Lecture by Nick Beams

# The World Economic Crisis: A Marxist Analysis

## Part 2

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*The following is the second part of a lecture delivered by Nick Beams, national secretary of the Socialist Equality Party (Australia) and a member of the International Editorial Board of the* World Socialist Web Site*, to audiences in Perth, Melbourne and Sydney in November and December, 2008.* Part 1 *was posted yesterday and parts* 3, 4 *and* 5 *will be published next week.*

Nick Beams speaking in Sydney

The escalating antagonisms between the major capitalist powers are the result not of intellectual deficiencies, or an incorrect political program, or an inability to see the dangers ahead. They arise from contradictions within the capitalist order itself—contradictions that will intensify as the global slump deepens and which, at a certain point, will become the basis for political and military conflicts.

The questions we need to probe are the following: how has this financial crisis come about? How did problems involving $34 billion in US subprime mortgages, which emerged 18 months ago, morph into the catastrophe now engulfing the $57 trillion US financial system and financial markets the world over?

And furthermore, how is it that the lives of hundreds, no, thousands of millions of people around the globe are threatened by a crisis arising from a financial system in which they are not involved, over which they have no control and about which they have little or no knowledge? How is it that highly complex financial operations involving things such as collateralised debt obligations, credit default swaps, and asset-backed securities can have such a far-reaching impact on their daily lives? Why has this financial crisis led to a breakdown in the global capitalist order, giving rise to the very real threat of depression and war? How has all this happened and, on the basis of our analysis, what must now be done? These are the issues with which we will be grappling in this lecture.

### The ABCs of capitalism

In order to grasp the processes at work in the world of finance and their impact on the so-called real economy, we need to consider some of the ABCs of the capitalist mode of production.

The driving force of capitalism is not production for use or need, or even production for the market as such, but the accumulation of capital—the making of profit. In its simplest form, the process of accumulation begins with a mass of capital in the money form M, which is turned into a new and greater quantity of capital, M', that is, the initial quantity of capital plus an increment, ?M ("delta M").

The source of this increment is the surplus value extracted from the working class in the process of production. Money, as capital, is used to purchase the means of production plus the labour power of workers. This labour power, or capacity to work, is a commodity available in the market, along with other commodities. The value of this commodity—the labour power that the worker sells to the capitalist in the wage contract—is determined by the value of the food, clothing, housing and other necessities of life needed to sustain the worker and the workers' family. But the value of these necessities (the worker's wage) is not the same as the value added by the worker to the commodities supplied by the capitalist in the course of the production process. In other words, the worker's wage is less than the value he or she contributes in the production process. This difference is the source of surplus value. Labour power is consumed in the production process, but the commodities produced by it have additional, or surplus, value embodied in them. They are then sold on the market to realise M', comprising the initial M plus an increment ?M—the profit made by the capitalist out of the production process.

The capitalist mode of production sets in motion a vast accumulation of the forces of production. As Marx noted in the *Communist Manifesto*, in contrast to all previous modes, capitalism involves the continuous revolutionising of the means of production. This is inherent in the system itself. Accumulation depends on increasing the productivity of labour, and the key to increasing labour productivity is the development of the productive forces. The pressure of competition drives this process forward. Every section of capital must strive to develop the productivity of labour on pain of extinction.

This ever-increasing scale of the production process induces changes in the financial structure of the capitalist economy. It means that the capital now required to set in motion the process of accumulation—the initial amount, M—far outgrows the capacity of individual capitalists. It has to be drawn from the resources of society as a whole. Two great financial developments make this possible: the rise of the credit and banking system, and the formation of joint-stock or shareholding companies.

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Credit, made available from the pool of money gathered up in the hands of the banks from all corners of society, provides the capitalist firm with resources on a scale far beyond the capacities of an individual or even a group of individuals. The functioning capitalist, Marx explains, becomes a mere manager of other people's money. Without this money, Rupert Murdoch is an ordinary citizen. But with the resources of numerous banks placed at his disposal, he is a colossus, invited to deliver the Boyer lectures on ABC radio, explaining how we all should live.

