THE ORIGINS OF THE CRASH AND THE LIMITS ON RECOVERY

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Three years after the global financial crisis (GFC) it is timely to assess its origins, impacts and consequences. The dominant explanation for the crisis in popular discourse has focused on factors that lie outside the sphere of capital accumulation, whether these are the 'common sense' ideas that the GFC resulted from unbridled 'greed' by the bankers or the incapacity of poor people to manage their mortgages, or the Keynesian notion that the crisis resulted from inadequate regulation of the financial system (Elliott & Atkinson, 2008; Roubini, 2009). To the extent that there is a solution to these problems, other than moral homilies addressed to financiers, most writers have pointed to the need for better regulation of the financial system and a more balanced relationship between financial and productive capital (Arestis & Sawyer, 2010). Such themes are evident also in the work of some of those working in the Marxist tradition, such as Blackburn (2008). Common to all of them is the idea that capitalism can somehow be reformed into performing more effectively and future crises warded off (McNally, 2011: 88).

In this article I draw on a very different account of the crisis provided by Chris Harman (2009) which builds upon and updates his earlier work (Harman, 1984). In these books Harman provides a cogent account of the development of post-war capitalism and capitalism's crisis tendencies and uses these to explain the roots of the GFC. Harman (2009) argues that the crisis has its roots not in financialisation or greedy bankers, but the long term slowing down in the dynamism of the advanced economies. While this gradual slowing of the advanced economies is something that has been recognised and widely discussed by a range of writers (Itoh, 1990; Armstrong, Glyn & Harrison, 1991; Brenner, 2006), Harman provides a compelling account of Marx's analysis of capital accumulation and spells out a persuasive explanation of the boom and

systematic account of the background to the crisis. It is for this reason that I use his work for what follows. The contribution of this article lies in the analysis that is provided for the period since the onset of the GFC, which is where Harman's last book finishes. While the GFC marked a crisis in the world economy at large, the focus of the article is on the advanced economies and in particular the United States whose GDP - at $14.7 trillion – is equivalent in size to the next three largest economies, China, Japan and Germany, combined (International Monetary Fund (IMF), 2011a).

The Origins of the Crash: a Long Term Perspective

The quarter century following the end of World War II was characterised by strong capital accumulation, full employment, rising real wages and sustained growth in every Western economy (Maddison, 2003; Harman, 2009: 161; McNally, 2011: 27). This was a period of growing and relatively evenly distributed prosperity. But from the early 1970s crisis tendencies became increasingly obvious and in 1974 the post-war boom came to an end. Since that time, most advanced economies have experienced at least two serious recessions, and many, three, each characterised by high unemployment (McNally, 2009). The intensity of these recessions and the periods of growth experienced between each of them have evidently varied across different countries but the general trend is fairly consistent.

Harman, among others, sources this great slowdown in the Western economies to the tendency for the rate of profit to fall.[1] That the rate of profit fell in the latter stages of the post-war boom is not controversial and is widely accepted by writers including Dumenil & Levy (2002), Brenner (2006), Mohun (2006) and McNally (2011). But the reason for the fall in the rate of profit *is* contested (Shaikh, 1978; 1999). Harman (2009: 68-72) uses Marx's analysis in Capital volumes I and III as the foundation for his explanation. A brief elucidation follows. Driven by competition, Marx argued that each capitalist is forced to invest greater sums of capital in constant capital as opposed to variable capital –

1 In a series of appendices to his 1984 book, Harman deals with a range of other explanations for the crisis of the 1970s. See also Shaikh (1978) and Kliman (2007).

machinery as opposed to labour power – in order to cheapen costs of production. The result is a rising organic composition of capital. While every capitalist who engages in this process enjoys a higher rate of profit by doing so, the overall effect, *ceteris paribus*, is to reduce the general rate of profit in a given country or sector because only labour power is capable of creating additional value over and above its own cost of reproduction.

Marx traces, and Harman elaborates upon, a series of 'counteracting causes' which offset this tendency for the rate of profit to fall (Harman, 1984: 20-49; Harman, 2009: 72-75). In particular, Harman points to the destruction of capital during the Great Depression and World War II as the foundations for the post-war boom, and this growth was further sustained by what Harman calls, after Kidron (1968), a 'permanent arms economy', the process by which capital was siphoned off into waste production, in this case the arms industry, and thereby removed from the process of capital accumulation (Harman, 2009: 129-32; 166-68). The organic composition of capital was thereby held down for a prolonged period, putting a floor under the rate of profit.

But the permanent arms economy could not work forever to stave off a return to crisis. The post-war boom came to an end when the United States was forced to respond to rising Japanese and German competition by diverting surplus back into productive accumulation and away from arms production, thereby driving up the organic composition of capital and pushing down the rate of profit (Harman, 2009: 198-200). The weakening of US capitalism was indicated by the end of the Bretton Woods system in 1971, but it was the oil and commodity price shock and the inflationary surge that resulted that finally ended the long boom.

