Shades of 1929: Bear Stearns collapse signals deepest crisis since Great Depression

The editorial board
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However the events on Wall Street play out during the next few weeks, there is no question but that a crisis of historic magnitude is now unfolding. After a generation of relentless media propaganda, which touted the infallibility of the capitalist market and the genius of Wall Street's financial wizards, the United States economy now stands on the very brink of an economic breakdown on a scale not seen since the Great Depression.

The collapse of Bear Stearns last Friday and its subsequent takeover organized by JP Morgan Chase and the Federal Reserve Board mark a major turning point in the history of post-war global capitalism. It signifies that the contradictions within the world capitalist economy are now reaching the point where the type of financial catastrophe and social and economic devastation experienced in the 1930s is not only possible, but is becoming increasingly likely.

The plight of Bear Stearns's 14,000 employees, at least half of whom are expected to lose their jobs and whose life savings in company stock have been wiped out at a stroke, foreshadows the social catastrophe that threatens to engulf the working class in the United States and throughout the world.

The measures taken by the Fed over the weekend underscore the fact that Bear Stearns is the first of what threatens to become a rash of bank and financial institution failures in the US and internationally. The Fed announced late Sunday that it would take responsibility for some $30 billion in illiquid assets held by Bear Stearns, as part of the takeover agreement with JP Morgan Chase.

In addition, it announced a quarter-point cut in the discount rate it charges for direct loans to banks, and added—in a move with no precedent since the Great Depression—that it would extend unlimited credit for six months not only to commercial banks, but also to investment banks and brokerage houses. Normally, the Fed's so-called discount window is restricted to commercial banks, i.e., depository institutions, and closed to less regulated and traditionally more speculative investment banks.

By invoking an emergency provision added to the Federal Reserve Act in 1932 at the height of the Depression allowing Fed loans to investment houses, the Fed signaled that it feared the failure of other major Wall Street firms. Veteran economist Allen Sinai has predicted that "several major financial institutions" will be lost in some form.

The Fed took these actions in advance of its scheduled meeting Tuesday, at which it is believed the central bank will further slash short-term interest rates between 0.50 percent and 1.0 percent.

In highly volatile trading on the New York Stock Exchange Monday, the Dow Jones Industrial Average closed slightly higher, but financial stocks, with the exception of JP Morgan Chase, continued to fall sharply. Of the major remaining investment banks, Lehman Brothers, the largest underwriter of mortgage-backed securities, fell the most, losing 19 points on top of a 15 point decline on Friday. Citigroup, the largest commercial bank in the world, in terms of market value, fell 6 percent.

The dollar hit new lows against the euro, the yen and the Swiss Franc.

The Fed's actions, coming on top of massive infusions of liquidity into the financial markets and an agreement to accept as collateral mortgage-backed assets that cannot be sold and are of dubious value, mean that the US central bank is taking onto its balance sheet perhaps hundreds of billions of dollars in bad investments. This threatens to undermine global confidence in the solvency of the Fed itself and accelerate the stark fall of the US dollar on world currency markets.

It is now broadly acknowledged that the current financial crisis is the worst since the stock market crash of 1929 that ushered in the Great Depression. "NBC Nightly News" led its coverage Monday night with the assertion that the moves surrounding the buyout of Bear Stearns were of a type "not seen since the Great Depression."

In a column published Monday in the *Financial Times* of London, former Federal Reserve Chairman Alan Greenspan wrote: "The current financial crisis in the US is likely to be judged in retrospect as the most wrenching since the end of the Second World War."

There are those within the US corporate and financial establishment who are harshly critical of the actions by the Fed and the Bush administration, on the grounds that they are seriously undermining the dollar and the global position of American capitalism. The *Wall Street Journal* published an editorial Monday that began: "In the credit market panic that began in August, we have now reached the point of maximum danger: A global run on the dollar that could become a rout."

The *Journal* went on to complain that "the Fed's main achievement so far has been to stir a global lack of confidence in the greenback... The Fed needs to restore its monetary credibility or today's panic could become tomorrow's crash."

There were also criticisms from some quarters that the Fed's intervention was interfering in the operations of the "free markets." However, most analysts insisted that the action was necessary because of the state of world financial markets. A complete collapse of Bear Stearns would have led to a fire sale of its assets and a cascading effect across financial markets, as the value of all financial assets was marked down, undermining the balance sheets of other major banks and financial institutions, all of which have made similar investments to Bear Stearns.

