A series of neo-reformist illusions

The Real World Economic Outlook 2003 The Legacy of Globalization: Debt and Deflation, Anne Pettifor (editor), Palgrave Macmillan

Nick Beams
10 February 2004

This book, written as a challenge to the *World Economic Outlook* reports issued by the International Monetary Fund and comprising a collection of articles critical of the dominant economic order, is a useful publication from two standpoints.

In the first place, it brings together facts and figures on the increasing instability of the capitalist world economy and refutes the claims of the proponents of the "free market" that their policies promote economic growth, a lessening of poverty and increased living standards.

Secondly, by setting out clearly the program of national economic re-regulation, which forms the foundation of many of the policies advanced by the "global justice movement", it opens the way for a critique of these policies and the clarification of some fundamental issues both of economics and political perspective.

One of the key themes of the book is that the vast expansion of credit over the past 20 years—the basis of the Japanese stock market and land boom at the end of the 1980s, the East Asian financial bubble of the mid-1990s and the US equity and dot.com bubble of the late 1990s—has created the conditions for a major financial crisis.

According to an article by Romilly Green, the total stock of financial assets in five of the major world economies, which stood at around $20 trillion or five times their combined gross domestic product (GDP), had risen to almost $140 trillion by 2000, equivalent to 10 times GDP. In some countries the rise was even more rapid. Japan experienced a rise in financial assets from six to nine times GDP in the decade from 1980 to 1990 while in the United Kingdom the stock of financial assets stood at almost 15 times GDP in 2000.

Green points out that in the late 1970s and early 1980s, the stock of financial assets and the stock of "real wealth"—defined as physical capital, human resources and research and development expenditures—were roughly the same. However "by 2000, financial assets were worth about three times the value of the real assets underlying them. There was a total divorce from economic reality" (p. 23).

An article by economic researcher Peter Warburton, author of the book *Debt and Delusion* published in 1999, examines the significance of the increase in debt default in the advanced capitalist countries in the recent period. "Corporate bond defaults have rocketed, both in number and size, as the telecommunications and energy sectors have plunged into loss. Personal and corporate bankruptcies are increasing across the developed world as hapless borrowers seek protection from their creditors. The so-called sub-prime mortgage sector in the United States is experiencing its worst-ever default rate and unpaid consumer credit debts are mounting in Europe as well as North America. European banks and insurance companies are nursing huge write-offs against their profits" (p. 165).

Warburton warns that increasing default levels could spark a major financial crisis. "In truth," he writes, "the tolerance limits in the world financial system are very fine. Once annual default rates approach 1 percent (of the value of the debt) across the whole lending spectrum, banks' profitability is called into question. If default rates reach 2 percent, then the probability of a financial crisis rises appreciably. By my calculations, the first of these landmarks has already been reached" (pp. 165-166).

One of the more specious claims of the defenders of the present economic order is that the "free market" promotes economic growth and consequently is the only sure antidote to global poverty. Hard facts give the lie to this claim.

During the 1970s, as a contribution by Alan Freeman draws out, per capita global growth was 3.76 percent, while in the 1980s it fell to just 0.7 percent, before declining in the period 1990-2000 to minus 0.2 percent. In the former Stalinist-ruled countries, now designated as "transition countries", per capita GDP actually fell by between 50 and 75 percent in the decade of the 1990s.

Freeman points out that divergence between the major capitalist economies and the so-called developing countries is increasing. Not only is there an increase in relative poverty but "absolute impoverishment is back." In 1980, 118 million people living in nine countries experienced an absolute decline in per capita GDP over the previous decade. In 1998, however, there were 60 such countries with a combined population of 1.3 billion (p. 154).

One of the main factors at work in this process is the global financial system that transfers wealth from the poor to the wealthy. "Textbooks tell us," Romilly Green writes, "that capital should flow from countries where it is plentiful—the rich world—to those in which it is scarce—the poor world. But the opposite is happening. Even the World Bank, not known for its radical critique of globalisation, has finally admitted that 'on a net basis, capital is no longer flowing from high-income countries to economies that need it to sustain their progress towards the Millennium Development Goals.' What the Bank is saying, in essence, is that the poor are financing the rich" (pp. 34-35).