In return for the provision of capital, the bank receives a portion of the surplus value extracted from the working class in the form of interest payments. The loan agreement with the bank, or the issuing of a bond by the company, entitles the creditor to regular interest payments. That is, the holder owns a title to income.

In the case of the joint stock company, established through the issuing of shares, the shareholders, in return for supplying money capital, receive a title to property. They do not have a right to a portion of the company. As a shareholder of a retail chain, you cannot go into a store and claim some of the merchandise, on the grounds that you are a part owner of it. The merchandise is the property of the incorporated person, the company. What you are entitled to is a portion of the profit, in the form of a dividend.

With the development of credit and shareholding we have the creation of new markets—financial markets—in which these titles to income, bonds and shares, are bought and sold. And as the prices of these financial assets rise and fall, so profits can be made by buying and selling them.

Here I want to emphasise that there are not two forms of capital. The money that was supplied, either as credit or through share subscription, has been deployed to purchase labour power and the means of production. It has become productive capital engaged in the process of extracting surplus value from the working class. It does not exist in the form of money as well. The shares and bonds are what Marx called "imaginary" capital, or fictitious capital. They are, in the final analysis, titles to income, to a share of the surplus value extracted by productive capital.

However, in the world of finance, of fictitious capital, it is possible to make great profits by buying and selling financial assets. This is an enchanted world, a world of illusion, because here it is possible to make money simply through the manipulation of money. Money, through the payment of interest, seems to accumulate as a natural function of its existence. Money begets money as Nature herself nurtures the growth of plants and animals. How could labour possibly be the source of all profit when clever manipulations and trades by financial operators can result in the accumulation of vast wealth?

The enchanted world of finance not only engenders illusions in the minds of its inhabitants and those who profit from it, but also in the minds of those who would try and abolish it. From the very earliest days, financial markets have been denounced by those who would like to expunge or at least control them, but without overturning the capitalist economy as a whole.

"Regulate the bad side of capitalism!" is their catch-cry, so that the good—that is, capital in the productive form—might be able to grow and society advance. Insofar as finance capital is necessary, ensure it works for society as a whole! But, as Marx explained more than 150 years ago, such efforts are based on an illusion. The "good" cannot be separated from the "bad" and, in fact, it turns out that the "bad" is often the very driving force of historical development.

As the founder of scientific socialism noted in relation to the joint stock company: "The world would still be without railroads if it had to wait until accumulation had got a few individual capitals far enough to be adequate for the construction of a railroad. Centralisation, however, accomplished this in a twinkling of an eye, by means of joint-stock companies" [Marx, *Capital* Volume I, p. 780].

**Fictitious capital and the growth of debt**

In the light of these ABCs let us now probe the present financial crisis. Numerous statistics demonstrate the growth of the financial system over the past three decades. One of the most important indicators is the level of debt.

In 1981 it is estimated that the US credit market was 168 percent of GDP. By 2007 it was 350 percent. Financial assets were five times larger than GDP in 1980, but over ten times as large in 2007. Moreover this debt has been increasingly used to finance operations in the financial markets themselves, rather than to expand productive capital. The debt taken on by banks and other financial institutions rose from 63.8 percent of US GDP in 1997 to 113.8 percent in 2007. Debt issued by US financial institutions nearly doubled between 2000 and 2007. And this debt has balanced, ever more precariously, on an ever-smaller capital base. In 2004, large investment banks had an asset to equity ratio (a measure of the extent of debt leveraging) of 23. By 2007 this had risen to 30.

Goldman Sachs, for example, used its $40 billion of equity as the foundation for assets worth $1.1 trillion. Merrill Lynch's $1 trillion of assets rested on $30 billion of equity.

The reason for such large leveraging ratios lay in the enhanced profit rates they provided. Consider the following simple scenario: If an asset purchased for $100 million increases in value by 10 percent during a year (worth $110 million at the end of the year), and if the purchase of this asset is financed by equity capital of $10 million and borrowings of $90 million, at an interest rate of 5 percent, then the profit at the end of the year, after interest of $4.5 million (5 percent of $90 million) has been paid, will be $5.5 million. This means a profit of $5.5 million has been made on an initial outlay of $10 million, giving a rate of return of 55 percent.

