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Economic crisis

Toxic capitalism

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The crisis that we are witnessing today is shaking the very foundations of neo-liberal capitalism. It is unfolding at an accelerating speed, and nobody is capable of saying where it will lead.

This article does not try to follow its unfolding step by step, because it would be likely to be outdated by the time it was published . It seeks rather to suggest some keys to interpret this crisis and to demonstrate what is at stake on the social level.

The mechanics of the financial crisis

The complexity of the financial crisis makes us a bit dizzy, but it is nevertheless possible to identify its principal mechanisms [1] [2]. The starting point is the existence of a considerable mass of "free" capital in search of maximum profitability. Periodically, this capital discovers a new seam and unleashes a dynamic which feeds on "self-fulfilling prophecies": by rushing to cash in on what seems most profitable, the capitalists in fact raise the cost and thus confirm the optimism that started the rush. The warnings of those who explain why the Stock Exchange or the mortgage market cannot go sky-high are made to seem ridiculous, since the system works.

Graph 1 points out these principal episodes: the Stock Exchange crash of 1987, followed by another in 1990 preceding the First Gulf War. From the middle of the year 1995 there began the period known as the "new economy" which was accompanied by a delirious rise of the Stock Exchange. The crises in Southeast Asia and Russia - and the bankruptcy of Long Term credit Management (LTCM) in the United States - only temporarily deflated the bubble in 1998, and it was at the start of the year 2000 that it burst violently.

The headlong forward flight started again two years later and finally led to the subprime crisis in July 2007.

For the bubble to be able to take off, it is not enough to have available capital; it is also necessary for the system of regulation not to put up any obstacles. And regulations were circumvented by decisions of a political nature and by the implementation of sophisticated financial innovations and increasingly opaque practices. We can take the example of the leverage effect, which makes it possible to multiply enormously the sum of which a financial institution initially disposes. Derivative products make possible complicated operations of purchase and forward sale. The banks can get rid of their doubtful debts by placing them with others in a kind of lucky bag which can then be sold in the form of a security (whence comes the term of securitization). The risk attached to the various debts starts to circulate and no longer forms part of the institution's balance sheet, thus escaping the prudent rules which require debts to be limited to a certain proportion of the institution's own equity.

The subprime crisis erupted in a relatively narrow economic sector, the one dealing with loans granted to poor households and guaranteed by the house that they were buying. These contracts were real swindles, since the banks knew very well that they would not be repaid. But securitization made it possible to get rid of them. The fall in the real estate market coincided with the first bankruptcies of households: the sale of the houses with which these rotten loans were guaranteed was no longer possible, or was possible at a price which no longer covered the initial loan. The housing crisis started a chain reaction: one after the other the banks discovered their losses and were gradually unable to obtain new funding sources to cover these losses. In order to prevent a series of bankruptcies, central banks and governments injected money or "nationalized" part of the banks.

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1: The Stock Exchange and household wealth in the United States

– The Dow Jones index at current prices (base: 100 in 1960)

– Net wealth of households as a multiple of their current income

Sources and data for the graphs: http://hussonet.free.fr/toxicap.xls

From the virtual to the real

This briefly summarized scenario raises several questions. The most fundamental one is that of the passage from the virtual economy to the real economy. Every financial crisis, such as the one that is currently unfolding, must in fact be interpreted as a call to order by the law of value.

Financial assets have a "value". If I have a million shares whose price is 100 euros, my wealth is 100 million euros. If the price of my shares doubles, my wealth doubles, and if it falls by half, I lose 50 million euros. But these figures only measure the virtual value of my financial fortune. Profits (or losses) become real only at the point where I seek to get rid of my shares in order to obtain cash for the purpose of buying something real, for example a house. The stock exchange capitalisation, i.e. the total value of the shares, does not in itself mean anything. The financial markets are mainly secondary markets, where people sell, for example, shares in Vivendi in order to buy shares in France Telecom. According to supply and demand, the price of these shares can fluctuate, but these transactions are also virtual in the sense that the price at which these exchanges are carried out is relatively symbolic. These prices, of a particular kind, could be multiplied by a thousand, as if they were expressed in a special currency, disconnected from real currencies. So we could imagine an economy where everyone would be a billionaire in shares, on condition of not seeking to sell them. To use expressions which are really quite eloquent, we would have a real economy progressing at a measured pace, and a financial sphere inflating at incredible speed.

