Table of Contents

Notes on the Last Few Months

ByHillel Ticktin

Here is Hillel Ticktin's editorial for the forthcoming issue of *Critique* #46, due on December 1st, analysing the current crisis and its denouement:

http://www.critiquejournal.net

The most important ongoing event is the spectacular implosion of the financial system and the ongoing downturn. We will be having a number of articles on the subject in the next issue. These notes have conducted a running theoretical and empirical commentary but we will have more articles to supplement those in the April 2008 issue in the next issue-due to come out at the end of January.

The Implosion of Finance Capital-Depression and Deflation

It is almost impossible to open a newspaper without some reference to the historically important nature of our times. It is clear that we are living through a period comparable to that of the Great Depression in its political economic importance, even though it is unlikely to reproduce its length, depth and misery. These same establishment newspapers and journals find it necessary to defend and justify capitalism as a system, when there is no important movement challenging it. Marx is frequently quoted, both to support and criticise capitalism. [1] Nor is it only the media who are enamoured of Marx and gripped with self-doubt. Bankers and other establishment figures have excused themselves for not taking Marx seriously. Banksâ advice now includes the caution that Marx may be right about capitalism collapsing under the weight of its own contradictions. [2] Although, we may assume that the authors are not entirely serious, it is nonetheless a sign of the times.

Karl Marx appears then to have made a return from the grave to which he had been assigned in the nineties. Marxism has been declared wrong, irrelevant and worse for one and half centuries, only to return with renewed force. The suddenness of the conversion was unexpected. After all, far-left parties are marginal at best and detested at worst. The economics profession is, as ever, pro-market. Why then has there been this criticism of capitalism itself?

It was almost an orthodoxy that capitalism could always re-invent itself. That has been repeated by the historian Tristram Hunt [3] He points out that Engels had repeatedly expected a crisis to crack the system. He derives his material from Engelsâ letters to Marx and concludes that capitalism gets through its crises. There is no doubt that capitalism is not at an end not least because there is no working class movement for socialism. However, Tristram Hunt has missed the point. We are now living in a period of instability, and the instability is that of the system itself. When someone argues that capitalism has survived, the question is always by what means. After all, the system has survived through repression, imperialism, and war as well as through the welfare state. We have never had a peaceful capitalism in the developed countries, without exploiting peoples beyond its borders. In the third world, the situation was and remains dire, with certain exceptions.

It is not accidental that Marx can be quoted and that the system itself be questioned by those at the heart of the system. This is in part because those personages know the weaknesses of the system in some detail but it is also in part because the Cold War is over and Marx is no longer tarnished with the taint of Stalinism. It is of particular note that these writers and commentators see capitalism as a system even if they argue that there is no replacement. Once capitalism is perceived as a system, its limitations can also be discussed and then it is a short step to perceiving capitalism itself as in evolution from its birth to its dotage.

Defence of Capitalism in the Downturn

The wave of questioning has led to three lines of defence. We are told that in the end we will be back where we were before the downturn or perhaps before the speculative rise in asset prices from 2004. Simon Jenkins, a liberal commentator, has argued that all the discussion of the limits of capitalism is just hot air.[4] The failure lay in the regulators and the politicians who removed the regulation or who urged banks to extend their lending. Rationally considered, it can be argued that the financial crisis was an accident of history caused by the greed or incompetence of bankers or lack of regulation over a market which has to be regulated in order to function properly. In fact, there are three theses being put forward here.

Firstly, it is argued that capitalism is necessarily cyclical, but eternal, and hence the economy will recover and be better than ever, having learned its lesson. Secondly, it is maintained that the market requires regulation and regulation was systematically reduced over a period of more than twenty years, notably through the repeal of the Glass-Steagall Act in 1999 in the USA, allowing commercial banks to operate as investment entities as well as continue their everyday functions.[5] Thirdly, it is held that things might not have gone awry had not a number of individuals been so greedy for ever higher rewards. A fourth thesis could also be put forward. The contradictions of capitalism are showing themselves but the system will continue as long as there is no political movement to replace it. The first view merges with the fourth. Much of the organised left effectively supports the last view, having given up on the idea of capitalism entering a systemic crisis. Tristram Huntâs argument fits in here.

