The global collapse: a non-orthodox view

Thursday 19 February 2009, by BELLO Walden (Date first published: 11 February 2009).

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Week after week, we see the global economy contracting at a pace worse than predicted by the gloomiest analysts. We are now, it is clear, in no ordinary recession but are headed for a global depression that could last for many years.

The fundamental crisis: overaccumulation

Orthodox economics has long ceased to be of any help in understanding the crisis. Non-orthodox economics, on the other hand, provides extraordinarily powerful insights into the causes and dynamics of the current crisis. From the progressive perspective, what we are seeing is the intensification of one of the central crises or "contradictions" of global capitalism: the crisis of overproduction, also known as overaccumulation or overcapacity. This is the tendency for capitalism to build up, in the context of heightened inter-capitalist competition, tremendous productive capacity that outruns the population's capacity to consume owing to income inequalities that limit popular purchasing power. The result is an erosion of profitability, leading to an economic downspin.

To understand the current collapse, we must go back in time to the so-called Golden Age of Contemporary Capitalism, the period from 1945 to 1975. This was a period of rapid growth both in the center economies and in the underdeveloped economies — one that was partly triggered by the massive reconstruction of Europe and East Asia after the devastation of the Second World War, and partly by the new socioeconomic arrangements and instruments based on a historic class compromise between Capital and Labor that were institutionalized under the new Keynesian state

But this period of high growth came to an end in the mid-1970s, when the center economies were seized by stagflation, meaning the coexistence of low growth with high inflation, which was not supposed to happen under neoclassical economics.

Stagflation, however, was but a symptom of a deeper cause: the reconstruction of Germany and Japan and the rapid growth of industrializing economies like Brazil, Taiwan, and South Korea added tremendous new productive capacity and increased global competition, while income inequality within countries and between countries limited the growth of purchasing power and demand, thus eroding profitability. This was aggravated by the massive oil price rises of the seventies.

The most painful expression of the crisis of overproduction was global recession of the early 1980s, which was the most serious to overtake the international economy since the Great Depression, that is, before the current crisis.

Capitalism tried three escape routes from the conundrum of overproduction: neoliberal restructuring, globalization, and financialization

Escape Route # 1: Neoliberal Restructuring

Neoliberal restructuring took the form of Reaganism and Thatcherism in the North and Structural Adjustment in the South. The aim was to invigorate capital accumulation, and this was to be done by 1) removing state constraints on the growth, use, and flow of capital and wealth; and 2) redistributing income from the poor and middle classes to the rich on the theory that the rich would then be motivated to invest and reignite economic growth.

The problem with this formula was that in redistributing income to the rich, you were gutting the incomes of the poor and middle classes, thus restricting demand, while not necessarily inducing the rich to invest more in production. In fact, it could be more profitable to invest in speculation.

In fact, neoliberal restructuring, which was generalized in the North and south during the eighties and nineties, had a poor record in terms of growth: Global growth averaged 1.1 percent in the 1990s and 1.4 percent in the ‘80s, compared with 3.5 percent in the 1960s and 2.4 percent in the ‘70s, when state interventionist policies were dominant. Neoliberal restructuring could not shake off stagnation.

Escape Route # 2: Globalization

The second escape route global capital took to counter stagnation was “extensive accumulation” or globalization, or the rapid integration of semi-capitalist, non-capitalist, or pre-capitalist areas into the global market economy. Rosa Luxemburg, the famous German radical economist, saw this long ago in her classic “The Accumulation of Capital” as necessary to shore up the rate of profit in the metropolitan economies.

How? By gaining access to cheap labor, by gaining new, albeit limited, markets, by gaining new sources of cheap agricultural and raw material products, and by bringing into being new areas for investment in infrastructure. Integration is accomplished via trade liberalization, removing barriers to the mobility of global capital, and abolishing barriers to foreign investment.

China is, of course, the most prominent case of a non-capitalist area to be integrated into the global capitalist economy over the last 25 years.

By the middle of the first decade of the 21st century, roughly 40-50 percent of the profits of US corporations came from their operations and sales abroad, especially in China.

The problem with this escape route from stagnation is that it exacerbates the problem of overproduction because it adds to productive capacity. A tremendous amount of manufacturing capacity has been added in China over the last 25 years, and this has had a depressing effect on prices and profits. Not surprisingly, by around 1997, the profits of US corporations stopped growing. According to one calculation, the profit rate of the Fortune 500 went from 7.15 in 1960-69 to 5.30 in 1980-90 to 2.29 in 1990-99 to 1.32 in 2000-2002. By the end of the 1990s, with excess capacity in almost every industry, the gap between productive capacity and sales was the largest since the Great Depression.

_Escape Route # 3: Financialization

Given the limited gains in countering the depressive impact of overproduction via neoliberal restructuring and globalization, the third escape route — financialization — became very critical for maintaining and raising profitability.

With investment in industry and agriculture yielding low profits owing to overcapacity, large amounts of surplus funds have been circulating in or invested and reinvested in the financial sector — that is, the financial sector is turning on itself.