The stagflationary crisis of the mid to late 1970s was the catalyst for a major rethink in the ranks of the capitalist classes and their states (Harman, 2009: 192). Keynesianism was junked, monetarism was toyed with, wages controls were implemented but none of these moves restored the system to its earlier dynamism (McNally, 2011: 31-33). It was in this context that the Thatcher government and Reagan administrations launched their programs – marking the beginning of what is now known as neoliberalism (McNally, 2011: 33-36; 42-49). The neoliberal revolution under Thatcher and Reagan had two essential components: destruction of inefficient capital through high interest rates (the 'Volcker squeeze'), privatisation, deregulation and, in the case of the UK at least,

harsh government austerity; and, second, a sustained attack on the working class in order to increase the rate of exploitation by raising both absolute and relative surplus value (Moody, 2007). Other factors that contributed to the partial recovery in the rate of profit included more efficient use of the capital stock, including methods such as just in time and lean production, increased unproductive expenditure on marketing and advertising, and a slowing down in the rate of accumulation which reduced pressure on the organic composition of capital to rise over time.

While the US and UK led the way, most other Western economies followed suit over the subsequent decade, marking a new 'Washington Consensus'. The results were fairly uniform: a higher average level of unemployment, a further concentration and centralisation of capital, stagnation (or reductions) in real wages, and a substantial shift in the distribution of income to capital versus labour. The mass of profits soared and the rate of profit began to recover (Mohun, 2006; McNally, 2009; Shaikh, 2010).

The rising rate of profit in the US in the 1980s and 1990s did not resolve certain underlying problems for the American capitalist class. First, growth rates were, on average, lower than they had been during the post-war boom, and this applied to both the rates of GDP growth and investment growth (Foster & Magdoff, 2009; Harman, 2009, 231-32; Beitel, 2010). Indeed, on Brenner's figures, capital accumulation slowed successively across the G7 in every decade after the 1960s (Brenner, 2006: 282). According to Harman (2009: 233) and Kliman (2009), the growth of the system was held back by the fact that the crisis mechanism, in particular the devaluation of capital, did not work its way through. The crisis of the 1920s required the slump of the Great Depression and a world war to achieve the purging of capital that was required to restore vigour to the Western economies (Harman, 1984: 71-74). However, such has been the concentration and centralisation of capital since that time, involving a growing size of firms and rising interconnectedness, both domestically and internationally, that the US government and those of other advanced states could not afford simply to let 'their' businesses go to the wall, for fear of the chain reaction across the whole national economy (Harman, 2009: 233). Some household names such as Texaco, PanAm and Enron certainly went under, and the number of bankruptcies grew over time; but the process did not extend sufficiently to provide a stimulus for a fresh round of expansion (Kliman, 2009). And so, while the rate of profit in the US in the 2000s was certainly higher than 20

years previously, it was still lower than in the 1960s and the early 1980s (Brenner, 2006: 7).[2] In Japan and Germany the situation was more urgent as the rate of profit continued to trend downwards through the whole period (Brenner, 2006: 7).

The second major problem experienced by the capitalists was that one of the most important methods that they had used to boost the rate of profit – squeezing the wages share, and in the United States, real wages (Brenner, 2006: 4 & 283) - also held back growth of markets. Wage cuts may have enabled the American capitalist class to reap more surplus value from the working class but they also limited its ability to realise this value.[3] Every capitalist was busy cutting wages while wanting their rival to raise theirs. And, with investment in retreat due to an inadequate rate of profit, demand for the output of American industry suffered. Although US capacity utilisation in industry experienced cyclical volatility, the general trend was downwards (Figure 1).

It is in this context that we can understand the significance of the 'financialisation' that accompanied the neoliberal revolution. With rates of profit still relatively weak in productive industry (compared to the post-war boom), but with ever growing pools of investible funds, capitalists in many advanced countries, both productive and financial, looked to the financial sector, where profit rates were higher, as an outlet for their investments (Harman, 2009: 283). The result was a speculative boom in Western real estate and the stock markets, starting in 1982 and interrupted only briefly by the 1987 crash and the 2000 dotcom bust (Harman, 2009: 278-79). The proportion of profits accounted for by financial investment as opposed to productive investment grew steadily (Blackburn, 2006: 39). Cheap money flooded the Western economies, encouraging companies to borrow to invest more in further speculation. Such asset price bubbles helped to create an illusion of profitability. In practice, all that they were doing was putting off the day of reckoning. Measures used by the Federal Reserve – chiefly the reduction of interest rates – to reboot the domestic economy after each speculative bubble burst only exacerbated the problem, even if they provided some short term relief (McNally, 2011: 102).

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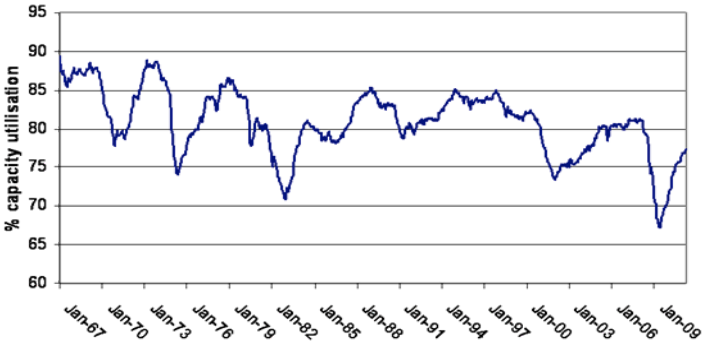
2 Although it should be noted that Kliman (2009) challenges the notion that the rate of profit in US industry experienced any sustained recovery prior to 2000.