Clearly, none of these arguments says much for the capitalist system itself but then âthe danger of meltdownâ has been a constant refrain in all the media. It would appear that both the capitalist class and those who manage their operations have been seriously frightened. Indeed, the two weeks that followed the nationalisation of the mortgage companies was described in graphic detail in the media, âNightmare on Wall Stâ being probably one of the best headline.

At the same time, although there is no organised left of any importance in the USA or Europe, the population is both worried and angry. It is one thing for a factory owner to receive a subsidy but another for bankers to be bailed out. Most people do not see bankers as anything but parasitic, receiving huge salaries for receiving other peopleâs money and lending that money out at exorbitant rates of interest. While financial capital is necessary for the capitalist system to function, the dominance of finance capital and the huge rewards it receives are a function of the present stage of capitalism itself and that view is widely held. Outside of the Anglo-Saxon countries, industrial capitalism plays a greater role and finance capital is often resented. As a result, Finance Capital and its functionaries see themselves as beleaguered, and in a fragile situation, both because of the threat to their âbusinessâ and because of a possible systemic threat.

The Implosion of Finance Capital - A Turning Point in History

In these notes, we have made the point that we are living through a turning point in history[6]. Finance capital itself has imploded and as the USA is the heart of finance capitalism, the dominance of the USA as the controlling world power is in decline, without a successor. One author writes that it is âinevitable that the Anglo-Saxon model of unfettered capitalism that has dominated thinking for half a century will be much diminished. What will replace it is unclear, but it may well look more like a form of state capitalism - perhaps not full-blown, but something much closer to Chinese capitalism than would have seemed conceivable just a month ago.â [7] However, it is clear that that the USA will remain the dominant power and China will continue to be dependent on it for investment, for technology and for the market for its goods. Another writes:âThe autumn of 2008 marks the end of an era............To invert Karl Marx, investment bankers may have nothing to gain but their chainsâ. [8]

At this point, it is worth defining Finance Capital. Finance capital is a Marxist concept, which is often misunderstood and insufficiently theorised. It is defined as abstract capital: that is to say, abstracted from its conditions and locality and hence automatically global as opposed to industrial capital, which is confined to a locality or a number of localities. It is financial capital become independent and dominant over the process of accumulation. It is unproductive of value and so must extract it from the productive sector. It is predatory and parasitic in that it transfers capital from where it is originally accumulated to itself. It then invests where it can obtain the maximum return in as short a time as possible. It therefore invests in unproductive areas like property speculation, commodity speculation, equity and bond speculation as well in itself âin derivatives of all kinds. It invests in industry but in so doing it distorts the economy and industry in its own interests in order to obtain maximum returns as soon as possible. It therefore has every incentive to bend the rules, change accounting practices, and avoid tax. In the present period, it has extended the practice of asset stripping enterprises, the most obvious examples being given by private equity. It avoids investing in innovations that require long-term involvement, preferring industry that will give high returns quickly. Even where industry does not borrow capital, the norm is set by finance capital. In general, finance capital is global and so dominated by the major economic power-the USA, with the assistance of the UK, but not all countries conform to the same degree-witness Germany and France.

In the 1970s, finance capital returned to its former role, replacing industrial capital as the dominant sector of capital. The theory of monetarism was its economic policy while so-called âneo-liberalismâ was its political-economic strategy. This was a deliberate shift in order to contain the working class, who were demanding more control over production, higher wages and better conditions. Industrial growth shifted downwards, unemployment rose, the government found itself with a fiscal deficit and so reduced welfare and other government expenditures. The levels of unemployment were hidden by shifting the long-term unemployed onto new categories. For example, in the UK, they receive disability benefit, over fifties receive pensions and the young go onto various training schemes. The reality is that the number of economic inactive rose from around 1 per cent in 1970 to figures lying between 10 and 20 per cent, depending on the years involved. On the other hand, profits rose, and management incomes rose many times. As is well known, income distribution has never been so skewed since the Second World War. On the one hand, there were large sums of money to invest but on the other hand, there were limited investment opportunities. This was all the more so once the Cold War came to an end. Official military expenditure in the US budget as a percentage of GDP fell to well under half of what it had been in 1986 by 1997. The Iraq and Afghan wars have doubled the figure of military expenditure but the budgeted military expenditure as a percentage of GDP is still not much more than half of what it had been in 1986.