But a lasting divergence between the two is not possible, because there exist "nodes of conversion" between the financial sphere and the real sphere. An economy which grows at 2 or 3 per cent cannot provide a universal profit of 15 per cent, as the defenders of equities claim. As long as the incomes drawn from financial assets are re-invested, the fortunes increase independently of any material link with the real sphere and the variation can potentially become infinite. But if part of these drawing rights which are constituted by financial assets seek to be transferred to the real sphere, in other words to be exchanged against goods, this transfer must comply with the law of value, or more prosaically, with the law of supply and demand. Let us in fact imagine that this new purchasing power does not find a counterpart on the production side, nor does it succeed in becoming a substitute for demand emanating from wages: the adjustment then takes place through rising prices, which amounts to devaluing incomes, including financial revenues. This is what in fact explains the great sensitivity of shareholders to inflation, since the real income derived from their fortunes depends on it. But if such a devalorization occurs, it has repercussions on the evaluation of fortunes and the price of shares must then fall, in order to correspond to the real income which they provide.

Financial assets represent the right to a share of the surplus value that is produced. As long as this right is not exercised, it remains virtual. But as soon as anyone exercises it, they discover that it is subject to the law of value, which means, quiet simply, that you cannot distribute more real wealth than is produced. From an objective point of view, prices on the Stock Exchange should thus represent the anticipated profits of companies, from which financial revenues can be paid. But they have completely taken off and now maintain nothing more than a distant relationship with the profitability of capital based on the exploitation of human labour. Never, in the entire history of capitalism, has this phenomenon attained such scope, and it was not possible for it to last forever.

The economic basis of financialisation

Financial bubbles are not based solely on the covetous illusions of speculators. They are nourished by the permanent creation of free capital. The first source is the tendential growth of non-accumulated profit, which results itself from a double movement: on the one hand, a generalized decline in wages [3] and on the other hand the stagnation, even a decline, in the rate of accumulation, in spite of the re-establishment of the rate of profit. Graph 2 shows that the rate of profit and the rate of accumulation evolved in parallel until the beginning of the 1980s, then started to diverge considerably. The gray zone makes it possible to measure the increase in the non-accumulated fraction of surplus value.

https://internationalviewpoint.org/IMG/jpg/Husson-2.jpg

2: Rate of profit and rate of accumulation: The United States + European Union + Japan

* Rate of accumulation = rate of growth rate of the net volume of capital
 * Rate of profit = profit/capital (base: 100 in 2000)
Sources and data of the graphs: http://hussonet.free.fr/toxicap.xls

This new and unprecedented configuration poses a priori a problem of realization: if the share of wages drops and if investment stagnates, who will buy what is produced? In other words, what are the reproduction schemas that are compatible with this new model? There is only one possible answer: consumption resulting from non-wage incomes must compensate for the stagnation of wage consumption. And this indeed what is happening, as graph 3 shows.

https://internationalviewpoint.org/IMG/jpg/Husson-3.jpg

3: United States Share of wages and of private consumption in Gross Domestic Product (GDP)

Source of data and graphics: http://hussonet.free.fr/toxicap.xls

https://internationalviewpoint.org/IMG/jpg/Husson-4.jpg

Figure 4. European Union Share of wages and of private consumption in Gross Domestic Product (GDP)