3 Such "realisation crises" are discussed by Marx in volume III of *Capital* (Chapter 15, section 1).

Figure 1: Capacity utilisation in US industry, 1967-2011



Source for data: Federal Reserve Bank of St Louis (2011)

Thus the reduction in interest rates following the dot com bust only prepared the way for the property bubble of the 2000s which had an impact on not just the United States, but Australia, Ireland, Spain, the UK and a host of other countries (Harman, 2009: 286). Plentiful supplies of cheap money also allowed US households to borrow more in order to offset the declining value of their wages and thereby sustained markets for the output of American producers (Harman, 2009: 287; Kliman, 2009)). Household and corporate indebtedness grew rapidly. And, under the George W Bush administration, US government debt also rose sharply as cuts to taxes on capital and high income earners, alongside a steep increase in military spending, took their toll.

It is important to note that 'financialisation' flowed from factors that had their roots in the weakness of productive capitalism. But it did not mark any victory of finance over industry, as Dumenil and Levy (2004) and Crotty (2005) suggest. The big industrial corporations such as General Motors also joined in, finding that they could make as much money from financial operations as they could from actually making commodities (Harman, 2009: 284-85). Further, the financial boom then fed back into the productive sector, with strong demand for housing fuelling demand for construction and consumer goods and thence to raw materials and heavy industry (Harman, 2009: 288).

The economic growth of the 2000s, underwritten by this process of financial expansion, underlay the optimism that pervaded reports by the

international financial organisations such as the IMF in the mid-2000s. Successive Federal Reserve chairmen Alan Greenspan and Ben Bernanke were applauded as astute economic managers. US growth, although weak compared to the boom of the 1950s and 1960s, provided markets for the world trading system as it turned into importer of last resort. In Europe the boom eased the transition problems associated with the integration of the EU27. US growth also assisted China, which broke through in the 2000s as a major exporter and cheap labour source for Western manufacturers moving offshore. Finally, an apparent synergy developed in the 2000s between the so-called 'surplus' nations of Germany and China and the rest of the European Union and the United States. Germany restricted wages and cut social spending through its Agenda 2010 program, and used the cheap euro to depress imports and boost exports (to 40 per cent of GDP), thereby establishing a trade surplus equivalent to 6 per cent of GDP. China too capitalised on low wages and a low exchange rate to boost its exports to the US, running up significant trade surpluses equivalent to 5 per cent of GDP. The reserves of US dollars or Euros held by China and Germany resulting from increasing trade surpluses were then ploughed back into purchases of government bonds in debtor nations, in particular the US and Southern Europe (Padoan, 2011). Given that China and other East Asian surplus nations appeared to have no limit to their appetite for US bonds, the US government under George W. Bush saw no problem with extending its budget deficit with successive tax cuts for the rich. The purchase of US bonds by the governments of East Asia and the oil producing nations also prevented their currencies from rising (thereby maintaining their competitiveness) and their domestic money supply from accelerating. And surplus government purchases of debtor government bonds helped to keep the latters' economies expanding, thereby providing markets for the former.

This review of conditions as they existed at the time of the GFC in the last quarter of 2008 is necessary to deal with the argument that the GFC was the result of bad policy, lack of regulation or factors external to the circuits of capital accumulation. If this were the case the current crisis could be overcome by intelligent policy fixes. On the contrary, I suggest that the current crisis has its roots in the crisis of profitability in the 1970s and the measures that were adopted to respond to that. To summarise: the neoliberal response to the crisis of the mid-1970s involved restructuring of capital and suppression of working class living

standards. These measures boosted the rate of profit rate but not sufficiently to fuel a sustained and broad based advance in the world economy. The result was that an increasing proportion of surplus value generated in the productive sector was devoted to the financial sector, yielding paper profits or fictitious capital, rather than extended accumulation. Further, the restorative measures that were used in the 1980s and 1990s to overcome the crisis paved the way for the current crisis and the weak recovery in three ways. First, attempts to boost the rate of profit by cutting wages depressed consumer spending on which sustained recovery might be based, and efforts to overcome this by extending credit to households spurred the speculative bubbles which eventually burst with the GFC. Second, the process of regular capital destruction, which Marx argued was a crucial regenerative feature of capitalism, did not work its way through comprehensively. And, third, the apparently mutually beneficial relationship between the surplus and deficit nations established in the 2000s could and did turn sour when the crisis of 2008 unfolded.

The Crisis in the US and Other Advanced Economies Today

The existence of deep underlying problems in the advanced economies even during the growth phase of the 2000s helps explain why a housing crisis in the United States quickly brought the world economy to its deepest crisis since the Great Depression. The bust in the US housing sector, starting in 2007, resulted from excess housing stock and a surge in mortgage defaults associated with rising unemployment and an inability to pay. A series of mid-tier US banks began to topple. The process by which fictitious or paper profits had been created over the preceding 10 years – through pricing financial assets at their highly inflated bubble values (‘mark to market’) – now went into reverse and deleveraging began. With US housing prices falling sharply (Standard and Poor’s, 2011), the entire US financial system, which had become increasingly dependent for its expansion on real estate speculation and the creation of highly leveraged synthetic and repackaged financial assets, was seized by panic. The credit crunch of September-October 2008 resulted and the entire structure of Western capitalism, and thence world capitalism, appeared at risk (McNally, 2011: 13-20). Industrial

output and world trade plunged (Eichengreen and O'Rourke, 2010). Fixed investment in the advanced economies, already falling before the crash, plummeted in 2008-09 (Figure 2). Unemployment rose sharply (Figure 3). Capacity utilisation in the US fell rapidly from 81 per cent in January 2008 to 67 per cent by June 2009 (Figure 1) and company profits dropped from $1.35 trillion in 2006 to $850 billion in 2008 (Bureau of Economic Analysis, 2011a).

