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

## Part 3

**Nick Beams**
**18 April 2008**

*The following is the final 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* Part 2 *on April 17. Beams, an international authority on Marxist political economy, is the author of regular WSWS articles and analyses on globalisation and political economy.*

What are the implications of this economic and financial crisis?

In the *World Socialist Web Site* editorial board statement of March 18, we explained that the political tasks facing the working class centred on the fight for an international socialist program that "aims at ending the subordination of the economy to the dictates of private profit and utilising the vast wealth which is created by the labour of working people the world over for the benefit of all."

Was that just some kind of obligatory rhetoric? Is there not perhaps some more immediate, practical, reform of the financial system to which we should give our support?

Let us examine the possible proposals. One is for new regulations to control the type of predatory practices that have led to the present disaster. But we seem to have heard this somewhere before. Was this not put forward in the wake of the Enron and WorldCom collapses at the end of the 1990s? What was the result? The type of criminal activity with which those two companies, and others, became synonymous was simply extended on an even wider scale.

There was legislation introduced in the form of the Sarbanes-Oxley Act of 2002. Bush signed it into law on July 30, 2002, declaring that it included "the most far-reaching reforms of American business practices since the time of Franklin D. Roosevelt."

But this legislation has been under fire ever since, because tighter US regulations have disadvantaged Wall Street as a financial centre in relation to London. Accordingly, the recent regulatory proposals set out by Treasury Secretary Henry Paulson seek to lessen, not increase, oversight of the financial system. In other words, regulation is a pipedream in conditions where the financial market is global in scope and subject to the ever-more ferocious competition between the different nationally-centred markets.

Moreover, the very nature of a financial crisis renders bankrupt regulatory procedures. Earlier, we noted the comment of SEC chairman Cox that Bear Stearns had met all the necessary supervisory standards. No doubt it had. But those standards proved completely useless. The reason lies in the irrational nature of the market itself, based as it is on the private interests of massive financial institutions.

There is a fundamental contradiction at the very centre of the market that no amount of regulation can overcome—that is, the contradiction between individual rationality and the system as a whole.

Over-indebted individuals or individual firms have three choices: to cut spending, to sell assets or to declare bankruptcy. If too many cut spending, a downturn in the economy will occur, causing further problems. If too many assets are sold, their value will drop even further, leading to more pressure to sell before prices fall again. And if too many default then the financial intermediaries, which provided insurance, are hit. In other words, while it may be completely rational for an individual to take any one of these actions, the consequences may worsen the overall situation.

In a speech on March 6, Timothy Geithner, president of the Federal Reserve Bank of New York, explained the way this contradiction unfolds.

"The current episode has a basic dynamic in common with all past crises. As market participants have moved to reduce exposure to further losses, to step on the brake, the brake became the accelerator, amplifying the shock. Measured risk has increased more quickly than many institutions have been able to reduce it, and attempts to reduce it have added to volatility and downward pressure in prices, further increasing measured exposure to risk. Uncertainty about the market value of securities and about counterparty risk has increased, and many hedges have not performed as intended. The rational actions taken by even the strongest financial institutions to reduce exposure to further losses have caused significant collateral damage to market functioning. This, in turn, has intensified the liquidity problems for a wide range of bank and nonbank financial institutions. ...

In other words what is rational for the individual financial institution can produce disastrous consequences.

As Geithner continued: "This self-reinforcing dynamic within financial markets has intensified the downside risks to growth for an economy that is already confronting a very substantial adjustment in housing and the possibility of a significant rise in household savings."

Faced with increased exposure to risky assets, banks, or their SIVs (structured investment vehicles), move to sell them off, lessening their exposure and increasing their holdings of cash. But the consequence is a fall in the price of those financial assets, worsening the position of other institutions that hold them. This leads, in turn, to a further weakening in the position of other banks and financial institutions which may not have been affected by the initial downturn. They may not have even held the asset class that was initially affected.

Northern Rock, the collapsed British bank, was not exposed to American subprime mortgages. But it was highly dependent on the short-term money market for the funds that it used to finance mortgages. As interest rates in this market began to rise, Northern Rock collapsed. This "self-reinforcing dynamic" as Geithner terms it, involves vast sums ... in some cases, amounts of money larger than entire economies. It is completely rational for an institution facing problems caused by risky assets to sell them. But that rational action can lead to a whole series of forced sales, resulting eventually in a major financial crisis and an economic collapse.

Millions of people's lives, their welfare, their jobs, the future education of their children, are dominated by the workings of a system over which they have no control and over which *no one* has any control. That is, the market rationality for the individual bank or financial institution produces social irrationality and madness. This madness cannot be cured by regulation, but only through the abolition of the financial markets and their replacement with a system of social control over the wealth and assets created by the labour of society as a whole.

**Socialist revolution**

The perspective of socialist revolution is grounded on objective processes in the historical development of capitalism. The current global financial crisis constitutes the opening of a new chapter in that history.

To understand its significance let us place it in context. In 1919, in the wake of the Russian Revolution, Leon Trotsky commented on the fact that the press of the day was preoccupied with the names of Lenin, the leader of the revolution, and Woodrow Wilson, the president of the United States, who had journeyed to Europe to try to prevent its spread to the rest of Europe. "Lenin and Wilson—these are the two apocalyptic principles of modern history," he remarked.

Which would conquer? We now know the answer to that question. With the greatest difficulty, and only with the assistance rendered to it by the social democratic and Stalinist leaderships, through their betrayals of the working class, was the United States, after three decades of bloody war, depression, fascism and the death of tens of millions, able to restabilise the world capitalist system.

Economically, the new equilibrium rested on the strength of American capitalism. Now we have a crisis—the most serious since the 1930s—which has struck at its very heart.

This crisis signifies the passing of an entire historical era. For decades, the United States functioned as the stabiliser of world capitalism. Now it is the great destabiliser. Just as the rise of American economic power changed the course of world history, its decline will have even more far-reaching consequences.

The decline of American capitalism stretches back over decades. In the early 1980s, it sought to overcome the first phase of its decline by undertaking a vast process of restructuring. But the very processes it set into motion at that time have now given rise to a crisis of even greater proportions.

All the issues that confronted the working class in the first decades of the twentieth century and that saw millions of workers, youth and socialist-minded intellectuals enter the struggle for international socialism have returned with renewed force. Not only do we face the threat of a global slump, if not a depression, but escalating economic tensions among the major capitalist powers, resulting from the decline of the US, must increase the danger of war.

For the past 35 years, the world economy has functioned on the basis of the US dollar as the chief global reserve currency. This has conferred enormous advantages on the United States. But the decline of the dollar means that the US will face new challenges to its supremacy. This is not a matter of anyone's bad intentions, but arises from the logic of economic processes. How long can the rest of the capitalist world—the old powers in Europe and Japan, together with the new rising powers, China and India, as well as the oil exporting countries of the Middle East—go on funding the US to the tune of $2 billion a day, placing vast reserves in US debt instruments that are steadily losing their value?

Of course all the capitalist powers have an interest in preserving global stability—no one wants to provoke a crisis. But at a certain point, the costs of maintaining the present system become prohibitive.

How will the US respond to such a situation? We have already seen the answer to that question in Iraq. It will seek to maintain its position by military means.

Once again global humanity faces the danger of depression and war. The only answer to this threat is the struggle for an international socialist program. This is the perspective of the SEP and the ICFI.

*Concluded*