Source of data and graphics: http://hussonet.free.fr/toxicap.xls

In a stylized way, we can summarize as follows how things have evolved: in the United States, the share of wages remains relatively constant but household consumption increases much more quickly than GDP. In Europe, it is the share of consumption in the GDP which remains fairly constant, in spite of the marked decrease in the share of wages. In both cases, the gap widens between the share of wages and the share of consumption (gray zones), so as to compensate for the difference between profit and accumulation. Finance is what is used to effect this compensation, and to do so it follows it three main routes. The first is the consumption of shareholders: part of the non-accumulated surplus value is distributed to the holders of financial revenues, who consume it. This is an important point: reproduction is possible only if the consumption of shareholders comes to support the consumption of wage-earners, in order to provide sufficient outlets, and the increase in inequalities is thus consubstantial with this model.

The second intervention of finance consists in introducing a certain confusion between wages and unearned income: an increasing part of the income of wage-earners takes the form of financial remunerations which can be analyzed as a distribution of surplus value rather than as real wages. Lastly, and this is especially true of the United States, finance makes possible an enormous increase in the debt of households, whose consumption increases, not because of rising wages, but by a decrease in the rate of saving [4].

Finance is thus not a parasite on a healthy body. It feeds off uninvested profit but, in time, it acquires a degree of autonomy which reinforces this mechanism. Free capital circulates in search of maximum profitability (the famous 15 per cent norm) and it succeeds, at least temporarily, in obtaining it in certain sectors. The banks themselves collect an increasing share of profits. This competition for maximum profitability raises the norm of profitability and rarefies a little more the places for investment that are considered to be profitable, thus releasing new free capital which will in its turn go in search of financial hyper-profitability. This vicious circle is based once again on a distribution of income that is unfavourable to workers and to the recognition of their social needs.

Transmission to the real economy

In 1987, the stock exchange crash led the majority of economists to envisage a brutal deceleration of the world economy. It was the opposite that happened: as from 1988, the developed countries experienced a very dynamic cycle of growth. The stock exchange crisis had thus not been transmitted to the real economy and, on the contrary, it had served to purge it and make it possible to start afresh. It is after all a traditional function of crises to clean up the accounts and eliminate lame ducks. A few years later, a large-scale estate and mortgage crisis struck Japan, which was at that time being presented as the rising power out to conquer world markets. There then began a decade of almost zero growth, from which the Japanese economy had great difficulty in escaping.

Finance is thus more or less autonomous according to the place and the time and today we have to address the question of whether the financial crisis will be communicated to the real economy. A first thesis consists of saying that the current deceleration is not explained mainly by the financial crisis, but by other factors: the rise in the prices of oil and raw materials, inadequate monetary and budgetary policies in Europe, competition from the emergent countries, etc. According to this thesis, the financial crisis concerns above all the United States and will have relatively little effect on the world economic situation. The demand of the emergent countries will be there to take over from the United States, according to the so-called decoupling thesis. The intervention of the central banks and governments will make it possible to avoid a sequence similar to that of the great crisis of 1929 and to spread out over time the losses of the banks. In short, the financial sphere and the economic sphere will be relatively compartmentalized.

This analysis is based on undeniable realities but does not draw from them the conclusions which go against its relative optimism. It is true that the crisis combines several dimensions, and in particular the rise in the prices of oil and raw materials. But these various aspects are part of the same system and bring us back, fundamentally, to a common origin, which is the current organization of the world economy. You do not understand anything about the present crisis if you think that it can be divided into watertight compartments. This simultaneity of several dimensions will on the contrary reinforce the transmission of the financial crisis to the real economy. It will follow six principal channels, whose relative importance can vary from one country to another:

1. The contraction of credit (credit crunch) plays a big role in the diffusion of the financial crisis, since the banks which are put in difficulty by their losses are not succeeding in being refinanced. But these restrictions also concern household consumption and investment by companies. This effect will be particularly marked in countries like the United States or the United Kingdom where household consumption is fuelled by debt.