Western governments and central banks took three measures to prevent the GFC turning into a catastrophic shutdown (Khatiwada, 2009). First, they bailed out the threatened banks, which converted the debts accumulated by the main investment banks into public debt. With governments standing behind the banks, some confidence was restored and bank to bank lending resumed, ending the credit crunch. Second, governments issued stimulus packages of additional spending to reflate the economies and boost world trade. And, third, central banks cut their cash rate to zero, or close to it, in an attempt to spark business investment and consumer spending (Reserve Bank of Australia, 2011).

Figure 2: Investment as % of GDP, 2000-10

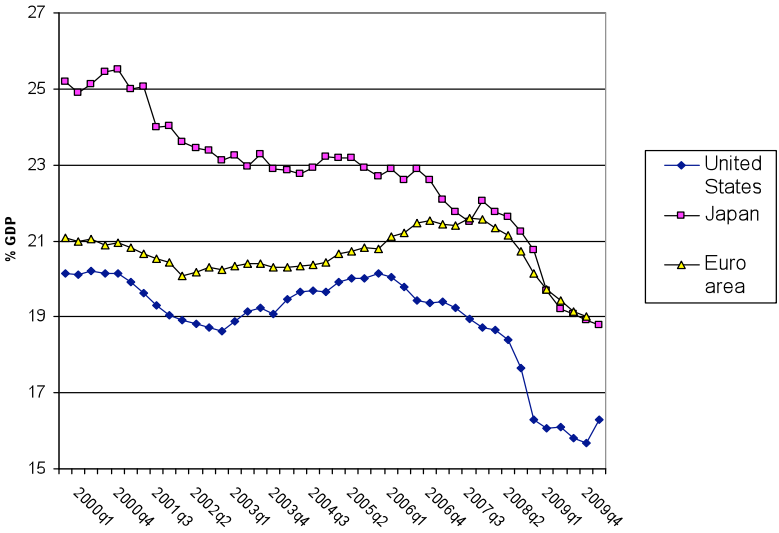
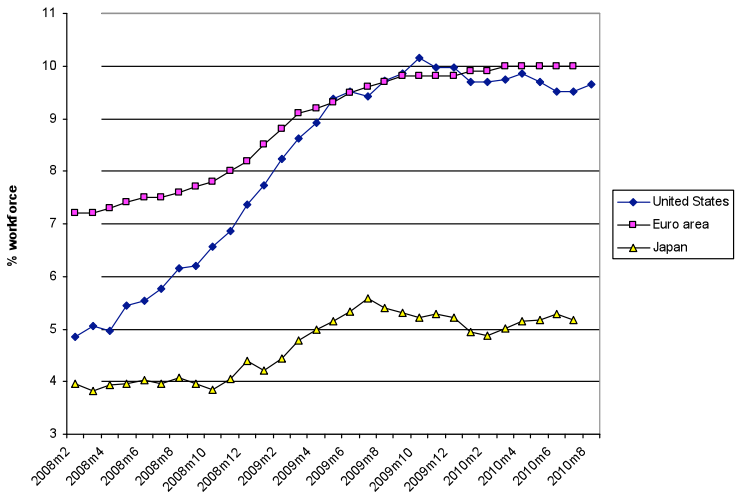


Figure 3: Unemployment rates, 2008-10

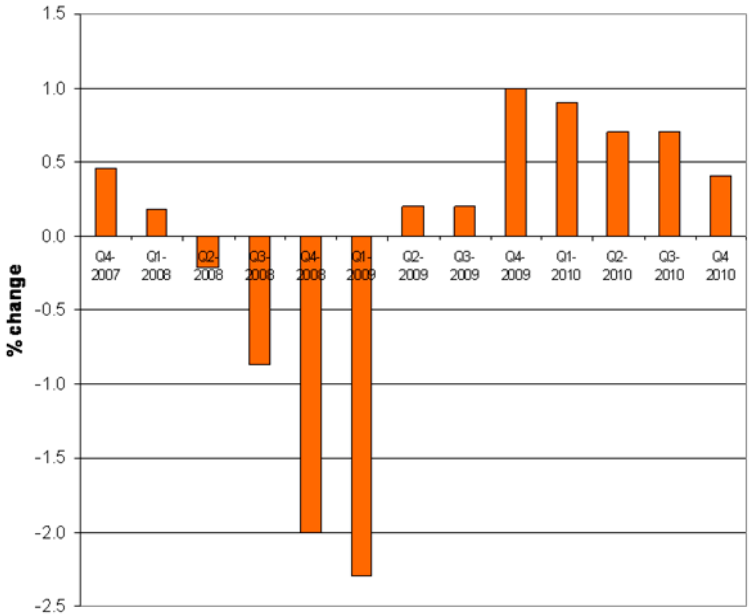


Source: OECD (2010a)

These emergency measures contributed to a snap-back. World trade and output stopped shrinking and began to grow again in the latter half of 2009 (Eichengreen and O'Rourke, 2010; Padoan, 2011). GDP across the G7 started to recover (Figure 4, next page).

The restocking of inventories by manufacturers in 2009, reversing the cost-cutting depletion of inventories at the height of the crisis in late 2008, also boosted production. Labour productivity and capacity utilisation in the US rose strongly (OECD, 2010b: 5; also Figure 1). Company profits recovered most of the ground lost in 2007-09 (Bureau of Economic Analysis, 2011a) and higher profits and low interest rates drove the stock market higher - the Dow Jones industrial average rose from its March 2009 trough of 6,627 to 11,204 by April 2010.