The point of the last two paragraphs is to provide the background to the current implosion. Apart from the flows of money coming from pension funds and insurance companies, the rich and seriously wealthy have had huge resources looking for an investment. The Swiss Bank UBS has the largest total of âAssets under Managementâ of any bank- some 3.2 trillion Swiss francs. One estimate argues that there is over 500 billion dollars of money per annum, looking for investment coming from the third world, apart from official flows. While the Chinese and Japanese governments have accepted the need to put much their money into US government bonds, private investors prefer to get higher returns. The pressure, therefore, on the investment houses was enormous, given the competition, which exists among them. Capital, therefore, turned to investing in itself. We have given the figures in the previous Critique Notes, [9] but it is enough to note that the total over the counter derivatives rose five times from 2001, while credit default swaps rose from almost 1 trillion dollars to 62 trillion dollars. The Dow Jones index of shares rose 7 times from 1987. There was a huge asset inflation during this period of revived finance capital. The house price rise in the USA and the UK was just one aspect of this asset inflation. At the same time, the rewards to finance capital soared: âAs the financial industry prospered, its share of the American stock market climbed from 5.2% in 1980 to 23.5% last yearâ. [10]

Derivatives became an arcane way of extending credit on a huge scale, as banks could âsecuritizeâ their loans and so extend new loans. Combined with the expansion induced by the Iraq War, there was a short-lived boom on a global scale. It was global because finance capital both invested capital in China, which then expanded industry on a vast scale, and vastly extended worldwide credit. The increasing US balance of payments deficit temporarily boosted third world balance sheets and so left the IMF with a weakened hand. The vast expansion of derivatives, particularly credit swaps, could only end in grief, given the limited base. Given the static nature of real incomes, demand for goods and services, and Chinese industrial goods in particular, could only reach a ceiling and go down. Without an extended war, the system had to crack. The fact that it did so over house prices was not coincidental since they embodied both the derivative expansion and the limit on workersâ incomes

The Current Crisis and Its Denouncment

The fall of commodity prices, including oil in particular, preceded the threat of meltdown. Oil had dropped by almost half from 147 US dollars in July to 70 dollars in October. We have asserted over a number of issues in these *Notes* that the impetus behind the rise in prices was the same as the reason for the credit crunch and overall downturn-the very- the large surplus of capital over areas of profitable investment. Finance capital has turned to derivatives, wherever it looked a possible haven, and so implicitly to loan packages of various kinds, as well. While the press has been divided between the viewpoint that shortages forced up the prices and the impact of speculation, it has become known that the Federal Reserve played a role in helping to bring down commodity prices [11] . It is, therefore, clear that speculation played a crucial role in the price rises, even if shortage had some part to play. The division between the West Europeans and the Anglo-Americans over the cause of the price rises ran exactly between those where finance capital was dominant and those whose economies remained primarily industrial.

It has to be said that there was every indication that the US government needed to intervene in the world economy in order to ensure its own stability both internally and internationally. So much for the market bringing order or stability. The nationalisation of Fannie Mae and Freddie Mac has made this point very clear. It seems that the Bush administration did not want to do it and so took longer than was wise to put the two firms into conservation, as it is put. The fact that a conservative administration has had to intervene in saving Bear Stearns and the two mortgage wholesale enterprises plus AIG has been justified by arguing that these are temporary measures. However, commentators, like Martin Wolff in the Financial Times, have pointed out that privatisation will take a long time and certainly not two years. [12]

It is possible that the subsequent threat of meltdown would not have happened if the US Government had acted faster and had it also saved Lehman brothers. It is clear that market ideology prevented them acting until too late. In a sense, it was too late because the end result has been an extinction of the investments banks combined with the prospect of a tight regulatory regime, over partly or wholly nationalised banks. Finance Capital will not be able to play its previous role.

