Capitalism in Apocalyptic Mood

Wednesday 27 February 2008, by BELLO Walden (Date first published: 25 February 2008).

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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.

CAPITALIST APOCALYPSE?

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." What is "out there" is suggested by the fact that it has only been in the last few weeks that a series of Swiss, Japanese, and Korean banks have owned up to billions of 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 US 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 weeklong 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." "It's not that the pendulum is now swinging back to Marxist socialism," he told the press, "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's Bush's Council of Economic Advisers in 2005, Ben Bernanke attributed the rise in US housing prices to "strong economic fundamentals" instead of speculative activity, so is it any wonder, ask critics, why, as Fed 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 of the piece in the eyes of some. They blame the bubble on his aggressively cutting the prime rate to get the US 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 it. 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 US economy is Japan 's experience of virtually zero growth per annum and deflation in the nineties and early part of this decade, despite one stimulus package after another, after Tokyo 's great housing bubble deflated in the late 1980s.

THE INEVITABLE BUBBLE

Even as the finger-pointing is 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 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. 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 but the latest of some 100 financial crises that have swiftly followed one another ever since Depression-era capital controls began being lifted 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 to many observers. 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 that would slow 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. Even a relatively weak "sovereign debt restructuring mechanism" akin to the US Chapter Eleven to provide some maneuvering room to developing countries undergoing debt repayment problems was killed by the banks despite its being proposed by 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 aiming at greater transparency of financial operations and new standards for capital. Despite the fact that it was Northern finance capital 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.

While there were calls for regulation of the proliferation of many of the new, sophisticated financial instruments such as derivatives being placed on the market by developed country financial institutions, these got nowhere. Assessment and regulation of derivatives were to be left to market players who had access to sophisticated quantitative "risk assessment" models that were being developed.

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 Streeter Robert Rubin, formerly Secretary of State 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 "collaterized 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, with the most sophisticated quantitative risk models left in the dust as risk was priced according to one rule by the sellers of securities: 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. As one report on the conclusions of a recent meeting of the Group of Seven's Financial Stability Forum put it:

"[T]here is plenty of blame to go around for the financial chaos: The US subprime mortgage market was marked by poor underwriting standards and 'some fraudulent practices.' 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 G7 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.

This growing gap between the financial and the real cannot be comprehensively understood without referring to the crisis of overaccumulation that overtook the center economies in the late seventies and 1980s, a phenomenon that is also referred to as overproduction or overcapacity.

The golden period of postwar growth globally that skirted major crises for nearly 25 years was due to the massive creation of effective demand via rising wages for labor in the North, the reconstruction of Europe and Japan, and the import-substituting industrialization in Latin America and other parts of the South. This was done principally via state intervention in the economy. This dynamic period came to a close in the mid-seventies, with stagnation setting in, owing to global productive capacity outrunning global demand, which was constrained by continuing deep inequalities in income distribution. According to the calculations of Angus Maddison, the premier expert on historical statistical trends, the annual rate of growth of global gross domestic product (GDP) fell from 4.9 per cent in what is now regarded as the golden age of the post-World War II Bretton Woods system, 1950-73, to 3 per cent in 1973-89, a drop of 39 per cent. These figures reflected the wrenching combination of stagnation and inflation in the North, the crisis of import substitution industrialization in the South, and erosion of profit margins all around.

In the eighties and nineties, global capital blazed three escape routes from the specter of stagnation. One was neoliberal restructuring, which included redistribution of income towards the top via tax cuts for the rich, deregulation, and an assault on organized labor. Neoliberalism took the form of Thatcherism and Reaganism in the developed North and World Bank and International Monetary Fund (IMF)-imposed structural adjustment in the global South.

Another was corporate-driven globalization or "extensive accumulation," which opened up markets in the developing world and moved capital from high-wage to low-wage areas. As Rosa Luxemburg long ago pointed out in her classic *The Accumulation of Capital*, capital needs to constantly integrate pre-capitalist societies to the capitalist system to shore up the fall in the rate of profit. In the last two decades, the most spectacular case of incorporating a pre-capitalist society into the global capitalist system was China, which became both the world's second biggest exporter and the primary destination of foreign investment. This was, however, a double-edged sword for capitalism, as we shall later see.