Figure 4: Quarterly change in G7 GDP, 2007-10



Source for data: OECD (2011)

Nonetheless, the recovery lost momentum fairly quickly and quarterly rates of growth across the G7 began to slide (Figure 4). In Q1 2011, GDP in Britain and the US rose by only 0.5 per cent and 0.4 per cent respectively (OECD, 2011). These GDP data suggest that the advanced economies are far from a sustained recovery. It appears that, like the oil and commodity price shock of 1973-74, the housing crisis in the US was only the tip of the iceberg. Several factors that prevent a sustained and strong recovery can be traced back to the problems that existed in the years leading up to the bust of 2008.

Depressed Consumer Spending and Business Investment

The first problem is the consistent weakness in household spending. For a long period working class living standards were squeezed as part of the neoliberal revolution; consumption was only sustained by the expansion

of personal credit. The GFC exacerbated this situation as it squeezed the working class still further.[4] The number of people employed in the US fell by six per cent over the course of 2008 and 2009 and the recovery of GDP in 2010-11 saw only a modest recovery in jobs (Rampell, 2011). The total number of US workers either registered as unemployed, underemployed or jobless and no longer looking for work stood at 23 million in March 2011 (Bureau of Labor Statistics, 2011). Amongst those American workers who remained in work, many lost overtime and in some cases experienced pay cuts. For those joining the workforce, many American employers have now set lower rates of pay ('two-tier pay scales') for new recruits. The result was that median income for US households fell in real terms by $2,188 between 2007 and 2009 (US Census, 2010). Wealth has become even more skewed towards the rich (Economic Policy Institute, 2011) and the poverty rate has soared. One in seven Americans (44 million) are now living below the meagre US poverty line of $22,000 for a family of four, and one in six (51 million) are without health insurance (US Census, 2010).

The US housing market was still suffering excess supply and low prices and, after a brief and shallow recovery in 2010, house prices were dropping again in early 2011 (Standard and Poor's, 2011). With the housing sector still in a slump, many millions of American workers remain trapped by negative equity in their homes. Others have been thrown out of their homes and are living with family members, in shelters or in their cars. The banks, which were liberal with housing loans in the credit bubble of the 1990s and 2000s, are reluctant to extend credit to working class households now that housing prices have fallen so low. The 'wealth effect', whereby workers borrowed on the strength of the increased equity in their homes as prices rose, has now gone into reverse.

The result of falling median incomes and household wealth is that household spending in the US, which accounts for 70 per cent of GDP, has failed to recover strongly during the economic recovery of 2009-11. In 2010 US consumer spending rose in real terms by a modest 1.7 per cent (Bureau of Economic Analysis, 2011b), far below the usual bounce-back after a deep recession. The weakness in consumer spending also

4 For more detail on the plight of the US working class, see Gould and Shierholz (2010).

holds back business investment which could, in other circumstances, give a fillip to growth. In the US, non residential fixed investment grew by only 5.7 per cent in 2010, after dropping sharply by 17.1 per cent in 2009 (Bureau of Economic Analysis, 2011b). Business is holding its bumper profits in cash reserves or is extending them in speculative ventures rather than productive investment.

A similar pattern of weak consumer spending and business investment holds true in other advanced economies. Unemployment in the EU stands at 23 million, 50 per cent higher than in 2007, and the unemployment rate is 9.5 per cent (Eurostat, 2011). Consumer spending in the G7 rose by only 1.9 per cent in 2010 (OECD, 2011) while G7 gross fixed capital formation rose by a sturdier 5.0 per cent for the year, but by only 0.4 per cent in Q4 2010 (OECD, 2011). None of these figures suggests a robust recovery.

Governments are now adding to the downward pressure on living standards and thus consumption with their austerity budgets. In late 2008 and in the first half of 2009, governments across the OECD borrowed trillions of dollars to bail out banks and stimulate their economies. On the other side of the ledger, government income was hit hard as businesses shut down and workers lost their jobs. The rise in social security outlays accompanying mass unemployment and tax cuts for business and the wealthy also contributed to the mix. The result was a sharp rise in budget deficits and public debt (Padoan, 2011). Since early 2010, with the worst of the downturn over, economic debate is now focused on the sovereign debt crisis, and governments across the advanced economies are now cutting spending in order to reduce public debt.

Pressure to wind back the debt comes from several quarters. Some capitalists have a direct interest in the matter – banks that have bought government bonds which they fear may not be repaid if the most indebted governments (most obviously the so-called 'PIIGS' in Europe – Portugal, Italy, Ireland, Greece and Spain) default on their debts (Lapavitsas, 2010). Of these nations, Italy is rather different because, although highly indebted, it has not been pressured by the speculators in the same way as the others, and 'the markets' appear to be relatively calm about its prospects at the moment. Northern European banks want the other PIIGS governments to cut borrowing to ensure that they can repay their existing loans. A default by any of the PIIGS will slash the asset sheets of the lending banks and jeopardise the weak recovery under