The subsequent passage of the Troubled Assets Relief Program (TARP) by Congress was assailed as being socialist by the right and the left has had much fun with the ultra-montane Congressmen, who saw freedom coming to an end with the advent of âsocialist interventionâ. There is, however, a serious side to their complaints, in that government intervention does limit the operation of the market and so the functioning of capital. It does lead to the growth of government and so of bureaucracy under capitalism. Without question, this is a far better solution than a deep downturn or a depression. At the same time, Congress and the capitalist class are faced with a choice of two evils, from the point of view of capitalism, but only seriously stupid or blinkered politicians could want to cut their noses off to spite their faces, and refuse to bail out the banking system, so precipitating a possible repeat of 1929.

The Effects of the Solution

There are two results that follow here. The first is the question of ideology. The doctrines propounded by finance capital going under the name of âneo-liberalismâ now look dated at best and a failure at worst. The market does not know best and in fact would collapse without government intervention. As the downturn is likely to last several years with further government intervention quite certain, these issues will continue to come to the fore. Governments have been pushed to intervene and will continue to be forced to intervene to help those evicted from their homes and those living in fuel poverty, while continuing to nationalise banks and probably industrial firms, as well as to prevent a systemic collapse. Countries, particularly those in the third world, will have to be helped to survive both for their own sake and in order to avoid a domino effect.

Commentators talk of the socialisation of risk and the privatisation of profit. In fact, this has always been the case, but the absurdity of the Thatcherite claim that you cannot buck the markets has brought reality to the fore. As the downturn continues, we might expect âmarket fundamentalismâ and even the concept of âlassiez faireâ to lose their dominance. Keynesianism has returned, at least in name. Sam Brittan, a deputy editor of the Financial Times announced that:

> âThere will be no âglad confident morningâ for free-market principles for a long time to come.â [13]

The second question concerns the extreme nature of the dangers facing the capitalist system. Again, it is clear that without the nationalisation of the two mortgage companies and AIG there was a risk that many non-US banks, who had invested in these companies, would be in grave trouble. Given the fact that banks, like the Swiss bank, UBS, had already suffered huge losses this could tip them over the edge. This situation would apply to hedge funds and other financial institutions. The danger to the system as a whole was considerable and had to be quickly dealt with. In fact, it took some time for the government to make up its mind, and for Congress to pass the administrationâs preferred bill, so prolonging the risks and the agony. The nationalisations combined with the proposed government purchase of âtoxic debtâ, supply of money to the money markets and further purchase of shares in troubled banks have steadied the world monetary and credit system for the time being. If the US government had followed the advice of its right wing and let the market take over, then the crash of 1929 would have looked like a picnic. Engels dictum that every crisis is worse than the last would have been proven. The failure to pass the initial bill had led to precisely such fears: âTerrified of a catastrophic Wall Street meltdown, the House Friday approved an unprecedented $700 billion bailout bill - and President Bush quickly signed it into lawâ. [14]

Keynesianism and Social Democracy

While commentators may accept criticisms of capitalism, they remain bound to the system itself. Will Hutton speaks for them when he argues that the issue is not capitalism itself but the necessity of a fairer and more redistributive form.[15] However, the capitalist class will not willingly return to the social democratic form of the immediate post-war period, as it would be far too dangerous to the system itself. Full employment, a high rate of growth, a rising standard of living, free health and education and affordable housing provide a springboard for the working class to demand greater control over its own life, better working conditions and higher wages. In Marxist terms, the abolition of the reserve army of labour and the removal of the fetishism of the commodity leaves the system without control over labour. It only worked in that period because the working class had come through a much worse period of fascism, depression and war and was still contained within a Cold War.

The frequent references to âmoral hazardâ indicate that that the ideology of the market remains. The fact that dithering over nationalisations due to worries around the âmoral hazardâ involved has receded shows that market ideology is losing some of its hold.