2. The fall in prices on the Stock Exchange devalues the financial and real estate holdings of households (see graph 1) and pushes them to consume less. This is the “wealth effect”.

3. Generalized uncertainty - the “loss of confidence” - influences how people behave in regard to consumption and investment.

4. The housing crisis as such contributes to the general economic deceleration.

5. The considerable sums assigned to the various rescue plans will necessitate a reduction in public spending or an increase in taxes.

6. Lastly, the deceleration is transmitted to the whole of the world economy through trade and investment.

All these mechanisms are currently at work and they combine with other dimensions of the crisis (oil, etc.) to extend its effects well beyond the financial sphere. There is thus no watertight bulkhead between finance and the real economy, because finance is a key component of neo-liberal capitalism.

Where is the crisis going?

It would be premature (and presumptuous) today to try and predict where this crisis is taking us, but its scale makes going back to normal improbable. One thing is sure, in any case: the very foundations of the United States model will be called into question by the financial crisis. This model rests on a double deficit, an external trade deficit and a deficit of domestic saving. In both cases, finance plays a crucial role in the management of these imbalances: on the domestic level, it is finance which made possible the growth of debt, in particular on the mortgage market; externally, its function is to ensure the equilibrium of the balance of payments. But if finance deflates, the foundations of this model of growth disappear: household debt is henceforth blocked, and the entries of foreign capital are no longer guaranteed. Consequently, the financial crisis will result in a durable deceleration of growth in the United States, which will be transmitted to the rest of the world.

But at the same time, it is not easy to see what it could be replaced by. The real alternative would be to go back to a form of “Fordism” based on rising wages parallel to rising productivity, a less uneven distribution of income and a rebalancing of foreign trade. Such a model is possible in the abstract but supposes a brutal inversion of social relations which is for the moment out of reach. If Obama is elected, as seems probable today, we cannot count on him to carry out a “Rooseveltian”: programme: he lacks the political will, but also the means, since the rescue plan will durably weigh down the budget.

The concrete modalities of the way out of the American model will have repercussions on the rest of the world economy. The first unknown factor relates to the exchange value of the dollar, which should continue to fall, because it is a means for the United States of giving a shot in the arm to its exports and reducing its trade deficit, but also because of the loss of quality of the US national debt. But that amounts to exporting the recession towards Europe, which is globally sensitive to an overvalued exchange rate of the euro. This fall of the dollar, or even its maintenance at its present rate of exchange, raises another question: will capital continue to flow towards the United States? The emergent and oil-producing countries are likely at a certain point to be discouraged from exporting it because of insufficient profitability or increasing risks. From another angle, they have no interest in acting to weaken the dollar, since the value of their holdings already placed in dollars would also be devalued. Another factor must be also taken into account: if the economy of the United States slows down durably, an important outlet for the exports of the emergent countries will dry up and to push them to recentre their growth on the internal market. It is difficult to balance these different factors, which will not evolve at the same speed, but we can nevertheless make two prognostics:

1. The time necessary to get out the crisis is proportional to the enormity of the sums devoted to the rescue of the financial sector. The most probable trajectory is a Japanese-style scenario, where several years will be necessary to absorb the amounts of money that have been swallowed up, which are in another league from what we have seen during preceding financial failures. If no alternative measure is imposed, capitalism will find itself, at least in the developed countries, in a situation of slow growth and social regression. The real economic recession is already with us, and its objective determining factors, for example the crisis of the car industry, are taking over from the financial storm.

2. The way out of the crisis will be marked by an intense struggle of the major economic actors, each seeking to dump the consequences of the crisis on others. On the social terrain, that implies increased pressure of capital against wages and social spending. On the international level, the commercial and economic war between great

powers will take place on a larger scale and will generate a tendency towards the fractioning of the world economy, all the more so in that, as the German Minister for Finance, Peter Steinbrück, said: “The United States will lose its status as the superpower of the world financial system”.

