

United States: The new banking crisis

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As discussed by Marxist economist Sam Williams on his *Critique of Crisis Theory* blog, early in March, Silicon Valley Bank (SVB) in California, the “favorite bank of the area’s tech companies and associated venture capitalists”, announced it was selling its government bonds to raise cash. Fearful that their deposits were in danger, there was a run on the bank, forcing the Federal Deposit Insurance Corporation (FDIC) to shut the bank down.

Around the same time, two other banks collapsed. The California Silvergate Bank wound up operations, and the New York-based Signature Bank was shut down by the FDIC. As Williams reported, these banks were “heavily involved in lending to cryptocurrency companies”, and the problems leading to their collapse “could be traced back to the collapse of Sam Bankman-Fried’s FTX cryptocurrency exchange last year”.

While the collapse of these later two wasn’t directly related to the collapse of SVB, their collapse added to the jitters that spread to the whole banking system in the United States and internationally.

The crisis at Credit Suisse led to another Swiss bank taking it over. Problems at Germany’s Deutsche Bank led to big stock losses.

Big deposits propped up

Under US law, Williams writes, bank deposits are insured up to US\$250,000 — to protect small and medium sized deposits. Most of SVB’s deposits came from tech companies and venture capitalists, and were much higher. Despite this, the FDIC rapidly announced that all deposits would be fully covered.

The big commercial banks, says Williams, “will be asked to cough up the money to make up for the massive losses FDIC will incur by paying off large capitalist deposit owners”. This applies to SVB and any further bank collapses.

One of the functions of money is that it is used as currency. But, as Williams writes, coins “are now almost worthless as currency except in large quantities or for making change”. Even Federal Reserve Notes — dollar bills — buy little these days.

“Today people use their bank accounts as a day-to-day currency that circulates through credit cards, debit cards, and smartphones — to purchase weekly groceries (and morning coffee),” writes

Williams. “If a run on the banks paralyzed the banking system, even if only for a short time, the circulation of commodities would contract to an extent impossible at earlier stages of capitalist development.”

The FDIC hopes to stave off such a general collapse of the currency system, writes Williams, which “would lead to an economic crisis worse than the bank runs of 1931–33”, which “marked the transformation of the recession that began in 1929 into the Great Depression”.

Extortion

This threat gives the capitalist class great extortion power, writes Williams, to “insist that the FDIC, the Federal Reserve System or the Treasury bail out large depositors”.

The Joseph Biden administration complied, and “wasted no time in claiming the taxpayer — unlike in 2008 — would not have to pay anything” for the bailout, “because the losses incurred by the FDIC would be paid with a special levy on the commercial banks”, writes Williams.

However, as Williams notes, “the levy would tend to contract bank credit. If this happens the world economies — including in the US — would sink into a deep recession, causing mass layoffs within a few months”.

“And there’s another danger if the capitalists become convinced their bank deposits are as good as the dollar bills issued by the Federal Reserve Banks,” writes Williams. “In that case, they may decide Federal Reserve Notes are no more secure than bank deposits without the FDIC, Federal Reserve, and government guarantees. This would trigger a run on the dollar and paper currencies linked to it under the dollar-centred international monetary system into gold, the money commodity ... This danger is real, as shown by the movement of the dollar price of gold since the crisis began.”

This would lead to stagflation as occurred in the 1970s, and then to a severe recession.

Such a scenario could happen if the Federal Reserve eases up interest rates to contain the crisis by printing more money (known as quantitative easing) in a bid to “secure a soft landing from the COVID aftermath boom”, writes Williams.

“In the current crisis, the Federal Reserve is forced to prop up bank deposits as the currency system on one side while staving off the collapse of the [dollar-centred] international monetary system on the other. These are contradictory goals.”

Overproduction

The cause of the current crisis is the overproduction of commodities in the COVID-aftermath boom.

After the 2007–09 bank crisis and Great Recession, capitalists were cautious about accumulating inventories and investing, writes Williams. “This prevented a new worldwide overproduction crisis for years, at the price of lingering unemployment and eroding living standards. However, by late 2019 signs of overproduction were again developing, causing a spike in interest rates, though the situation had not yet reached a crisis.

“But then came COVID. In March 2020, the ruling class feared the virus would decimate the working-class population to such an extent their ability to squeeze surplus value out of the survivors

would be impaired. They used state power to shut down much of the economy, throwing millions out of work overnight.”

The COVID shutdowns also caused a forced underproduction of commodities and reduction of inventories, writes Williams. When the shutdowns were eased, the boom began to rebuild inventories as demand for commodities soared. Demand exceeded supply at prevailing prices, resulting in high prices and higher profits. There was a rise in demand for labour power. But wages didn't keep up with inflation, so real wages declined.

Inflation

The mainstream media and economists try to convince us that wage rises cause inflation, but the opposite is true. Workers' wages struggle to keep up with inflation, which has other causes.

“The Federal Reserve System, headed by [Donald] Trump appointee Jerome Powell, hoped that inflation would disappear as the economy reopened,” writes Williams. But once set in motion, what economists call “multiplier and accelerator effects” accelerate a boom and its associated inflation, “until they run into the barrier of a shortage of ready cash”.

“At that point, they go into reverse. The boom is replaced by recession to liquidate overproduction at the price of millions of jobs,” writes Williams.

Banks use their customer deposits to make loans, and make money off the spread between what interest they charge on their loans and the interest they pay on deposits. But financial institutions are currently facing a changing economic climate, in which the free-money era of ultra-low interest rates has ended as the Federal Reserve tries to rein in inflation by making it more expensive to borrow.

The result caught Silicon Valley Bank unable to service its depositors.

Middle way?

The Federal Reserve System faces a quandary: If it creates more dollars not backed by gold to keep the boom going, profits in dollar terms would remain high for a while but turn negative in gold terms. This would cause capitalists to transform as much of their capital as possible into gold. The resulting run to gold would accelerate dollar inflation and threaten to bring down the dollar-centred international monetary system.

On the other hand, if the Federal Reserve allows the bank money system to become paralysed by bank runs, the dollar would be saved, but the economy would fall into a second Great Depression.

So the Federal Reserve is attempting to find a middle way: to keep the system of bank deposits as currency functioning, without bringing down the dollar's role as the world currency — and other currencies linked to it.

The aim is to achieve a relatively soft landing, even if that means a recession with millions losing their jobs. But if the Federal Reserve is successful, it will keep a recession from turning into a depression, while saving the international monetary system.

Whether the Federal Reserve can pull it off this time remains to be seen. But even if it does, the

world will face a similar crisis again in a decade or so.

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P.S.

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