A third was the process we are mainly concerned with here: "intensive accumulation" or "financialization," that is, the channeling of investment towards financial speculation, where much greater returns were to be derived than in industry, where profits were largely stagnant. Finance capital forced the elimination of capital controls, the result being the rapid globalization of speculative capital to take advantage of differentials in interest and foreign exchange rates in different capital markets. These volatile movements, the result of capital's liberation from the fetters of the post-war Bretton Woods financial system, were one source of instability. Another was the proliferation of novel sophisticated speculative instruments like derivatives, that escaped monitoring and regulation. Instability derived ultimately from the fact that speculative finance boiled down to an effort to squeeze more "value" out of already created value instead of creating new value since the latter option was precluded by the problem of overproduction in the real economy.

The disconnect between the real economy and the virtual economy of finance was evident in 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 which, like Amazon.com, still had to turn a profit. The dot.com phenomenon probably extended the boom of the 1990's by about two years. "Never before in US 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, wiping out of $7 trillion in investor wealth.

A long recession was avoided, but it was only by encouraging another bubble, the housing bubble, and here, as noted earlier, Greenspan played a key role by cutting the prime rate to a 45-year low of one per cent 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 US 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 per cent in real terms, with the run-ups, according to Baker, being close to 80 per cent in the key bubble areas of the West Coast, the East Coast, North of Washington, DC, and Florida. How big was the bubble created? It is estimated by Baker 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 US 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 US, 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 per cent GDP growth rate, and Europe, which grew annually by 1.45 per cent in the last few years.

With stagnation in most other areas, the US has pulled in some 70 per cent 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 US market but also capital for speculation. The relationship between the US 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 US consumption on China's lending the US Treasury and private sector dollars from the reserves it accumulated from its yawning trade surplus with the US — one trillion 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 US's fragile economic growth but only by raising consumer indebtedness to dangerous, record heights.

The China-US coupling has had massive consequences for the global economy. One has to do with the addition of massive new productive capacity by American and other foreign investors moving to China. This 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 per cent in the 1980s and 1.1 per cent in the 1990s, compared to 3.5 per cent in the 1960s and 2.4 per cent 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 limited owing to growing inequalities, it erodes profits in the long term. And indeed, the profit rate of the largest 500 US transnational corporations, which fell drastically from +4.9 percent in the 1954-59, to +2.04 in 1960-69, to -5.30 in 1989-89, -2.64 in 1990-92, and -1.92 in 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 US have had the function of absorbing investment that did not find profitable returns in the real economy and thus not only artificially propping up the US 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 OR CHAIN-GANG ECONOMICS?

In this regard, talk about a process of "decoupling" of 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 per cent, or $60 billion. Indeed, China became the main destination for Asia's exports, accounting for 31 per cent while Japan 's share dropped from 20 to 10 percent. As one account 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 Jayati Ghosh and C.P. Chandrasekar 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 US and Europe, not for its domestic market. Thus, "if demand for Chinese exports from the US and the EU slow down, as will be likely with a US 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 US.

NEW BUBBLES TO THE RESCUE?

One must not, however, overestimate the resiliency of capitalism. Many are now asking: After the collapse of the dot.com boom and the housing boom, is there a third line of defense against stagnation owing to overcapacity? One theory is that military spending could be a way that the government might pull the US out of the jaws of recession. And, indeed, the military economy did play a role in bringing the US out of the 2002 recession, with defense spending in 2003 accounting for 14 per cent of GDP growth while representing only four per cent of the GDP of the US. 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 — that “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 is that InVision, a General Electric affiliate, producing high tech bomb detection devises 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 play the role played by financial bubbles is open to question. For to feed them, at least during the Republican administrations, has meant reducing social expenditures, resulting in their positive employment effects being overwhelmed fairly quickly by reductions in effective demand. A study Dean Baker 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.

But even more important as a 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 that could trigger a backlash both abroad and at home. This 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.

P.S.

* Focus on Trade #137, February 2008.

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