The strategy of Finance Capital has gone into meltdown and there is no replacement. We are at the end of the beginning of this downturn. The next phase involves declines in industrial production, and overall profits and a large rise in unemployment. Governments are talking of investment in infrastructure. Will Hutton points out that it makes sense to raise unemployment benefit.[16] At the same time, contemporary economic ideology dictates a balanced budget or at least the lowest possible deficit. There is no question that governments could pour money into the economy, nationalising failed concerns where necessary and so limit the downturn. However, the concept of workersâ wages being raised in order to increasing spending power is unlikely to be endorsed, as it would obviously reduce profits not just immediately but for some time in the future.

The Military Solution - A New Cold War?

The usual alternative of increasing military expenditure is not an option at this time because of the failure of Iraq war and the absence of a Cold War. It is possible that the sabre rattling over the Russian invasion of Georgia was seen as an alternative rallying point, raising the spectre of a new Cold War. However, the idea that modern Russia could conduct a Cold War is so absurd that one wonders whether the British and US foreign offices knew what they were doing. Russia today is a weak power. Its troops went into South Ossetia, in Georgia, in large part because of its weakness. Its Southern borders are permanently unstable. Chechnya remains under occupation there. The Russian elite took the opportunity to raise its standing among one section of the population in that area and warn off the rest. No doubt the Russian elite harbours expansionist tendencies but that does not mean that they are about to invade former Soviet countries. Russiaâs military forces and thermo-nuclear weapons are not those of the USSR. They have been run down and the military personnel remain demoralised.

The strong stand taken against Russia directly conflicted with Western aims in the area of the former Soviet Union. Hitherto their aim has been one of helping to remove the remnants of Stalinist forms and replacing them with the market. Since that has turned out to be an elongated and possibly unsuccessful process, Western governments, or the capitalist class, have every interest in encouraging Russian governments to participate in global market forms. Instead, there were demands that Russia not be admitted to the World Trade Organisation. Since the dominant section of the Russian elite does not want to join the WTO, and is being pushed by the more liberal section of the Russian elite as well as by the West that demand seemed absurd.

The Western campaign did lead to a massive outflow of money from Russia. When the financial crisis emerged Russian finance capital was badly hit. With the continuing decline in prices of raw materials, the Russian economy will be in more trouble than most countries, other than Iceland, to which it is, paradoxically, giving a loan. There is every probability that at the end of the downturn Russia will have achieved a more substantial return to state control of the economy.

Depression or Recession

What the downturn will now be called is a question of economistsâ vanity. For some time, downturn was used rather than recession. Then recession became acceptable. Today the question is whether one can call this downturn a depression. In any reasonable discussion, it would be called a depression, since the word recession was invented to avoid the odious associations of a depression, of unemployment, hunger and suicides but did not add any more meaning to the discussion. After all one can have a shallow depression and a deep depression. Today there are discussions whether the recession will be shallow or deep, with many opting for the latter. As Paul Krugman noted:

> âÂ Just this week, we learned that retail sales have fallen off a cliff, and so has industrial production. Unemployment claims are at steep-recession levels, and the Philadelphia Fed’s manufacturing index is falling at the fastest pace in almost 20 years. All signs point to an economic slump that will be nasty, brutish - and longâ [17]

One may add that the upturn, when it comes, is likely to weak.

As there is no comparison with any other downturn other than the 1929 depression it is clear that we are in a classic depression, with somewhat more spectacular fireworks but with much more government intervention. Whereas the downturns in the last century after the last World War were largely a result of anti-inflationary measures, the downturns of March 2000 and August 2007 are a result of surplus capital not finding a profitable outlet.

Footnotes

1 One of many instances is that of John Plender: "Shut Out" in the *Financial Times, 18-10-2008, p.11,* in which cites a very pertinent paragraph from Marx: "Karl Marx was wrong about many things, but in 1893 he provided as good an account of today’s financial implosion as any living commentator. "To the possessor of money capital, 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."

That passage from *Das Kapital* is a fine description of the financialisation of the economies of the English-speaking countries in recent years and of the resulting credit bubble." Das Kapital first appeared in 1867, as is well known, and Marx died in 1883.

