Demystifying the Financial Sector #2: MAKING SENSE OF THE CRISIS



CORPORATE WATCH

Making Sense of the Crisis

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INTRODUCTION



MAKING SENSE OF THE FINANCIAL CRISIS may sound like a daunting task. Often the financial system comes across as an impenetrable web of obscure institutions and complicated transactions. Explanations of how these institutions work, what instruments they use and the impact that they have on us often get lost in the technical jargon used to talk about them. Libraries are full of economic theories and analyses used to explain or justify policies and opinions, yet they often assume readers are up to speed with the facts and debates. So is it possible to make sense of the crisis?

We would like to think that it *is*. By going back to basics and gradually building an understanding of how capitalist finance works, the crisis might well start to make more sense. A good starting point is seeing that the financial system is inseparable from the daily economic interactions in which we are all engaged on a daily basis. Many of the concepts that may seem intangible (debt, interest rates, inflation, bonds and so on) are rooted in the actions and livelihoods of normal people and, more generally, in the social relations of capitalism. Realising the ways in which we are tied up to the financial system on a day-to-day level, and how this system locks our lives into exploitative relations, is not only key to understanding the crisis but also to any struggle for radical social change.

'Back to basics' means reminding ourselves of some of the basic underlying principles of how a capitalist economy works. Thus, before we delve into the ins and outs of the crisis, it is important to remind ourselves that, like other capitalist markets, the financial industry revolves around what is known as the 'profit motive'. Just like company directors, bank and fund

managers are *legally* bound to "act in good faith" in the "best interests" of the company or the fund they manage (this is known as their 'fiduciary duty'). These interests are almost always interpreted as maximising benefits for the shareholders or the clients. In turn, this normally translates as profit maximisation and the ability to issue ever-greater returns on investments. 'External factors', such as environmental or social impacts, which might be detrimental to profit maximisation, are not supposed to be taken into account, except where they are deemed beneficial to the long-term interests of the company or the fund itself.¹

Yet, it must be admitted that making real sense of the crisis is not so easy. Many of the issues involved are quite complex and confusing, even for industry insiders. As much as we've tried to simplify them in this briefing and make them more accessible and relevant to non-specialist readers, they still require some background knowledge and a grasp on some basic concepts. A good place to start is our first briefing in this series, *Demystifying the Financial Sector: A Nuts and Bolts Guide*.²

A common trend in mainstream analysis of the financial crisis has been to blame individual institutions or managers for 'bad investment decisions' – the good old 'bad apples' argument. The **first article** in this briefing deconstructs this and other myths and shows how the credit crunch came about as an inevitable result of the recent developments in the present arrangements of the economic and financial system, i.e. capitalism.

The **second article**, *Crisis Stories*, provides summaries of, and comments on, different interpretations and analyses of the financial crisis (Marxist, Keynesian and so on). Though it was originally written and published online in 2009, the author's analysis of the credit crunch still holds up and is, in fact, supported by recent developments. There are a couple of points to note, though, about what has happened since then.

First, the so-called 'Keynesian resurgence' proved very short-lived. After all the initial talk of reform and regulation, it was actually the neoliberal right rather than the Keynesian liberals who proved – with some display of barefaced cheek – able to turn the crisis to their own gain. In a brazen move straight out of Naomi Klein's *Shock Doctrine*, they used their own mess to justify declaring a state of economic emergency. And so we got 'austerity' packages, with even more deregulation, and loads more profitable sell-offs.

Second, one of the main points of the article is how both liberal and radical analyses (back in 2009) largely ignored the big global shifts behind the crisis. People have since been waking up to this issue more. Recent decent writings on the crisis, and on the economic state of things more generally, have taken a more global focus. In this regard, Paul Mason's book *Meltdown* is worth reading, and so is *Aufheben* magazine #19.³

Finally, to complement 'our' critical take on the crisis, we have included **an interview** with a bank trader to give readers a glimpse into how 'they' think.

We hope you enjoy the briefing and find it useful.

MAKING SENSE OF THE CRISIS: THE CREDIT CRUNCH

MUCH OF THE MEDIA HYPE around the financial crisis that began in 2007 focused on 'rogue' financial speculators, as opposed to the good, old capitalist investors. It was often argued that, unlike investment, speculation is not based on thorough economic analysis but on hasty betting decisions. However, in the world of finance, there is no clear distinction between speculators and investors as both seek to profit from price fluctuations. The only difference is that the former often look at the short-term, while the latter at the long-term. It is true, however, that practices such as 'short-selling' – that is, the selling of *borrowed* stocks to make a quick buck on fluctuating prices – may cause prices to deviate from the 'norm', especially when speculators trade on misinformation, or if they simply get it wrong.