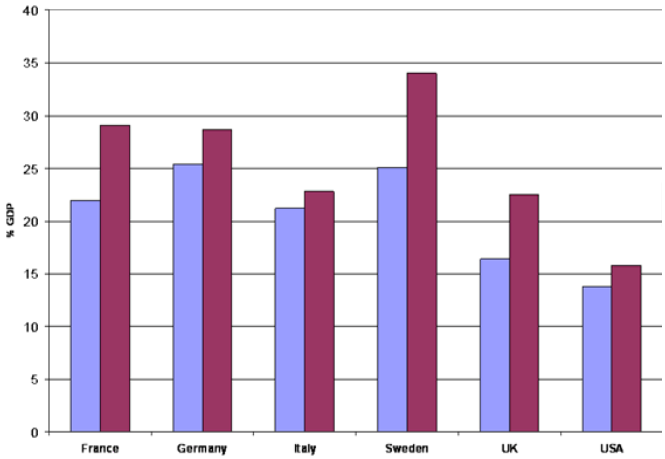
way. Then there are those capitalists that have interests and investments in those banks that have loaned money or hold bonds in the PIIGS. These include banks and investors in the USA. The fortunes of the Greek and Spanish governments are tied to the stockholders of New York by a chain of shaky loans and investments.

Over the course of 2010 and early 2011, speculators, acting on the belief that these governments would default on their debts, drove up interest rates on the bonds of Greece, Ireland and Portugal – in the case of the first to as much as 12 per cent at a time when the average rate for euro member states was only 4 per cent (Padoan, 2011). These governments were thereby forced to rely on bailouts from the European Union and IMF, totalling hundreds of billions of euros to finance their operations. In essence, this was a transfer of funds from the richer EU member states to the banks domiciled within their own borders. Attention has now turned to Spain.

Other governments have debt to GDP ratios that are similar to those of the PIIGS: 80-100 per cent in the case of the USA, Britain, France and Germany, as compared to 130 per cent in Italy and Greece and 100 per cent in Ireland and Portugal (Padoan, 2011). None, however, faces any immediate threat to its ability to raise money in capital markets. Such is the size of their economies and, in the case of the US, its ability to fund its debt by issuing dollars, that the markets have judged that these governments are financially secure and at no threat of defaulting.

Nonetheless, the debt crisis has become as pressing a political question in these countries as in the much more precariously positioned PIIGS. The debt crisis here is as much an excuse by the capitalist classes to make heavy inroads into the welfare states of Europe and what remains of the social security and Medicaid systems of the United States. Despite neoliberal rhetoric about small government, social welfare spending as a proportion of GDP actually grew in the 1980s and 1990s across the OECD (Figure 5). This trend continued into the 2000s, with the British government spending more on social security, health and education as a proportion of GDP in 2009-10 than ever before (Figure 6). Now the capitalists see an opportunity to make serious cuts to state outlays on the working class so as to enhance their competitiveness and raise the rate of exploitation.

Figure 5: Welfare expenditure as % of GDP, 1979 and 1995

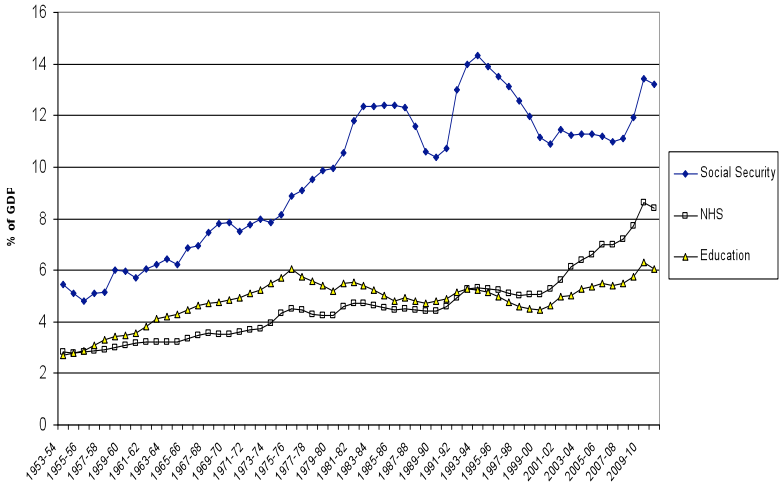


Source for data: Harman (2009: 238)

Whether the debt crisis is in any sense real or only manufactured, the outcome is the same: the imposition of drastic austerity measures across the West. In virtually every country, governments have cut public sector pay, axed public sector jobs, frozen pensions, reduced aged care programs, lowered unemployment benefits, reduced funding for prescription drugs, raised indirect taxes (VAT), and sold off public enterprises (McNally, 2011: 21-24). The cuts have been most severe in the PIIGS but workers in the richest European countries have also experienced austerity. The Conservative- Lib Dem government in Britain announced cuts of £81 billion in its October 2010 budget, the deepest cuts to public spending proportionately since 1922. Half a million public sector jobs will be lost as a result. The Merkel government in Germany has committed itself to cutting the budget deficit in Germany by $US13 billion each year for the next five years. The Sarkozy Government's cuts to state pensions in October 2010 are just the first of what are expected to be a series of attacks on the French welfare state in coming years. Across the Atlantic, the Obama administration announced $38 billion in spending cuts to the US federal budget in April 2011 and put forward plans to reduce government net outlays by $4 trillion over the next ten

years. The Republican opposition is promoting still harsher austerity, with $6 trillion in proposed cuts. State and local governments for their part, lacking federal government funding and unable to run budget deficits for more than a year or two, are closing schools and fire stations, cutting public sector pay and sacking tens of thousands of public servants.