2 *Eye on the Market* - A commentary written for JPMorgan clients by its Global Chief Investment Officer Michael Cembalest and Private Wealth Management Chief Investment Officer Hans Olsen, New York: JPMorgan, 7 October 2008, Paragraph 6. "How will we ever get out of this mess?"

"Most of our professional careers were spent watching global central banks fight (and then win) a battle against inflation. The tragic irony is that if nothing is done to prevent this credit spiral, those inflation gains will be for naught, with economic activity crumbling in a deflationary spiral. The stakes are high, with each region having its own visceral memories of what it's like to get it wrong. Â For the U.S., the Depression of the 1930's. Â For Japan, the 15-year deflation of the 1990s. Instead of history, the greatest fear for Europe might be that Karl Marx was right: that capitalism is a system doomed to destroy itself through its own internal contradictions. Â So to answer the question, I think that global consciousness has been rudely awakened: while the decision to build a market economy based on massive amounts of debt was left to the private sector (see second chart below), the consequences of unwinding it cannot be. The flurry of public sector activity in the last 12 months and 12 days suggests to me that by the end of the year, we will see more explicit plans to safeguard the surviving banks, which will mark the beginning of the long road back."

3 *The Guardian*, London, 20th September, 2008. Tristram Hunt.

4 Simon Jenkins: "The end of capitalism? No, just another burst bubble.Those drooling over the free market's collapse are wrong: this passing crisis is down to lax regulation and craven ministers" *Guardian*, 15 October 2008, p.29.

5 A short history of modern finance, Link by Link, *Economist,* 16 October 2008, p.96-98

6 Critique Notes, *Critique 44*, p;1-4.

7 Andrew Graham, 'If China spends its trillions, recession could be averted', *Guardian*, London, 15 October 2008, p.28:

8 A short history of modern finance, Link by Link, *Economist*, 16 October 2008, p.96.

9 Critique Notes, *Critique 45*, p.172.

10 A short history of modern finance: Link by Link, *Economist*, 16 October 2008, p. 97.

11 This report refers to the July 11th 2008 decision to support Fanny Mae and Freddy Mac.

According to Mr. Coxe, the Fed's ultimate goal was to trigger a rally in financial stocks, which would, in theory, help banks hammered by the credit crisis raise fresh capital and repair their balance sheets. To accomplish this, the decision to support Fannie and Freddie was deliberately announced on a Sunday, which had the effect of maximizing the reaction from thinly traded financial stocks on overseas markets.

Because many hedge funds were using massive leverage to short financials and go long on commodities, when North American markets opened and banks initially rallied, the funds were forced to cover their short positions.

At the same time, the U.S. dollar was rallying because the risk of holding Fannie and Freddie paper had diminished. The rising dollar, in turn, made commodities less attractive, giving funds that were already scrambling to cover their financial shorts another reason to dump oil, grains and other commodities.

The losses were swift and dramatic. On the Friday before the July 11 announcement, crude oil closed at $145.18 a barrel. Over the following five days, it plunged 11 percent. "Leverage was being unwound dramatically," Mr. Coxe said on a conference call last week. "We had a true panic."

As oil and other commodities were tumbling, fears about the slowing global economy were mounting, giving resources another push downhill. This was also in keeping with the Fed's wishes, because lower commodity prices would help quell fears about inflation.
http://ftalphaville.ft.com/blog/2008/09/11/15798/the-fed-is-long-financialsshort-commodities/
Accessed 11 September 2008.

12 Martin Wolff: *Financial Times,* 10 September 2008, p.2.

13 'Capitalism and the credit crunch**'** By Samuel Brittan, *Financial Times*, 11 September 2008 18:33, Last updated: September 11 2008 18:33 Accessed:
http://www.ft.com/cms/s/0/b1e7adb2-801a-11dd-99a9-000077b07658.html?nclick_check=1

14*New York Daily News*,
http://www.nydailynews.com/money/2008/10/03/2008-10-03_house_of_representatives_passes_controve.html
, accessed 5 October 2008.

15 Will Hutton, *Observer*, 19 October 2008, p. 29.

16 Op. Cit.

17 Paul Krugman: 'Let's Get Fiscal', *New York Times*, 17 October 2008.