A lecture by Nick Beams

The World Economic Crisis: A Marxist Analysis—Part 3

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The following is the third 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 *and* Part 2 *were published on December 19 and 20, respectively. Parts* 4 *and* 5 *will be published this week.*

The violent economic contraction, to which Marx refers, was described in the infamous advice provided to US President Herbert Hoover in 1931 by his Treasury Secretary Andrew Mellon: "Liquidate labour, liquidate stocks, liquidate the farmers, liquidate real estate. Purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up the wrecks from less competent people."

Insofar as they have a theory of financial and monetary policy, US financial authorities have acted on the belief that they could avert the outcome advocated by Mellon through the correct use of monetary policy.

Milton Friedman and Anna Schwartz in their book *A Monetary History of the United States* advanced the theory that the "great contraction" was caused by the incorrect policies of the US Federal Reserve. In the years following the book's release this theory has become "conventional wisdom."

A vociferous advocate of the capitalist "free market", Friedman was motivated by the desire to demonstrate that the 1930s Depression was not a consequence of its failings and contradictions but of contractionary monetary policies. Had they not been implemented, there would have been a recession, but not the economic disaster that actually occurred.

Acceptance of the Friedman hypothesis has meant that whereas Mellon's advocated liquidation in response to a financial crisis, the Fed's policy, under Alan Greenspan and now Ben Bernanke, has been monetisation. This began in 1987, when Greenspan, shortly after his appointment, reacted to the October stock market crash by opening up the Fed's credit spigots. In every succeeding financial crisis—the Asian crisis of 1997-98, the Russian default of 1998, the collapse of Long Term Capital Management through to the collapse of the tech.com and share market bubble in 2000, and the subprime crisis of 2007—the same policy has been pursued. Interest rates have been cut and credit conditions eased.

Throughout his term, Greenspan insisted the Fed's task was not to try to prevent the formation of asset bubbles or to deflate them when they emerged, but to clean up after they collapsed. In practice, this meant that the collapse of one bubble would be countered by the creation of another through the provision of cheap credit.

Bernanke shares Greenspan's outlook. He defined his position in September 2004 thus: "For the Fed to interfere with security speculation is neither desirable nor feasible. ... [I]f a sudden correction in asset prices does occur, the Fed's first responsibility is ... to provide ample liquidity until the crisis has passed" [cited in Peter L. Bernstein, Introduction to Friedman and Schwartz, *The Great Contraction*, Princeton 2008].

For the 20-year period following the stock market collapse of 1987 this modus operandi appeared to be effective. Now it has broken down. In the 16 months since the current crisis first emerged, various attempts have been made to halt it through bailout operations. Unlike the experiences of the 1980s, the 1990s and the early years of the present decade, they have, however, failed.

In early October, the US Congress granted Treasury Secretary Henry Paulson $700 billion in bailout funds under the Troubled Asset Relief Program (TARP).

The TARP's stated purpose was to buy up so-called "toxic assets" from the banks and major financial institutions. In effect this meant using the resources of the US Treasury to maintain fictional asset values across the board. But on November 12, barely a month after the passage of the TARP, Paulson announced he was abandoning this plan. Asked to explain why, he replied: "The situation worsened, the facts changed."

Paulson was impaled on the horns of a dilemma. If the government paid the true value for these near worthless assets, the banks that held them would be forced to take massive losses. On the other hand, if the government paid the inflated values necessary to avoid these bank losses, the $700 billion would be but a drop in the bucket.

In other words, Paulson's change of mind expressed his recognition that the crisis was so large that the previous 20-year policy of pumping up asset values could no longer be continued. Whole sections of capital were going to have to be liquidated. Thus the TARP funds are being used to recapitalise banks and other financial institutions—at least those deemed worthy of saving, or with the closest connections and ties to the administration—while others will be allowed to go to the wall.

In short, the attempt to evade the laws of the capitalist economy through the use of monetary policy has come to an end. Those laws are now asserting themselves as they did in the 1930s, in the same manner that, as Marx explained, the law of gravity asserts itself when a house collapses about our ears.

Two fundamental contradictions

Having pointed to the extent and consequences of the massive devalorisation of capital that has now begun, we now need to deal with the following questions. What are the origins of this crisis? How did it develop to the extent that it now threatens the world's people with the kind of economic, social and political disasters that characterised the 1930s?

Is this a crisis of policy, of inherent greed, a product of slack regulation by central bankers and governments? Are we perhaps all to blame, as one rather ignorant academic wrote in his column published in the *Australian* on Monday November 24, or does the crisis arise out of contradictions inherent in the foundations of the capitalist mode of production?

In order to provide answers, we need, once again, to consider some ABCs of Marxist political economy.

Capitalist society is marked by a profound contradiction: between the material development of the productive forces, which it promotes, and the social relations within which this development takes place.

If we study the economic history of the past 150 years this contradiction—between the material productive forces and the social relations of production—has emerged in two forms. The first is the contradiction between the global development of the productive forces under capitalism, and the nation-state system in which the political power of the bourgeoisie is grounded. That contradiction, as we discussed in relation to the recent G20 meeting, has once again assumed an acute form.

The second is the contradiction between the growth of the productive forces on the one hand and the social relations of capitalist production, based on the private ownership of the means of production and the exploitation of the working class through the system of wage labour, on the other. This contradiction manifests itself in the tendency of the rate of profit to fall and the crises produced by it.