According to the *New York Times*, had Bear been allowed to sink, this would have resulted in a "wholesale dumping of mortgage securities and other assets" onto a market where credit is frozen, resulting in a "tsunami" that would swamp hedge funds and brokerage firms.

Reporting on the discussions between Fed Chairman Ben Bernanke and other Fed governors with Treasury Secretary Henry Paulson and Undersecretary Robert Steel, the *Wall Street Journal* noted: "If they allowed Bear to fail, the rest of Wall Street could have been dragged down with it. A major financial institution would have gone from being worth $8 billion to worthless, overnight." This could have led to a complete freeze on lending, dragging other Wall Street banks under and sparking a stock market collapse of "1987 proportions," causing "untold damage" to the US economy.

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There are growing concerns that the response of the Federal Reserve Board—cutting interest rates and the provision of credit to the banks—is becoming completely ineffective. Former Treasury Secretary Lawrence Summers has warned that "the principal policy tool on which we have relied—the Federal Reserve lending to banks in one form or another" is like "fighting a virus with antibiotics." He and John Lipsky, a top official at the International Monetary Fund, have suggested that public funds will be needed to bail out the US financial system.

As many analysts have pointed out, the inability of the Fed to resolve the crisis by pumping in more credit stems from the fact that the central problem confronting the financial system is not one of liquidity, but of solvency.

The crisis has its immediate origins in the fall of home prices which started in 2006 and has accelerated since then. This has resulted in tens of billions of dollars being wiped off the value of mortgage-backed securities held by the banks and investment houses, which no amount of interest rate cuts or additional credit will restore. The only way this solvency crisis would end is if home prices started to rise. But with the US economy entering a recession—possibly the deepest since World War Two, according to Harvard economist Martin Feldstein—home prices will continue to decline, further deepening the financial crisis.

The dependence of the global banks on the mortgage-backed securities business is indicated by the fact that the total issuance of these securities, which stood at $16.4 billion in 1998, had risen to $366 billion by 2007. Bear Stearns was only the eighteenth largest underwriter of these securities last year, meaning that many other institutions could go the same way.

The crisis they confront is compounded by the fact that there is no real valuation of the assets they hold, and therefore virtually no buyers if they went to sell them in order to raise cash. According to the *New York Times*, as of November 30 last year, Bear Stearns had on its books $46 billion worth of mortgages and mortgage-backed and asset-backed securities. Its annual report stated that $29 billion worth of these assets were valued using computer models "derived from" or "supported by" some kind of observable market data, while the value of the remaining $17 billion was based on estimates from "internally developed models or methodologies utilizing significant inputs that are generally less readily observable."

The methods used at Bear Stearns extend across the global finance and banking system, meaning that hundreds of billions of dollars in asset-backed securities are literally fictitious capital.

While the immediate cause of the financial crisis is the collapse of the subprime mortgage market, its historical roots lie in the changes in the physiognomy of US and world capitalism over the past three decades.

The 60 years since the end of World War Two fall roughly into two halves. In the first period, the American capitalist economy was characterized by the dominance of its manufacturing industry. In the second half, it has been characterized by ever-increasing financialization.

This process has seen the creation of a vast mountain of credit and the development of a mode of accumulation in which the profits of major banks and financial institutions are increasingly separated from actual production processes and obtained by ever-more complex financial operations and manipulation. This mode of accumulation is centered in the United States, but the financial crisis which has now erupted there is not simply an American issue. Rather, it is the expression in the American financial system—the heart of the world economy—of a crisis of the global capitalist order.

While the unfolding disaster has come as a surprise to so many of the Wall Street experts, one can find in the first chapter of Volume II of Marx's *Capital* a very timely insight into the background of the crisis. Karl Marx made the point that for the possessor of money capital (the banks and financial houses): "the process of production appears merely as an unavoidable intermediate link, as a necessary evil for the sake of money-making. All nations with a capitalist mode of production are therefore seized periodically by a feverish attempt to make money without the intervention of the process of production." The process depicted here as "periodical" by Marx has now become a permanent feature of American capitalism.

This has now led to the situation where fraud, manipulation and outright criminality have become a central feature of the process of wealth accumulation. When the share market bubble burst in 2000-2001, some of these methods came to light with the collapse of Enron and WorldCom. But far from being ended, they were extended on an even broader scale in the next period.