Figure 6: Social spending in the UK as % GDP, 1953-2010



Source: The Guardian (2010)

Austerity budgets are reducing spending power in every country where they are implemented. GDP in Greece fell by 6.8 per cent in 2010 and in Ireland, where the process is only just under way, by 0.5 per cent (OECD, 2011). Unemployment in these two countries rose in 2010 from 10.2 per cent to 14.1 per cent and from 13.1 per cent to 14.7 per cent respectively (Eurostat, 2011). In Portugal, soon to undergo its fourth austerity budget since the onset of the GFC, growth in 2010 was only 1.0 per cent and unemployment stands at 11.1 per cent (OECD, 2011; Eurostat, 2011). The stronger countries too are affected. In April 2011, the IMF cut its forecast for British growth for 2011 to only 1.75 per cent, as the country struggles to absorb the impact of substantial public sector spending cuts (IMF, 2011b). Furthermore, austerity will only feed upon

itself. With shrinking economies in the PIIGS, the tax base - and with it the capacity to repay the public debt - falls further, and the ratio of debt to GDP will grow (Varoufakis, 2010). The PIIGS may be trapped in a deflationary spiral – interest rates in Greece and Ireland in April 2011 were higher than before the 2010 EU/IMF bailouts, raising the question of what will occur when the bailouts end in 2013. It is likely that the EU will either have to accept a restructuring of PIIGS debt or provide further loans before the current ones expire.

The governments of the stronger European nations are facing the same dilemma as the US government experienced in the 1980s and 1990s: to what extent are they prepared to keep bailing out bankrupt entities (whether corporations or other governments) for fear of the alternative – default, bringing with it serious repercussions not just to the entities concerned but to the stability of the wider system. The German government is well aware that any sudden move on its part to insist on harsher conditions threatens bankruptcy on the part of its PIIGS debtors and the possibility that German banks will lose billions of euros through loan defaults. For the time being, the German government is committed to propping up the PIIGS governments. Likewise, while the Bush administration allowed the investment bank Lehman Brothers to go broke in 2008, scared by the financial panic that followed, both Bush and Obama have stepped in to prevent any further such bankruptcies. The Irish government simply nationalised two of the country's three major banks, rather than let them fail, and in doing so amassed a budget deficit in 2009 equivalent to 32 per cent of GDP. The stimulus packages and the bailouts prevented an economic collapse but have locked in problems for the future.

Toxic Debts Weighing on the Banks

The expansion of private sector debt, the growth of financial investments as a proportion of total investment and the low interest rate regime pursued by the Federal Reserve under Greenspan and Bernanke helped, as I argued above, to prevent a relapse of the US economy in the 1990s and 2000s back into the crisis conditions of the mid-1970s and early 1980s. Nonetheless, much of the rise in asset values in this period was based on speculative or fictitious gains. As Marx argued in Capital volume III, financial assets represent a claim on surplus value created

elsewhere in the productive sector of the economy (Marx, 1972: 465-68). If the generation of surplus value in the productive sector lags behind the rise in the market value of financial assets, at some point a correction will eventually occur. This is precisely what happened with the onset of the GFC.

The banks and institutional investors now had to face the fact that the mark to market value of their financial assets, set in the bubble-driven 2000s, bore no relation to the new, GFC-influenced price at which these assets could now be sold (Harman, 2009: 290; McNally, 2011: 19-20). The Federal Reserve stepped in to help US banks by purchasing $1.5 trillion in toxic debts in 2008. But the rest of the debt, the true value of which is not known, partly thanks to the weakened bank reporting requirements introduced by the Bush administration in the early stages of the GFC, still sits on their balance sheets. These securities are highly leveraged on a US housing sector that is still in a poor condition. The banks holding these assets cannot sell them on the open market because they would crystallise an enormous loss by so doing. So they hang onto them – as bad debt.

The US banking sector, which pumped up the bubble economy of the 1990s and 2000s, is now a drag on the productive economy in the US, even if the banks are making big profits. Weighed down by bad debt, undermined by weak domestic demand for credit from both households and businesses, and with plenty of opportunities to make profits simply by gaming the various bailout mechanisms still in place, banks have seen no reason to risk their capital on lending to initiate a new round of expansion in the productive sector (McNally, 2011: 8). Further, the risky practices engaged in by many banks during the speculative boom are still in play, and the new Basel III regulations (Bank for International Settlements, 2010), even when they are imposed in 2013, will do nothing to rein these in.

BRICS White Knights?

In the years running up to the GFC much hope was placed in the rise of China, and the BRICS (Brazil, Russia, India, China) more broadly, as potential 'white knights' for the West. It was hoped that, even if the Western economies were suffering from a variety of problems, the BRICS could keep the world economy growing. This illusion was

punctured in the GFC when output, trade and investment fell across the world economy, the BRICS included. Russia and Brazil experienced a collapse of industrial production and India saw modest growth wiped out. Chinese growth slowed sharply in late 2008 and the first half of 2009. As Chinese growth fell, the major commodity producers, beneficiaries of Chinese orders and investments, were initially hit hard.

In the event, the slowdown in economic growth in China in particular was short lived. China embarked on a massive stimulus package in late 2008, twice the size relative to GDP of the US package. By August 2010, industrial production was 13.9 per cent higher than a year earlier, retail sales had increased by 18.4 per cent, bank lending climbed 18.6 per cent and fixed asset investment rose by 24 per cent (Bradsher, 2010). The Chinese recovery helped to lift those economies that are now tied closely to its markets, most obviously Australia and Brazil.