The key to the process is the increase in asset values, fueled by cheap credit. If money is cheap it will pour into asset markets, bidding up prices, and providing large profits. The market may be in stocks and shares, or in commodities, or in housing.

Of course, it does not take any great intellectual capacity to see that such Ponzi schemes, involving the creation of asset bubbles, must eventually collapse. Why then did not at least some in financial circles call a halt? Why the herd mentality?

Involved here were not individual failings or a lack of intellect, but the very structure of the financial market itself. So long as credit is cheap and asset prices are rising, every financial institution is forced to participate. If, say, a particular fund manager sees the writing on the wall and decides to opt out, his institution will lose out in the competitive struggle for profits. His clients will simply go elsewhere, where bigger profits are on offer. It does not matter that he is right, and a collapse will eventually take place. So long as the collapse occurs across the market, no one involved loses their competitive position.

As the CEO of Citigroup Chuck Prince put it in July 2007, on the eve of the subprime crisis: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."

Now the music has stopped.

The subprime mortgage crisis was the trigger for the implosion that is now seeing the collapse of the mountain of debt accumulated not just over the previous few months, or even years, but for several decades.

To understand the mechanisms behind this implosion, take the following simple example. Suppose that an asset valued at $100 million, which had an expected return of $10 million, or 10 percent, now only returns $5 million or 5 percent, then the value of that asset will drop to $50 million. To put it another way, an investor seeking a rate of return of 10 percent would have been willing to pay $100 million for the asset. Now he will

only pay $50 million. The value of the asset in the market has halved.

But suppose the asset has been purchased with borrowed funds, say $90 million. Notwithstanding the fact that the market value of the asset has declined, the debt to the bank remains $90 million. The asset, however, is now worth less than the debt incurred to purchase it. How will the bank be repaid? Other assets may have to be sold to obtain cash. But to the extent that this takes place across the board, the value of those particular assets will fall and the crisis will worsen.

We said earlier that fictitious capital is a claim on income, the source of which, in the final analysis, is the surplus value extracted from the working class. But capital can grow far beyond the basis on which it ultimately rests. Financial market operations result in a massive growth in fictitious capital. At a certain point, however, this expansion comes to a halt and a crisis erupts.

The crisis is an expression of the reassertion of the fundamental laws of the capitalist economy. Its source lies in the fact that the claims of capital have vastly outgrown the available mass of surplus value. Capital must seek to overcome the imbalance. How is this accomplished? Through two interconnected processes: by intensifying the exploitation of the working class in order to expand the mass of surplus value and, above all, by bankrupting and eliminating whole sections of capital, thereby wiping out their claims to the available surplus value, and restoring the shares of those sections of capital that remain.

In a recent speech Kevin Warsh, a governor of the US Federal Reserve System, noted that the issues in the current financial crisis went far beyond subprime mortgages and pointed to the wider processes now unfolding.

"If the challenges to the economy were predominantly about the value of housing stock, my focus today," he told his audience, "would be narrower than the establishment of a new financial architecture. So, what diagnosis, beyond housing weakness, is consistent with the unprecedented levels of volatility and dramatic financial market and economic distress? I would advance the following: We are witnessing a fundamental reassessment of the value of virtually every asset everywhere in the world" [Kevin Warsh, *The Promise and Perils of the New Financial Architecture*].

This "reassessment", however, does not occur through some kind of accounting procedure. It takes place, as Marx drew out, through "violent and acute crises, sudden forcible devaluations, an actual stagnation and disruption in the reproduction process, and hence to an actual decline in reproduction" [Marx, *Capital* Volume III, p. 363]. In short, it takes place through a violent economic contraction, whose severity depends on the extent of the initial over-accumulation of capital. In today's conditions, we are speaking of processes that have already led to the implosion of one economy, Iceland, with even bigger ones, Ireland and even the UK, to follow.

*To be continued*

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