diverse group consisting of, among others, the economist Jeffrey Sachs, George Soros, former UN Secretary General Kofi Annan, the sociologist David Held, Nobel laureate Joseph Stiglitz, and even Bill Gates. There are, of course, differences of nuance in the positions of these people, but the thrust of their perspectives is the same: to bring about a reformed social order and a reinvigorated ideological consensus for global capitalism.

Among the key propositions advanced by partisans of GSD are the following:
• Globalization is essentially beneficial for the world; the neoliberals have simply botched the job of managing it and selling it to the public;
• It is urgent to save globalization from the neoliberals because globalization is reversible and may, in fact, already be in the process of being reversed;
• Growth must not be accompanied by increasing inequality;

• Trade must be promoted but subjected to social and environmental conditions;
• Unilateralism must be avoided while at the same time preserving while fundamentally reforming he multilateral institutions and agreements;
• Global social integration, or reducing inequalities both within and across countries, must accompany global market integration;
• The global debt of developing countries must be cancelled or radically reduced, so the resulting savings can be used to stimulate the local economy, thus contributing to global reflation;
• Poverty and environmental degradation are so severe that a massive aid program or "Marshall Plan" from the North to the South must be mounted within the framework of the "Millennium Development Goals";
• A "Second Green Revolution" must be put into motion, especially in Africa, through the widespread adoption of genetically engineered seeds.
• Huge investments must be devoted to push the global economy along more environmentally sustainable paths, with government taking a leading role ("Green Keynesianism" or "Green Capitalism");

The Limits of Global Social Democracy

Global Social Democracy has not received much critical attention, perhaps because, like the French generals at the start of the Second World War, many progressives are still fighting the last war, that is, against neoliberalism. A critique is urgent, and not only because GSD is neoliberalism's most likely successor. More important, although GSD has some positive elements, it has, like the old Social Democratic Keynesian paradigm, a number of problematic features.

A critique might begin by highlighting problems with four central elements in the GSD perspective.

First, GSD shares neoliberalism's bias for globalization, differentiating itself mainly by promising to promote globalization better than the neoliberals. Globalization, that is the rapid integration of production and markets but with effective regulation as EU Director General for Finance Jan Koopman, who describes himself as a Keynesian, puts it. This amounts to saying, however, that simply by adding the dimension of regulation, along with that of "global social integration," an inherently socially and ecologically destructive and disruptive process can be made palatable and acceptable. GSD assumes that people really want to be part of a functionally integrated global economy where the barriers between the national and the international have disappeared. But would they not in fact prefer to be part of economies that are subject to local control and are buffered from the vagaries of the international economy? Indeed, today's swift downward trajectory of interconnected economies underscores the validity of one of anti-globalization movement's key criticisms of the globalization process..

Second, GSD shares neoliberalism's preference for the market as the principal mechanism for production, distribution, and consumption, differentiating itself mainly by advocating state action to address market failures. The kind of globalization the world needs, according to Jeffrey Sachs in The End of Poverty, would entail "harnessing...the remarkable power of trade and investment while acknowledging and addressing limitations through compensatory collective action." This is very different from saying that the citizenry and civil society must make the key economic decisions and the market, like the state bureaucracy, is only one mechanism of implementation of democratic decision-making.

Third, GSD is a technocratic project, with experts hatching and pushing reforms on society from above, instead of being a participatory project where initiatives percolate from the ground up.

Fourth, GSD, while critical of neoliberalism, accepts the framework of monopoly capitalism, which rests fundamentally the concentrated private control of the means of production, deriving profit from the exploitative extraction of surplus value from labor, is driven from crisis to crisis by inherent tendencies toward overproduction, and tends to push the environment to its limits in its search for profitability. Like traditional Keynesianism in the national arena, GSD seeks in the global arena a new class compromise that is accompanied by new methods to contain or minimize capitalism's tendency toward crisis. Just as the old Social Democracy and the New Deal stabilized national capitalism, the historical function of Global Social Democracy is to iron out the contradictions of contemporary global capitalism and to relegitimize it after the crisis and chaos left by neoliberalism.