This may sometimes create a 'bubble' in which prices rise dramatically above the underlying value of the commodity in question. Such periods of increasing speculative purchasing are typically followed by a period of speculative selling, in which prices fall dramatically, leading in extreme cases to crashes or financial crises. While this briefing focuses on the recent crisis, this cycle of economic boom and bust has been repeated time and again throughout the history of capitalism.

I. CREATING A BUBBLE

The most direct catalyst for the current crisis was the bursting of the 'property bubble' in the United States, with a corresponding crash in the value of high-interest, high-risk, mortgage-based debt, in which almost every major player in the financial industry had invested.

a. The property boom

The immediate origins of this property bubble lay in the US government's response to the collapse of a previous economic bubble, the 'dot.com boom', in which the value of internet-related companies expanded spectacularly through the 1990's before falling through the floor at the turn of the millennium.

At their peak, stocks in internet businesses made up 8% of the value of the entire US stock market.¹ However, as investors optimistically poured money into dot.com enterprises, many of which had yet to turn a profit, their value became grossly over-inflated (i.e. their prices rose dramatically). Eventually, around March 2000, the irrational exuberance with which investors had embraced internet shares began to evaporate and the market plummeted. In just two years, \$5 trillion was wiped off the value of companies listed on the Nasdaq stock exchange.² The boom was over and the bubble burst.

In reaction to the threat of a recession posed by the crash in internet shares and alongside a cautious investment atmosphere following the 9/11 terrorist attacks, Alan Greenspan, the chairman of the US central bank, known as the Federal Reserve, or Fed, decided to lower national interest rates to around 1% in order to encourage more borrowing and thereby soften the effects of the crash. Central banks across the world followed suit and financial institutions were able to borrow from central banks very cheaply. This in turn enabled commercial banks to lower their own interest rates and encourage more people to take more loans to meet rising living costs not being covered by stagnant wages. As the policy had intended, the low interest rates attracted a flurry of borrowing. Banks were able to increase and diversify their investments, and lend out cheap credit to consumers.

Greenspan lowered interest rates in order to encourage more borrowing and thereby 'soften the effects' of the bursting of the dot-com bubble.

Traditionally, a large part of banks' profits comes from lending out the money they themselves have borrowed, but at higher interest rates, thus taking a cut – or 'spread' – between how much they pay for money and how much they lend it out for. The ease and low cost with which they could access credit from central banks from 2001 onwards stimulated a drive to expand their business by finding new opportunities to lend and invest. As part of this drive, banks and hedge funds created increasingly complex techniques for investing, and the years following the Fed's introduction of low interest rates saw the proliferation of new financial products and investment 'instruments'. As Robin Blackburn explains:

The very low US interest rates of 2001–06 were hugely lucrative to the banks, allowing them to take on more debt, improve the terms of their business and expand its volume. They sponsored hedge funds and private equity buyouts, packaged their own mortgage-related financial instruments, arranged bond insurance, and furnished lines of credit to their own structured investment vehicles (sivs) and 'conduits'. These bets were usually leveraged by extra helpings of debt, with some institutions—the investment banks and hedge funds—borrowing to buy assets worth as much as thirty times their capital.³

The cheap rates set by the Fed meant that borrowing was cheaper for both banks and consumers, but it equally meant a bad return for those who invested their money in the state, rather than borrowed from it. US Treasury Bills (the Bonds issued by the Fed in order to fund government spending) had traditionally been a solid, stable investment favoured by pension funds and other long-term, risk-averse institutions. They would pay a modest but acceptable interest rate and were, more importantly, very unlikely to default given the US' status as a military and economic superpower. However, with interest on treasury bills a measly 1% (throughout the 1990's it averaged around 5%),⁴ investors were forced to look out for

something better in order to keep their money growing. With the housing market booming, many began to put their cash into a new kind of investment bonds based on mortgage loans, known as a 'mortgage-backed security' (MBS)⁵ (more on these in the next section). As a result, part of this newly available investment capital began flooding into the housing market as investors sought to grab a piece of the lucrative mortgage lending business.

Home loans were dished out in increasing quantity throughout this period – in 2001, new mortgage lending in the US amounted to \$2,215 billion; by 2003, it had almost doubled. Economist Costas Lapavitsas has calculated that, after the initial boom in mortgages from 2001 to 2003, much of the mortgage borrowing demand from households with significant incomes had been met.⁶ This meant that, although it was easy for lenders to offer lucrative deals, there were not many consumers left who did not already have a mortgage. Supply outstripped the traditional source of demand. In response, mortgage lenders turned, with increasing rapaciousness, to the so-called 'subprime' demographic – people without assets or substantial incomes – in order to continue churning out profitable loans.