The response of the Fed to the implosion of the share market bubble was the same as it had been in all previous periods of turmoil, starting with the Wall Street plunge of October 1987. It lowered interest rates and pumped more credit into the financial system. This process led to the housing price bubble which accelerated rapidly after the 2000-2001 recession. It saw the emergence of the fraudulent practices associated with "teaser rates," "liar loans" and the packaging of debts of dubious quality into exotic financial instruments. These were then given AAA ratings by the credit-rating agencies which themselves stood to gain from the growth of these ever-more dubious financial practices.

Far from the claims of the "free market" boosters that deregulation has promoted transparency, the financial system has been marked by increasing deception and cover-up. Over the past decade, the volume of financial contracts which are not traded on any major exchange and are completely unregulated has increased rapidly, with trade in derivative contracts tied to stocks and bonds taking place in transactions between financial institutions. And in conditions where, as exemplified by the balance sheet of Bear Stearns, "value" is derived from internally generated computer models, it is only a short step to deliberate deception.

In fact, one of the reasons for the credit crunch is that the major banks and finance houses do not believe what they are being told by each other, and so refuse to make credit available.

The eruption of financial manipulation and criminality, while of major significance, is not itself the cause of the crisis. Rather, the events taking place at the heights of capitalist economy and society are the product of historical changes in the structure of the world capitalist economy.

It is these processes which have led to the prospect of a re-emergence of the type of social and economic conditions which characterized the 1920s and 1930s, and which eventually led to the eruption of World War Two.

The restabilization of the world economy after the devastation of the Great Depression and the war was grounded on the strength of US capitalism. It laid the basis for the reconstitution of the world market, after it had virtually disappeared in the 1930s, made possible the re-establishment of an international monetary and financial system under the Bretton Woods Agreement of 1944, and enabled the rebuilding of the European economy via the Marshall Plan of 1947.

The consequent extension to the rest of the advanced capitalist countries of the more productive methods of American industry made possible the upswing in the rate of profit which laid the foundations for the post-war economic boom.

But notwithstanding all the claims of bourgeois economists during the boom that Keynesian economics—based on government intervention to control interest rates and the level of aggregate demand—had ended forever the type of crisis which had exploded in the 1930s, the contradictions of the capitalist mode of production were not overcome. They signaled their re-emergence with a fall in the rate of profit from the end of the 1960s and the accumulating problems of the international monetary system, which led in 1971 to the removal of the gold backing from the US dollar and the ending of fixed currency relationships in 1973.

The 1960s and early 1970s saw an eruption of struggles by the working class in every country—a movement of potentially revolutionary

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dimensions which was contained only through the betrayals of the Stalinist, social democratic and trade union leaderships of the working class.

The containment of this movement provided the necessary political foundations for the vast reorganization of world capitalism which began at the end of the 1970s and the beginning of the 1980s. The "Volcker shock" of 1979, which saw the lifting of real interest rates to unprecedented levels and the imposition of the deepest recession since the 1930s, was the start of a restructuring of the US economy based on the shutting down of unprofitable sections of industry and a continuous offensive against the working class, starting with the destruction of the air traffic controllers union in 1981.

This offensive was coupled with the development of new computer-based methods of production and management aimed at cutting costs and thereby increasing profits. The impact of these measures was to be seen in the fact that average real wages for American workers underwent a continuous decline from 1973 to the end of the 1990s, whereupon a brief rise was followed by further decline which began in 2001.

While these measures played an important role, the most significant shift in the structure of the world capitalist economy has been the opening up of vast resources and pools of cheap labor in China and other regions of the world following the collapse of the Soviet Union and the Stalinist regimes at the beginning of the 1990s.

The exploitation of these resources enabled the world capitalist economy to enjoy an upswing following the recession of the early 1990s—although one marked by increasing instability, as revealed in the Asian economic crisis of 1997-98.

The hollowing out of the American economy—the rise of finance and destruction of the manufacturing industry—and the establishment of vast new production facilities in China and elsewhere are two sides of a global process which has increased economic growth in the past decade-and-a-half.

The expansion of credit in the US and the creation of a series of booms—the share market bubble, the dot.com bubble and the housing boom—have sustained the markets necessary for the expansion of production from China and other cheap-labor countries.

At the same time the lowering of production costs resulting from the transfer of manufacturing to these cheap-labor regions has enabled the US Federal Reserve to maintain the low interest rate monetary regime necessary for the creation of credit-based booms.

But these very processes, which led to increased growth over the past period, have now created the conditions for a global economic crisis which threatens to plunge hundreds of millions of people into a disaster.