GSD is, at root, about social management. What the left is about is about social liberation. GSD is about technocratic management, the left is about participatory democracy down to the level of economic enterprises. GSD is about making reconfiguring monopoly capitalism like the old Keynesianism did, though at a global level this time around. The left is about creating a post-capitalist system when it comes to property relations. GSD is about perfecting globalization. The left is about deglobalizing. GSD sees the future in Green Capitalism. The left sees decapitalization as a precondition for a truly ecologically benign social organization of the planet.

Like President Lula of Brazil, President Obama has a talent for rhetorically bridging different political discourses. He is also a "blank slate" when it comes to economics. Like FDR, he is not bound to the formulas of the ancien regime. Like Lula and FDR, he is a pragmatist whose key criterion is success at social management. As such, he is uniquely positioned to lead this ambitious reformist enterprise. Our task will not merely be how to support the positive aspects of the GSD program that promote the people's welfare while opposing those that lead to a restabilization of capitalism, but more important how, in the process, we differentiate our enterprise from the GSD enterprise and win people over to our strategic vision and program.

The Challenge from the Right

However, the choice in the coming period is not going to boil down between the Left and global social democracy. Would that it were that simple! In fact, there could be a response that would be anti-neoliberal in its economics, at least rhetorically, populist in its social policy, but exclusionist in its politics, evoking tribal as opposed to people's solidarity. We can already see some of this in the approach of President Nicolas Sarkozy in France. . Declaring that "laissez-faire capitalism is dead," he has created a strategic investment fund of 20 billion euros to promote technological innovation, keep advanced industries in French hands, and save jobs. "The day we don't build trains, airplanes, automobiles, and ships, what will be left of the French economy?" he recently asked rhetorically. "Memories. I will not make France a simple tourist reserve." This kind of aggressive industrial policy aimed at shoring up key sectors of the French capitalist class and winning over the country's traditional white working class can go hand-in-hand with the exclusionary anti-immigrant policies with which the French president has been associated.

Sarkozy's conservative populism is relatively mild. There are more radical ones waiting in the wings, like the anti-Muslim movement of Gerd Wilders in the Netherlands, which is said to be poised to win 28 per cent of the seats in the coming parliamentary elections, again with the same mix of communal solidarity, populist economics, and authoritarian leadership. We know of such movements everywhere in the developed and developing world, and my worry is that it maybe be in the developing crisis that they might make their breakthrough to becoming a critical mass.

The point is that things will become worse, much worse, before they become better, and the global crisis is not something that can be managed technocratically to a soft landing like the US Airways flight that was eased into a soft landing on the Hudson River in New York a few weeks ago. If Global Social Democracy fails in its effort to reinvigorate capitalism and the Left is unable to come out with a vision and program built on equality, justice, participatory democracy that appeals to people in a period of severe and prolonged crisis, then other forces will step in to fill the vacuum, as they did in the 1930's. If there is anything that Rosa Luxemburg and Gramsci and Lenin can teach us today, it is that, good will, values, and vision are not enough, that in the end, politics in the sense of a powerful vision, an effective strategy of coalition building, and wise supple tactics of building up a critical mass for winning power, with parliamentary and extra-parliamentary dimensions, is decisive. Nature abhors a vacuum, and we must be ready to fill that vacuum or we lose, decisively, and this we cannot afford to this time around.

Reveille for Progressives

Let me sum up. While progressives were engaged in full-scale war against neoliberalism, reformist thinking was percolating in critical establishment circles. This thinking is now becoming policy, and progressives must work double time to engage it. It is not just a matter of moving from criticism to prescription. The challenge is to overcome the limits to the progressive political imagination imposed by the aggressiveness of the neoliberal challenge in the 1980s combined with the collapse of the bureaucratic socialist regimes in the early 1990s. Progressives should boldly aspire once again to paradigms of social organization that unabashedly aim for equality and participatory democratic control of both the national economy and the global economy as prerequisites for collective and individual liberation and, one must add, ecological stabilization.

That is a perspective that we must might fight for not simply in a battle for people's minds but for their hearts and souls, and here the struggle is, on the one hand, against the technocratic capitalist restabilization schemes of Global Social Democracy and, on the other, the mass-based heated capitalist restabilization schemes of nationalist and fundamentalist populism. Ideas are not enough, and what will be decisive is how one translates our ideas and our values and our vision into a winning strategy and tactics that can triumph democratically. We must move away from the economism to which the global left was reduced in the neoliberal era. Politics, in short, must once more be in command.

P.S.

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