In the opening chapter, entitled "Making sense of our world: 1970-2003", Anne Pettifor, one of the principal organisers of the Jubilee 2000 campaign to reduce the debt of the most impoverished countries, seeks to provide an explanation for the vast changes in the world economy over the past three decades—from the relatively higher growth, and improving living standards of the post-war economic boom to the lower growth and worsening living standards of the past 20 years.

The answer, she maintains, is to be found in the rise of finance capital, and financial liberalisation which has led to a regime of global competitiveness, a "race to the bottom" in which living standards are sacrificed to the drive for profit by the major corporations and the financial markets. However the origins of financial liberalisation, she insists, lie neither in the development of new technologies and advances in communications, nor in the activities of corporations but in the subjective decisions of governments.

Rejecting the argument that the drive for markets and profits is the origin of "corporate globalisation, she writes: "On the contrary, we argue, democratic governments and their elected leaders have been the real driving force behind financial liberalisation" (p. 9).

Because this argument is repeated in one form or another by many of the political tendencies in the "global justice" movement it is worth examining Pettifor's arguments in some detail.

She maintains that the origins of financial liberalisation lies in the decisions by the US and UK government to remove statutory controls on the movements of capital in the wake of the balance of payments deficit problems caused by the rising cost of the Vietnam War.

There is certainly no question that the growth of the US balance of payments deficit at the end of the 1960s played a central role in the decision by US president Nixon in August 1971 to scrap the Bretton Woods agreement of 1944 under which the US dollar was exchangeable for gold at the rate of $35 per ounce. Faced with a situation in which US foreign investment and overseas military spending meant that the mass of dollars circulating outside the US vastly exceeded the gold holdings of the American government, Nixon removed the dollar's gold backing. This decision led inexorably to the ending of fixed exchange rates between the major currencies in 1973 and the lifting of controls on capital movements by the beginning of the 1980s.

But the decision to remove the dollar's gold backing was not undertaken lightly. Throughout the 1960s successive American administrations had sought to impose capital and currency controls in order to cut back on the dollars flowing through world financial markets. But the dollar-gold imbalance continued to grow and the US administration was confronted with a situation in which in order to preserve the Bretton Woods system it would have had to dramatically cut back its military spending abroad and impose a recession at home in order to reverse the balance of trade deficit.

Ruling out both these options, the Nixon administration sought to exploit the economic predominance of the US as it confronted the growing monetary crisis. It reasoned that even if the dollar were no longer backed by gold, the other major powers would nevertheless be forced to hold US dollars because of the pre-eminent position of the US economy within the world market.

While increased military spending played a significant role in the crisis that erupted at the end of the 1960s, the origins of the crisis lay within the Bretton Woods system itself.

Fixed currency exchange rates and capital controls—the mechanisms of regulation which the British economist Maynard Keynes saw as the antidote to the type of crisis which had gripped world capitalism in the 1930s—were established under conditions where the US enjoyed unprecedented economic dominance in the aftermath of World War Two.

Of course, the American negotiators at Bretton Woods sought to enhance the position of the US, especially at the expense of the British Empire. But at the same time, they worked to devise a financial framework that would facilitate an expansion of the world economy as a whole. However, such a global expansion, which was vital to the interests of the US if the experiences of the 1930s were not be repeated, necessarily meant the revival of the other major capitalist powers and a consequent weakening of the relative American position.

Viewed within this framework it is clear that increased military spending functioned more as a catalyst than a cause of the balance of payments crisis which emerged at the end of the 1960s and led to the scrapping of the Bretton Woods system. Already by the end of the 1960s—well before the explosion of military spending on the Vietnam War—the contradictions of the post-war monetary order were becoming apparent. In order to finance the expansion of world trade—a precondition for the stability of the world capitalism as the 1930s had so graphically demonstrated—there needed to be a continuous outflow of dollars from the US. But this led in turn to an accumulation of dollars in international markets, which increasingly called into question the ability of the US to back the dollar with gold.

In the final analysis, the developing crisis of the monetary system was an expression of the fact that the growth of the productive forces on a global scale in the immediate post-war decades, which the system of fixed currency relationships and stabilised world trade had done much to promote, was coming into conflict with the mechanisms of national regulation upon which Bretton Woods system was based.

These processes come more clearly into focus if we examine the role of the Eurodollar market, which played such a vital role in ending the system of currency regulation and capital controls. The Eurodollar market originated in the activities of multinational companies in the post-war period. These companies, in particular US multinational firms operating in Europe, were able to accumulate foreign currency reserves outside their own national borders, beyond the immediate control of national financial authorities.