The massive investments in China, and the increased demand for raw materials it has produced, have produced a resurgence of global inflation. This upsurge in prices is also being fueled by the continuous fall in the value of the dollar. At the same time, the dollar is continuing to slump because of the Fed's cuts in interest rates, aimed at sustaining the financial system. In short, the processes which created the upswing of an earlier period are working in reverse.

In the US, the unending assault on the social conditions of the working class and the exhaustion of the "coping mechanisms" developed over the past three decades to sustain family incomes—the entry of greater numbers of women into the workforce, the extension of work hours and the use of household mortgages to finance expenditure—threaten a reduction in consumption spending, leading to deepening recession.

The continuous weakening of the US dollar is not only boosting inflation, it is threatening to spark a reversal of the $2 billion daily inflow of foreign capital which is needed to finance the American financial system.

Apart from its immediate economic impact, the decline of the US dollar is the expression of a broader historical transformation. Last week, as the dollar fell below $1.56 to the euro, the US lost its title of world's biggest economy to the euro zone. This is not merely of symbolic significance.

The post-war restabilization of capitalism and the consequent boom depended on the strength of the US economy. But for a considerable period, at least since the early 1980s, the global position of American capitalism has been steadily weakening. This decline, however, has been covered over to a considerable extent by the fact that the US dollar has still functioned as the pre-eminent global currency. The dollar's role as world currency conferred enormous advantages on the US and boosted its financial system, to give it the appearance of a strength it did not have.

Now the underlying weakness has exploded to the surface as the value of the dollar collapses against all major currencies.

The eruption of the American financial crisis is an event of profound importance for the US and international working class.

Whatever its immediate outcome, it signifies that the fundamental contradictions of the capitalist profit system, whose eruption saw hundreds of millions of workers, youth and the best sections of the intelligentsia enter the road of struggle for international socialism in the 1920s and 1930s, are maturing once again.

The political tasks which confront the working class center on the fight for an international socialist program which aims at ending the subordination of the economy to the dictates of private profit and utilizing the vast wealth which is created by the labor of working people the world over for the benefit of all.

The financial crisis unfolds in a presidential election year in the US, and yet none of the prospective candidates of the two major parties has anything to say about the financial swindling of the banks or the increasingly dire consequences for tens of millions of Americans. The incumbent president, George Bush, attempts to pass off the growing catastrophe as a "rough patch." This in itself demonstrates that both parties are nothing other than instruments of the financial aristocracy.

For the past two decades, the high priests and publicists of the capitalist system have used the collapse of the counterrevolutionary and bureaucratic Stalinist regimes in the Soviet Union and Eastern Europe as the basis for an incessant campaign declaring that socialism is finished and that the capitalist market, based on private ownership and profit, and the division of the world into competing nation states, is the only historically possible form of economic organization.

This historic lie now stands exposed. It is as worthless as the exotic debt products which were passed off by the banks and finance houses as representing real value.

The fight for a socialist program can go forward only through a political struggle against the nostrums advanced by those who claim that a return to Keynesian measures, based on greater government control and regulation while leaving private ownership intact, can provide a solution.

The historical record shows that it was the failure of these measures in the 1970s which paved the way for the "free market" program which has led to the present crisis.

The working people in the US and the world over cannot allow their fate to be determined by the operations of a financial system which threatens them with catastrophe. They must take matters in their own hands.

They must unite across all national borders to fight for a socialist solution to the crisis, at the center of which is the demand that the entire financial system be taken out of private hands and placed under public ownership, subject to full public accountability and democratic control.

The rich and super-rich, along with their representatives in the media, will denounce any such program as not viable because it violates the dominance of private property. But the disaster created by their policies and their stewardship of the social order over which they preside means they have lost any right to direct the future economic organization and activity of society.

For a whole historic period there has been an attempt to deny the

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scientific analysis of Marx that the development of capitalist society is governed by objective laws which necessarily lead to a social and economic crisis, posing the need for a higher form of social organization. But those laws, hidden from view in the "normal" operation of the capitalist economy, have now come to the surface in precisely the manner described by Marx, just as the "law of gravity ... asserts itself when a house falls about our ears."

A new political era has been opened up by the eruption of the American financial crisis in which the working class must secure its future and that of mankind as a whole through the struggle for an international socialist program. This is the perspective of the Socialist Equality Party and the International Committee of the Fourth International.

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