Shades of 1929: the global implications of the US banking collapse

Part 2

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The following is the second part of a report delivered by Nick Beams, national secretary of the Socialist Equality Party (SEP) in Australia and a member of the World Socialist Web Site *international editorial board, to public meetings in Sydney and Melbourne on April 9 and 15.* Part 1 *was published on April 16 and the concluding third part will be published on April 18. Beams, an international authority on Marxist political economy, is the author of regular WSWS articles and analyses on globalisation and political economy.*

There is profound significance in the fact that the financial crisis now gripping world capitalism has erupted in the United States—the very heart of the global economy.

If we take an overview of the economic history of the twentieth century, it falls roughly into two halves. The first 50 years is dominated by the destructive consequences of the breakdown of the world economy, following the period of mighty expansion that characterised the nineteenth century. After 1945 a new period of expansion begins, which seems to have put an end to the terrible events of the previous decades.

This post-war expansion was founded above all on the strength of the US economy. It was this economic strength, not merely its military victory in World War II, which enabled the US to set in place the framework for a period of unprecedented capitalist expansion. The Bretton Woods agreement of 1944 established a new international monetary system and the Marshall Plan of 1947 ensured the reconstruction of war-devastated Europe.

Unprecedented economic growth saw the flowering of all manner of reformist illusions, principally those associated with the program of Keynesianism. Keynesianism maintained that depressions, like those of the 1930s, were now a thing of the past because governments and financial authorities were able to regulate the capitalist economy through spending and by controlling interest rates.

It seemed that the contradictions of capitalism had been overcome. But they were to rise to the surface, once again, by the end of the 1960s. The basis of the post-war boom had resided in the expansion of the rate of profit, made possible by the extension of the new systems of American production to the rest of the world. Now, however, the rate of profit began to decline.

Furthermore, the inherent contradictions within the international monetary system established under the Bretton Woods Agreement started to reappear. The Bretton Woods Agreement was an attempt to overcome a central contradiction that had bedeviled the world capitalist system—between the development of global economy and the division of the world into rival nation-states.

Capitalism had long ago outgrown the confines of the nation state and the national market. Even the biggest national market of all—that of the United States—was no longer sufficient. For American administrators, this was one of the chief lessons of the 1930s. No national economy could function without a viable global economy.

But a viable global economy required a global monetary system. What could function as global money? A return to the gold standard had been attempted in the 1920s but that had proved disastrous. Could some kind of global paper money and credit system be established? This was the proposal of Maynard Keynes. A global paper money and credit system required, however, a global political and financial authority to administer it. And for that to take place, the US and other major capitalist powers would have had to cede their authority to such a body. The US was certainly not willing to do that and so a compromise was adopted. The US dollar would function as international currency, backed by gold at the rate of $35 per ounce.

But the very expansion of the capitalist economy in the post-war boom, made possible not least by the Bretton Woods international monetary system, brought forward the contradiction at the very heart of that system—between the role of the US dollar as international money and its function as the currency of a nation-state, the US.

By the end of the 1960s, the dollars circulating in the world economy vastly outweighed the amount of gold held in the United States that was supposed to back them. In response to a run on the dollar—and moves to convert paper dollars into gold, thereby weakening the position of the United States—President Nixon on August 15, 1971 ended the Bretton Woods Agreement by closing the gold window. In 1973, after fruitless attempts to establish fixed relationships between the world's major currencies, the floating currency regime began.

The de-industrialisation of America

The collapse of the Bretton Woods system was an initial expression of the relative decline in the economic position of the United States vis-à-vis the other major capitalist powers. This decline was to assume a stark appearance by the end of the 1970s, as the dollar plunged to all-time lows and world capitalism experienced stagflation—a combination of rapid inflation with low growth, recession and record post-war levels of unemployment.

In 1979 Paul Volcker was installed as chairman of the US Federal Reserve Board, and he initiated a concerted effort, on behalf of the American capitalist class, to overcome these problems.

The "Volcker shock", as it became known, saw the lifting of interest rates to record levels. Volcker's policy had two interrelated purposes: to lift the value of the US dollar and ensure its position as the pre-eminent global currency (with all the advantages this brought to the US), and to wipe out unprofitable sections of American industry, forcing through a restructuring of the US economy to restore the rate of profit.

These measures involved an unrelenting offensive against the American working class, starting with the sacking of the air traffic controllers and the destruction of their union, PATCO, in 1981, the development of computerised methods of production and management (the PC was first developed in 1981), and the establishment of global production networks to utilise cheap labour resources.

The "Volcker shock" did have some impact. The stock market began a steady recovery from 1982 onwards, and the rate of profit began to increase. But American capitalism was far from enjoying an upswing. The decade of the 1980s ended with the savings and loans crisis, when more than 1,000 savings and loans institutions failed, in what economist John Kenneth Galbraith called the "largest and costliest venture in public misfeasance, malfeasance and larceny of all time", at an overall cost of $160 billion. The stock market collapsed in October 1987 and recession set in by 1990.

The US and the world economy as a whole did not begin a new upswing until an historic shift took place in the economic terrain—the collapse of the Soviet Union and the East European Stalinist regimes and the opening up of the Chinese and Indian economies. This made available vast new sources of cheap labour, doubling the global labour force, according to some estimates, and transformed the very structure of American capitalism, a transformation which is at the root of the current financial crisis.