The Eurodollar market first came into prominence in 1958 when the British government introduced a series of regulations aimed at preventing capital movements in the lead-up to the full convertibility of the pound sterling with the US dollar. British banks, anxious not to lose valuable business from major corporations, sought to avoid these regulations by issuing loans from their dollar holdings. This process was repeated in the 1960s when American banks, seeking to avoid restrictions imposed by the Johnson administration to halt the capital outflow from the US, deployed funds from the Eurodollar market.

In her description of the ending of currency regulation, Pettifor writes: "The existence of the Eurodollar market gradually led to the erosion of capital controls by all major Western governments and, finally most developing governments. This in turn laid the ground for a massive expansion in the role of finance capital in the global economy, and, as a consequence, for greater trade liberalisation" (pp. 10-11).

While Pettifor does not make an examination of the history of the Eurodollar market, even her limited remarks here completely undermine the thesis that the collapse of the Bretton Woods system was simply the result of "decisions" taken by governments. Those decisions, as she acknowledges, were themselves forced upon governments by the operations of the Eurodollar market, which was itself a product of post-war economic expansion.

In other words, even a preliminary examination begins to make clear that the collapse of the post-war boom arose not from government decisions—the end of the system of Keynesian regulation—but was the outcome of objective processes rooted within the global capitalist economy.

The most important of these trends was the re-emergence of the tendency of the rate of profit to fall at the end of the 1960s. This was the cause of the emergence of stagflation—the simultaneous development of high inflation and rising unemployment—in the 1970s and the collapse of the Keynesian program of government economic regulation.

The globalisation of production and the explosion of finance capital in the 1980s represented responses by different sections of capital to falling profit rates. Globalisation of production was aimed at boosting profits by exploiting cheaper sources of labour while the exponential growth of finance was the outcome of the attempts by other sections of capital to appropriate profits by purely monetary means.

Pettifor and other proponents of a neo-Keynesian revival never examine these processes as they insist that the origins of the present phase of capitalist development are to be found the in the decisions taken by government to promote financial liberalisation. The reason is not hard to find—their analysis has been framed in such a way as to support the policies they advocate.

If the present situation is the outcome of decisions made by governments then it follows that it is possible, without challenging the foundations of the capitalist economy, to undertake real reforms provided other governments are put in power and other decisions are made.

Setting out this perspective in the conclusion to the book, Pettifor and Green point to the threat of financial crises and the consequent prospects of political instability. "But governments need not throw up their hands impotently," they write. "They could choose to take action, as they did under the influence of Keynes in 1944, to stabilise the international economy. They could claw back their right to policy autonomy from financial markets. They could strengthen and democratise international institutions. They could re-localise global markets."

In short, they could bring about another "Great Transformation" like that which took place in the post-war period, following the devastation of the 1920s and 1930s, in which the power of the capitalist market is contained and regulated by government action.

Accordingly this second "great transformation" would involve measures such as the re-introduction of capital controls, the introduction of the so-called Tobin tax on international currency transactions, as well as "upsizing the state" and "empowering" governments to tackle financial markets while "downsizing the single global market." The problem, they maintain, is that instead of acting as the servant of society the finance sector is its master. This situation must now be reversed. "It is now time for the people, through their elected governments, to oversee, monitor, and restrain invisible and unaccountable financial markets" (p. 212).

The authors of this book, and those who follow them, may well be sincere and well-meaning individuals, motivated to action by the devastation inflicted by the dominance of global finance capital and its unrelenting drive for profit on the lives of countless millions of people the world over—in the advanced and "developing" countries alike.

But, at the same time, it must be said that their neo-reformist perspective, based on a false analysis of the historical development of the capitalist system, plays a vital ideological role in sustaining the very system that they claim to oppose.

This is because it holds out the fatal illusion that the present course of development can be reversed if only sufficient pressure is applied to the various capitalist governments. But the post-war reformist project—the first "great transformation"—did not collapse because of the malevolence of any section of the capitalist class. It broke down under the weight of the contradictions of the capitalist mode of production itself, ruling out the possibility of a second "great transformation".

This means that the only way forward lies in the international struggle for the world socialist revolution and the re-organisation of the world economy in the interests of human need. The task is not the reform and regulation of global financial capital but its overthrow.