Nonetheless, there are limits to the capacity of China to replace the United States as a locomotive for the world economy. First and most obviously, the Chinese economy, given current exchange rates, which are the appropriate measurement when considering relative sizes of economies on a world scale , is still substantially smaller than the United States (IMF, 2011).[5] Second, the Chinese economy suffers from a series of severe internal problems. These include a longstanding property bubble and an extremely lopsided economy (McNally, 2011: 7-8). Chinese growth is driven by very high levels of investment, rather than domestic consumption (the reverse of the US) (Harman, 2009: 244-45). Those parts of the 2009 stimulus package that did not go into property speculation went largely into infrastructure, especially roads, railways and runways, thereby building more excess capacity in the Chinese economy. Where the capacity is being used (as distinct from the ghost roads and railways that lead nowhere or the virtually uninhabited new cities being built in the interior), it is being used to move goods to the coasts for export.

The growth of Chinese export capacity highlights the limited contribution that China can make to lifting the US economy out of its current slow growth trajectory. The US is now attempting a version of the strategy pursued successfully by China and Germany in the 2000s –

5 The IMF (2011a) estimates US GDP in 2010 at $14.66 trillion and China's at $5.88 trillion.

to win a competitive edge by suppressing or cutting real wages and holding down its exchange rate. In the 12 months to the end of April 2011, the US dollar fell by 8.6 per cent against the euro, 11.9 per cent against the yen, 17.8 per cent against the Swiss franc, 13.9 per cent against the Australian dollar, 7.0 per cent against sterling but only 4.7 per cent against the yuan (Index Mundi, 2011). Evidently, the US has had more success in devaluing its currency with respect to some countries than others. China, in particular, but also other Asian nations which are now increasingly tied to the yuan, is very reluctant to see its competitiveness undermined in this way. So much of the Chinese economy is oriented to exports that any sudden loss of competitiveness would have a devastating impact on the broader economy. Although Chinese trade surpluses shrank in the last part of 2010 and early 2011, there is no indication that China's net trade balance will contribute to GDP expansion amongst its trading partners in any substantial way in the foreseeable future.

Tension between the US and China on these grounds is the basis of the so-called 'currency war' which became the subject of intense controversy at successive meetings of finance ministers and heads of state at IMF and G20 meetings in late 2010. If globally coordinated measures to adjust exchange rates do not eventuate, the temptation will be for individual governments to proceed to tariffs and quotas to address the imbalances directly. In September 2010 the US government called on the WTO to investigate Chinese restrictions on imports of US steel exports and the operations of US electronic payment providers too. China in turn claims that US steel is subsidised and is being dumped on the Chinese market (Beatty, 2010).

Conclusion

The GFC was not caused by a lack of regulation, bankers' greed or simply speculation, even if all of these played a role in its severity. The crisis was not restricted to the financial sphere, nor did it have its origins in the financial sector. Rather, crises occur organically, as part of the normal workings of productive capitalism; as Marx wrote in Capital volume III, 'the real barrier of capitalist production is capital itself'. The current crisis in the US economy has its origins in the factors that brought an end to the long post-war boom that had never been fully

resolved. Moreover, the methods that were used to promote profitability from the early 1980s onwards– for example, the suppression of working class living standards and the increasing recourse to speculation – may have helped to ameliorate the situation for a period but only added to the problems in the long run.

Today the US is in the midst of a deep and intractable crisis. Even though the country may no longer be in recession, technically speaking, it can in no sense be said to be on a growth trajectory. Consumer spending and fixed investment are lacklustre. Unemployment remains high. Austerity budgets stretching out more than a decade into the future are likely to further crimp domestic demand. And the country continues to run a large balance of trade deficit. The crisis is by no means restricted to the US. As the world's largest economy, the centre of the world financial system, the principal destination for world exports, and the world's biggest foreign investor, America's anaemic recovery has serious repercussions for the rest of the world economy. Other G7 member states are also barely growing and they too are now engaging in serious austerity measures. Although this article has not considered the Chinese economy in any depth, it is also difficult to see how China can maintain its current rates of growth indefinitely, given that so much of its growth over the past three decades has been focused on the US domestic market.

The sovereign debt crisis in Europe may yet spark off a second round of financial collapse and, with most governments now heavily in debt, it is also difficult to see how they can undertake another round of bailouts and stimulus packages in such an event. Nonetheless, such is the size and interconnectedness of the banking and productive sectors today, both nationally and globally, that it is unlikely that governments could allow the kind of multiple and linked corporate bankruptcies that such a financial collapse would bring about if left unchecked. The problem is, however, that precisely such a string of bankruptcies is required to purge the system of unprofitable capital and prepare the way for a resolution of the crisis and the resumption of growth on the lines of the post-war boom. The processes of weakening profitability in the productive sector and monopolisation of capital have intertwined in such a way as to create an impossible dilemma for the capitalist classes and their states.

At present, the only 'resolution' that the capitalist states are willing to prosecute is one of driving down working class living standards through unending austerity budgets. That this may only further drive down output

and income and raise unemployment in the advanced economies is evidently deemed to be of little importance, compared to the lift in profitability that cuts to corporate tax and reduced wages will create. The current crisis reinforces our understanding that prosperity for the capitalist class need have nothing to do with economic growth and well-being for the mass of society and that any proposals to 'fix' the crisis by any means short of a frontal challenge to the priorities of capitalism are doomed to fail.

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