European dogmas put to the test

During the crisis, competition continues. The cacophony of declarations and government decisions partly reflects this dilemma: on the one hand, everyone has understood that the crisis calls for global solutions; but, at the same time, everyone seeks to draw advantage from the situation, or at least save the essential. This is obviously true for individual capitals and the discussion over the modalities of the Paulson plan also dealt with this question: is it necessary to save all the financial institutions or only the “lame ducks”? But it is especially true on the level of the famous world government, and everyone has been able to observe the return in force of national interests.

The capitals deployed on the world market may find it very beneficial to return to port and shelter under the umbrella of their national state. But we cannot speak about “the return of the state” because the state always, in the last resort, provides a guarantee for the interests of the bourgeoisie. Once again, the theses on the “Empire” demonstrate their limits: globalization did not remove competition between capitals and inter-capitalist rivalry, nor did it lead to the formation of a world capitalist government. In Europe, the difficulties of coordination are explained by the unequal degree of exposure to the effects of the crisis and express the inexistence of a true European capital. As long as it was a question of injecting liquidities, the European Central Bank could intervene, certainly in response to events. But as soon as it was a question of expenditure to be integrated into the budget, we saw that the European Union was “constitutionally” deprived of the means of facing such a crisis. The gap is widening between France, which would like there to be a rescue plan on a European scale, and Germany and Ireland which prefer a policy of every country for itself. These divergences will no doubt be temporarily overcome if the crisis develops. It is nonetheless true that this crisis will durably call into question the very principles of European neo-liberal construction. Furthermore, it will underline the structural weaknesses of the European economy: “pessimism is necessary” even in the medium term. [5].

Effects on the workers

Everything is happening today as if the crisis were a kind of natural cataclysm which struck everyone in the same way, and French Prime Minister Fillon did not fail to call for national unity. The climate of panic is instrumentalised so that every one of us is put in the skin of a speculator. Banking bankruptcies are presented as a threat which also menaces the most modest depositors. All this is obviously not some kind of plot, but it contributes to try and obscure what is at stake socially, which we can summarize by posing the real question: who will pay for the damage?

As far as the rich are concerned, it is the workers who must now be put in the front line, not so much as savers, but as workers or pensioners. The crisis has already ruined millions of households in the United States, but it carries very serious consequences, first of all for pensioners in countries where pension funds are the most developed, as in the United States and the United Kingdom. In these two countries, the system was already on the verge of bankruptcy and the real value of pensions will obviously slump with the fall in the Stock Exchange. This is a lesson to be learnt: it is definitely a very bad idea to gamble your pension on the Stock Exchange and any rescue protection plan should take into account this aspect of things, which is of course absent from the Paulson plan.

Workers are doubly in the firing line: directly, because companies will try to compensate for their financial losses by freezing wages even more strictly, using the argument of the risks of inflation and oil prices, and taking advantage of the general climate of uncertainty. They will also suffer the indirect effects of the financial crisis on the real economy, which will bring a string of bankruptcies and lay-offs. The destruction of jobs has already started in the United States and in France. They will be also the first victims of the cuts in welfare spending that are intended to compensate for the cost of the rescue plans.

The eradication of finance and a social shield

The crisis is a glaring confirmation of the criticisms addressed to financialised capitalism from an anti-capitalist of and/or global justice point of view. All the economists who praised the benefits of finance are today making big speeches about the need to regulate it. In France, Sarkozy cannot find words hard enough to denounce the excesses of capitalism, whereas had put in his programme the development of mortgage lending. So the ideological landscape is changing extremely quickly and we have to take strength from the rout of the advocates of neo-liberalism.

But for all that, the crisis does not spontaneously create a climate that is favourable to alternatives. All the recycled neo-liberals have turned the lukewarm water tap full on and they are multiplying their own ideological rescue plans based on transparency, prudential ratios, separation of investment and deposit banks, reintegration of securitization into the balance sheets, limitation on the remunerations of the top executives, a credit rating agency, reform of accounting norms, etc.