The result is an increased bifurcation between a hyperactive financial economy and a stagnant real economy. As one financial executive noted in the pages of the Financial Times, “there has been an increasing disconnect between the real and financial economies in the last few years. The real economy has grown … but nothing like that of the financial economy — until it imploded.” What this observer does not tell us is that the disconnect between the real and the financial economy is not accidental — that the financial economy exploded precisely to make up for the stagnation owing to overproduction of the real economy

One indicator of the super-profitability of the financial sector is that while profits in the US manufacturing sector came to one percent of US gross domestic product (GDP), profits in the financial sector came to two percent. Another is the fact that 40 percent of the total profits of US financial and non-financial corporations is accounted for by the financial sector although it is responsible for only fiv percent of US gross domestic product (and even that is likely to be an overestimate).

The problem with investing in financial sector operations is that it is tantamount to squeezing value out of already created value. It may create profit, yes, but it does not create new value — only industry, agricultural, trade, and services create new value. Because profit is not based on value that is created, investment operations become very volatile and prices of stocks, bonds, and other forms of investment can depart very radically from their real value — for instance, the stock of Internet startups may keep rising to heights unknown, driven mainly by upwardly spiraling financial valuations.

Profits then depend on taking advantage of upward price departures from the value of commodities, then selling before reality enforces a “correction,” that is a crash back to real values. The radical rise of prices of an asset far beyond real values is what is called the formation of a bubble.

Profitability being dependent on speculative coups, it is not surprising that the finance sector lurches from one bubble to another, or from one speculative mania to another.
Because it is driven by speculative mania, finance driven capitalism has experienced about 100 financial crises since capital markets were deregulated and liberalized in the 1980s, the most serious before the current crisis being the Asian Financial Crisis of 1997.

_Dynamics of the Subprime Implosion

The current Wall Street collapse has its roots in the Technology Bubble of the late 1990s, when the price of the stocks of Internet startups skyrocketed, then collapsed, resulting in the loss of $7 trillion worth of assets and the recession of 2001-2002.

The loose money policies of the Fed under Alan Greenspan had encouraged the Technology Bubble, and when it collapsed into a recession, Greenspan, trying to counter a long recession, cut the prime rate to a 45-year low of 1.0 percent in June 2003 and kept it there for over a year. This had the effect of encouraging another bubble — the real estate bubble.

As early as 2002, progressive economists were warning about the real estate bubble. However, as late as 2005, then Council of Economic Advisers Chairman and now Federal Reserve Board Chairman Ben Bernanke attributed the rise in US housing prices to “strong economic fundamentals” instead of speculative activity. Is it any wonder that he was caught completely off guard when the Subprime Crisis broke in the summer of 2007?

The subprime mortgage crisis was not a case of supply outrunning real demand. The “demand” was largely fabricated by speculative mania on the part of developers and financiers that wanted to make great profits from their access to foreign money — most of it Asian and Chinese in origin — that flooded the US in the last decade. Big ticket mortgages were aggressively sold to millions who could not normally afford them by offering low “teaser” interest rates that would later be readjusted to jack up payments from the new homeowners.

How did problematic mortgages become such a massive problem? The reason is that these assets were then “securitized” — that is converted into spectral commodities called “collateralized debt obligations” (CDOs) that enabled speculation on the odds that the mortgage would not be paid. These were then traded by the mortgage originators working with different layers of middlemen who understated risk so as to offload them as quickly as possible to other banks and institutional investors. These institutions in turn offloaded these securities onto other banks and foreign financial institutions.

The idea was to make a sale quickly, get your money upfront and make a tidy profit, while foisting the risk on the suckers down the line — the hundreds of thousands of institutions and individual investors that bought the mortgage-tied securities. This was called “spreading the risk,” and it was actually seen as a good thing because it lightened the balance sheet of financial institutions, enabling them to engage in other lending activities.

When the interest rates were raised on the subprime loans, adjustable mortgage, and other housing loans, the game was up. There are about four million subprime mortgages which will likely go into default in the next two years, and five million more defaults from adjustable rate mortgages and other “flexible loans” that were geared to snag the most reluctant potential homebuyer will occur over the next several years. But securities whose value run into as much as$2 trillion had already been injected, like virus, into the global financial system. Global capitalism’s gigantic circulatory system was fatally infected. And, as with a plague, we don’t know who and how many are fatally infected until they keel over because the whole financial system has become so non-transparent owing to lack of regulation.

For Lehman Brothers, Merrill Lynch, Fannie Mae, Freddie Mac, Bear Stearns, Bank of America, and Citigroup, the losses represented by these toxic securities simply overwhelmed their reserves. Iceland’s banks and many European financial institutions have since joined the list of victims. Some, like Lehman Brothers, have been allowed to die, but most have been kept alive with massive injections of taxpayers’ cash by governments that want the banks to lend to keep the real economy going.

Collapse of the Real Economy

But instead of performing their primordial task of lending to facilitate productive activity, the banks are holding on to their cash or buying up rivals to strengthen their financial base. Not surprisingly, with global capitalism's circulatory system seizing up, it was only a matter of time before the real economy would contract, as it has with frightening speed in the last few weeks. Woolworth, a retail icon, has folded in Britain, the US auto industry is on emergency care, and even mighty Toyota has suffered an unprecedented decline in its profits. With American consumer demand plummeting, China and East Asia have seen their goods rotting on the docks, bringing about a sharp contraction of their economies and massive layoffs.

Globalization has ensured that economies that went up together in the boom would also go down together, with unparalleled speed, in the bust, the end of which is nowhere to be discerned.

P.S.

* Philippine Daily Inquirer, 11 February 2009. This is the longer version of an essay by the author released by the British Broadcasting Corporation (BBC) on Feb. 6, 2009. Circulated by the Transnational Institute.

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