At the end of World War II, American capitalism had achieved its position of economic supremacy on the basis of its industrial might. While losing its relative superiority during the post-war boom, as European and Japanese industry expanded, US industry was still a force to be reckoned with. Over the past 30 years, however, we have seen the de-industrialisation of the American economy and the rise of finance as its dominant and most dynamic component.

The significance of this transformation can be grasped if we examine the fundamental processes of capitalist accumulation. One of Marx's greatest discoveries was to lay bare the secret of capitalist accumulation. He showed that the ultimate source of capitalist wealth was the surplus value that capital extracted from the employment of wage labour. In capitalist society, wealth takes many dazzling forms. There is industrial profit, income that accrues to land and wealth from increases in asset values—stocks, houses, land. At times, it seems that money can somehow magically beget money, as if wealth simply came from a thing.

Marx showed that, in the final analysis, these various forms of capitalist wealth represent the division of the surplus value extracted from the working class among the various owners of property.

In Volume II of *Capital* he explained that for the possessor of money capital (the banks and financial institutions) "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 by Marx as "periodical" has now become a permanent feature of American capitalism.

The following figures indicate the extent of this process. In 1982, profits of financial companies constituted 5 percent of total corporate profits after tax. In 2007, they made up 41 percent, even though their share of corporate value-added only rose from 8 to 16 per cent. Between 1982 and 2007, the share of the finance sector's profits in US GDP rose six-fold. As the *Financial Times* commentator Martin Wolf noted, behind this boom was an economy-wide rise in leverage. Debt was now the philosopher's stone, turning lead into gold. Now the process of deleveraging threatens to turn gold back into lead. The leveraging process steadily advanced in the 1990s and then took off after 2000.

In an article published on March 19, 2008, the *Economist* noted: "Since 2000 ... the value of assets held in hedge funds, with their higher fees and higher leverage, has quintupled. ... The value of outstanding credit default swaps ... has climbed to a staggering $45 trillion. In 1980 financial sector debt was only a tenth of the size of non-financial debt. Now it is half as big.

"This process has turned investment banks into debt machines that trade heavily on their own accounts. Goldman Sachs is using about $40 billion of equity as the foundation for $1.1 trillion of assets. At Merrill Lynch, the most leveraged, $1 trillion of assets is teetering on around $30 billion of equity. In rising markets, gearing like that creates stellar returns on equity. When markets are in peril, a small fall in asset values can wipe shareholders out."

While this leveraging process was centred in the US, it has been a global phenomenon. In 1980, the global financial stock was roughly equal to world GDP. By 1993, it was double the size, and, by the end of 2005, it had risen to 316 percent—or more than three times world GDP.

One of the chief factors sustaining this process has been the lowering of interest rates. That has been possible, in turn, because inflation has been reduced—a product, not least, of the production of cheaper goods in China and elsewhere. In other words, there is a symbiotic—one could say parasitic—relationship between the rise of finance capital and the opening up of vast new sources of cheap labour.

How, then, is the surplus value extracted from Chinese workers actually distributed among the different sections of capital?

The provision of cheap credit has played a big role in the acquisition of land and the construction of shopping centre developments. (We have just seen, for example, the problems encountered by the Australian firm Centro, which ran into problems when the cheap credit upon which it had relied to expand its shopping centre acquisitions dried up at the end of last year.)

The provision of cheap credit boosts asset prices, including those of shopping centres. This means that the owners must increase rents in order to recoup their investments. But giant retail firms, such as Wal-Mart in the US—the largest importer of goods from China and now the largest employer of labour in the US—can pay these prices because of the large mark-up it is able to obtain on the low-cost goods it imports from China.

The extraction of surplus value takes place in the production of these goods. It arises from the vast difference between the value of the labour power (wages) of the workers employed and the value of the commodities they produce, and is then distributed among the various property holders—a certain portion to WalMart, some to the shopping centre owner in the form of rent and another portion to the finance companies that provided the money for its construction.

The process of asset-inflation can continue so long as cheap credit continues and the asset can attract sufficient income. But should either of those two conditions cease, then the process unravels in the reverse direction.

Following the collapse of the share market and dot.com bubbles, the US housing market underwent an inflationary boom based on cheap credit, starting in the late 1990s, but accelerating rapidly after the end of the 2000-2001 recession.

The new paradigm was the "originate and distribute" model. Mortgage providers would make funds available for home purchases and then immediately sell off the mortgages to finance houses, collecting a fee for having originated the debt. Then the mortgage debts would be aggregated and sliced and diced into various packages to be sold off to other institutions—to hedge funds or to special investment vehicles, created off balance sheet by banks and other financial bodies.

The income for these asset-backed securities was provided by the home purchaser. The financial security of the purchaser did not need to be examined too closely because in the event he or she defaulted, a new loan could be arranged, or, failing that, the house could be sold at a higher price.

The process, however, eventually encountered one insurmountable obstacle—a decline in the real wages of the American working class, something that had been underway during the previous 30 years, except for a brief period towards the end of the 1990s, and which has continued since the end of the recession in 2001.

And this is no temporary decline. As the American economist Robert Reich has pointed out, all the various coping mechanisms used to sustain incomes—the entry of women into the workforce, the working of longer hours, and, finally, the taking on of more debt, especially through home equity loans—have been exhausted. Millions of American workers and their families are facing a catastrophe as the potential sale price of their house falls below their remaining debt and their home equity turns negative—a process that is being replicated around the world.

To be continued