It is a question, as one of them has put it, "of saving capitalism from the capitalists". [6] These proposals destabilize the social-liberal left, because basically that is their own programme. But it is a thoroughly minimum program which is even likely to divert attention from the real issues. Some of the measures that are being proposed must be supported, such as the prohibition of tax havens, but it would be naive to have confidence in the financial authorities and governments to implement them. They have to be part of a wider project which aims at eradicating finance and which puts the social question in the foreground. Once again, the ultimate source of financialisation is the refusal to satisfy the social needs of the majority of the population. Consequently, you cannot burst the financial bubble once and for all without turning off the taps which supply it.

This orientation can be developed differently according to the countries. In Europe, it could combine two axes. The first is the nationalization of the banks. But that is exactly what they are doing, people will object. The argument can be turned around: that precisely proves that it is possible! And the nationalizations that we are seeing are only socializing the losses, and their function is to save privatized finance. Real nationalization must be carried out without any conditions and it must concern the whole of the system, because all the financiers are responsible for the crisis, whether or not they have lost money because of it. Otherwise, it is just providing state aid for the reorganization of the banking sector.

The second axis could be called a social shield, in reference to the tax shield which, in France, protects the rich from taxation. It really is a question of protecting workers from the repercussions of the crisis, because nobody can decently argue that they have any responsibility for it. At the same time, we have to think of measures which can provide the foundations for a different distribution of revenues and which is based on an elementary argument of social justice. It should be forbidden for companies to continue to pay their shareholders enormous masses of dividends, at the same time as they continue to lay off, further extend precarious work and freeze wages. In the case of France, the net dividends paid out by companies accounted for 12.4 per cent of the overall wage bill in 2007, as against 4.4 per cent 1982.

The crisis is thus the occasion to launch a counter-transfer of dividends towards wages. Rather than freezing wages, it is time to freeze dividends at their current level and transfer them to a mutual fund intended for other uses, under the control of the workers.

These sums could be used, in proportions to be discussed democratically, for the maintenance of the income of the unemployed (the prohibition on dividends would thus finance the banning of lay-offs) and for the financing of Social Security, social budgets and public services. Another measure would consist of imposing the maintenance of the purchasing power of workers by withdrawing, in corresponding proportions, government aid to companies which refuse to maintain it. Such measures are the only ones which can make pay those who are responsible for the crisis pay for it, and this would lay the foundations of a better sharing out of wealth. The sum potentially concerned is 90 billion euros: that is 5 per cent of France's Gross Domestic Product (GDP), in other words exactly the same proportion as the 700 billion dollars envisaged by the Paulson plan in the United States.

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[1] For a detailed account, see Les Echos, "La crise financiere mondial au jour le jour", http://tinyurl.com/toxico2 or Jacques Sapir, "Sept jours qui ont ebranle la finance", http://tinyurl.com/toxico1.

[2] For a synthetic presentation, see Michel Aglietta, "10 cles pour comprendre la crise", Le Nouvel Observateur, September 25, 2008, http://tinyurl.com/toxico3.

[3] See Michel Husson, "La hausse tendancielle du taux d'exploitation", Inprecor nÂ°534-535, January-February 2008, http://hussonet.free.fr/parvainp.pdf.

[4] See Michel Husson, "Etats-Unis: la fin d'un modele", La Breche nÂ°3, 2008, http://hussonet.free.fr/usbrech3.pdf .

[5] Patrick Artus, "Peut-on etre tres pessimiste sur la situation economique, a moyen terme, de la zone euro? ", http://gesd.free.fr/flas8420.pdf.

[6] Luigi Zingales, "Why Paulson is Wrong", September 2008, http://gesd.free.fr/zingales.pdf.