The tendency of the rate of profit to fall arises from the fact that while labour is the sole source of surplus value, and therefore profit, expenditure on labour power comprises an ever smaller portion of the total capital outlaid by the capitalist. This is an expression of the continuing growth of the productive forces and increased productivity of labour. But what it means is that to expand the total capital at the same rate, the same amount of labour must produce an ever-increasing amount of surplus value.

Let us utilise these insights to assess the present crisis. The origins of the crisis lie in the crisis of capitalism that erupted at the beginning of the 1970s—the end of the post-war boom—and the way it was overcome.

The demise of the post-war boom was marked by two major developments: the collapse of the Bretton Woods Agreement of 1944, which had ushered in the system of fixed currency exchange rates, and a sharp fall in the rate of profit in every major capitalist country. This profit decline led to a recession in 1974 followed by the onset of stagflation—high inflation combined with high unemployment—at the end of the decade.

The Bretton Woods Agreement was one of the pillars of the post-war economic order. It fixed the value of national currencies in terms of the US dollar, which, in turn, was tied to gold at the rate of $35 per ounce. The agreement was put together after more than two years of sustained work in British and American government circles to ensure the resumption of world trade, the fear being that if this were not done and there was a return to depression, revolution would erupt.

The agreement did its work, resulting in an expansion of trade and then investment. However, this very expansion exposed the contradiction lying at the heart of the Bretton Woods system—between a global economic expansion and currency systems still grounded on the national state.

For a time, the overwhelming economic superiority of the United States was able to overcome this contradiction as the dollar, backed by gold, functioned, in effect, as world money. But by the end of the 1960s a crisis was developing. It took the form of a dollar overhang—the dollars outside the United States in world markets vastly exceeded the amount of gold held in Fort Knox that was supposed to be backing them.

Various figures indicate what was underway. By 1968 the volume of dollars circulating outside the United States had grown to $38.5 billion, from just $5 billion in 1951. This amounted to $23 billion more than US gold reserves.

Moreover, the money circulating outside the US provided the basis for a new financial network, the so-called euro-dollar market. Banks found dollar resources were available that were outside the control of national authorities. Throughout the 1960s attempts were made by the Kennedy, Johnson and Nixon administrations as well as by British authorities to control the international movements of money and maintain the stability of the Bretton Woods system. But their attempts were thwarted by the operations of the euro-dollar market.

With efforts to regulate being undermined at every turn, US President Nixon cut the Gordian knot and removed the gold backing from the US dollar on August 15, 1971. The alternatives, such as imposing a recession in the US to reduce the trade deficit, clamps on US foreign investment and a reduction in US global military activities at the height of the Vietnam War, aimed at reducing the outflow of dollars, were simply not viable.

After August 1971 attempts to maintain a regulated currency system rapidly collapsed and in 1973 the floating dollar regime began.

In the final analysis, Bretton Woods foundered because the very expansion of world trade and world investment to which it had given rise—a global expansion of capital—could not be contained within a system of national regulation. The contradiction between world economy and the nation-state system had reasserted itself.

We now need to trace the development of the other central contradiction.

Following the immediate post-war economic and political restabilisation, the ensuing boom seemed like a golden age, which would continue indefinitely. Now, it was claimed, the seemingly intractable problems that had beset world capitalism after the eruption of World War I in 1914 could be overcome, or at least kept at bay. This would be done through the judicious use of so-called Keynesian techniques of economic management, based on the regulation of global capital flows on the one hand and the use of demand-management techniques by national governments on the other.

However, the "golden age" lasted barely a generation. By the end of the 1960s the rate of profit was beginning to fall. This tendency had been temporarily overcome by the extension of the Fordist system of assembly-line production from the United States to the rest of the world. Assembly line production, through the enormous increases in productivity it effected, had increased the rate at which surplus value could be extracted from the working class, so boosting profits. But after a quarter of a century, the process of catching up was coming to an end.

In 1974-75, after a period of rapid inflation, the world economy entered a recession. Recessions had developed during the boom, but they had given way to periods of even greater economic growth. The curve of capitalist development had continued to move up.

That was not what occurred after the recession of 1974-75. Pre-recession conditions were not restored and world capitalism entered a period of much slower growth, marked by rising unemployment and inflation—a phenomenon dubbed "stagflation". Keynesian measures, based on government spending to boost the economy, proved to be of no avail. In fact, they only worsened the situation by increasing the rate of inflation. Companies failed to respond to increases in effective demand by boosting production, as Keynesian theory suggested they should, but sought instead to lift their depressed profit rates by increasing prices while looking, at the same time, to cutting their workforce.

These great shifts in the economic base of society, starting from the mid-1960s, gave rise, as Marx had explained they would, to far-reaching political shifts. The period from 1968, beginning with the May-June events in France, to 1975, and the downfall of the right-wing Salazar dictatorship in Portugal, was one of immense revolutionary upheavals.

In every case, however, the struggles of the working class were betrayed by its social democratic and Stalinist leaderships, with the assistance of various radical tendencies. All of them promoted the illusion, in one way or another, that the bureaucratic apparatuses dominating the working class could be pressured to the left.

The betrayal of the revolutionary strivings of millions of workers around the world, and the resultant restabilisation of capitalist rule, did not signify that the economic contradictions lying at the base of this political turbulence had been overcome. How they were temporarily alleviated, and the way the measures that were adopted led to their eruption once again, but in an even more explosive form, constitutes the history of the world economy and the global financial system from the 1970s to the present day.

To be continued