b. *Making subprime appealing to investors*

Subprime mortgage contracts were often a 100% loan, not requiring a deposit, proof of income, assets or equity to demonstrate ability to repay both the mortgage debt and the interest levelled on the contract. They were referred to in the industry as 'NINJA mortgages' (No Income, No Job, No Assets). They had much larger fees, higher interest charges and heftier penalties for missing a repayment. These exorbitant charges were perceived by lenders as a counterbalance against the higher risk associated with subprime borrowers. More fundamentally, they reflected the assumption held in mainstream economics that any uncertainty can be eliminated as long as it is priced correctly (the so-called price mechanism). High-risk lending of this sort made up a \$1.75 trillion market – with 19.5% of all new mortgages in the US between 2004 and 2006 classed as subprime.⁷ In the UK, one in five borrowers was on a subprime-type mortgage, accounting for over £50 billion of all mortgage contracts.⁸

In the face of an intensified hunt for profitable investments, subprime lending was the financial system's attempt to expropriate wealth from those previously excluded from the mortgage market – some of the poorest or most marginalised sections of society. As Gary A. Dymski puts it, "Financial exclusion and loan denial were transformed into financial exploitation: households previously denied mortgage credit were now awarded high-cost, high-risk loans."⁹ Robin Blackburn claims lenders and investors craved these 'rubbishy assets', as "risky debt was potentially far more profitable than good debt because the latter is expensive to acquire and can never be worth more than par, while the value of the former was heavily discounted, and optimism about repayment prospects and the ingenuity of 'structured finance' led to high resale prices."¹⁰

In the US, this 'predatory lending' took on an overtly racial character. African-Americans were twice as likely as whites to receive a subprime mortgage contract, with the profit motive now exceeding the institutional racism typical of many US financial corporations, which had previously refused to lend to ethnic minorities.¹¹ The exploitative character of this lending was further reflected in the abundance of 'Adjustable Rate Mortgages' (ARM), which had a low rate of interest for the first few years but rose substantially after that initial period. This hit the poorest hardest, for whom the smallest change in interest rates could mean the difference between the ability to re-pay and defaulting on their mortgage.

Between 2004 and 2006, 47.6% of all originations (the process through which a mortgage lender creates a mortgage) in the US were ARM – contracts with a total value of \$4.3 trillion. ARM mortgage holders were encouraged to re-mortgage their homes, using the extra debt to cover interest rate rises hidden within their ARM contracts. This was done in the belief that the increasing value of their properties would eventually help pay for the accumulated debt. In 2000, 20.5% of originations were refinanced. At the height of the mortgage boom in 2003, this figure had surged to 66.4%.¹²

Re-mortgaging property in this way was attractive to lenders because new demand for loans was generated from already existing borrowers, which, in addition to the extra fees and charges, gave lenders access to a part of the appreciating value of properties, expropriated in the form of interest. This is value that would otherwise have sat idle until the home was actually sold. Even then, it would have been only to the homeowners advantage. Remortgaging thus allowed lenders to take advantage of increases in house prices as they happened, and was so common that it amounted to the near-total financialisation of workers' housing, as dependence on private finance for home ownership became endemic.

This fuelled a widespread sale of the American dream – the possibility of owning a home – to those at the bottom of society. The dream became increasingly dependent on fulfilling the needs of the financial markets: more 'high-risk' borrowers paying handsome interest rates to those with capital to lend. The failure of the subprime mortgage market cannot, therefore, be reduced to the fact that those taking on the loans were 'poor and financially irresponsible', as many commentators were quick to assert. The vast demand for housing created by the huge increase in mortgage lending sent property prices on an upward trajectory. But, paradoxically, it was this rise in prices that acted as the basis upon which new investments in mortgage debt were then made. In a classic example of an economic bubble, the value of property was first inflated by money being pumped into the market, then taken as the justification for investors to pump even more money in. Crucially, lenders believed that, if households defaulted on repayments, they could simply repossess the properties, which were increasing in value anyway, and sell them on.

Subprime lending was the financial system's attempt to expropriate wealth from those previously

excluded from the mortgage market... it enabled the sale of the American dream to those at the bottom of society.

What lay under this surge in demand? Was it purely the state's decision to give out large volumes of cheap credit? Was it based on the hope that pumping large amounts of money into the economy would generate long-term economic growth, rather than short-term speculation? Whatever the rationale was, the question remains: why did mortgage lenders give out such vast quantities of credit in the first place without considering the borrowers' ability to repay? Why did investors and financial institutions then happily buy up this debt without fear of risks? And how could what essentially started as a mortgage crash in the US grow into a global crisis of such epic proportions?

To even begin to understand these questions, we need to examine how mortgage loans were turned into complex financial products in a way that connected ordinary households to the global financial market.

II. SECURITISATION

We have already mentioned how financial institutions ploughed funds into the mortgage business in order to profit from the lucrative interest rates charged, particularly on risky subprime loans. But what turned these investments into such a huge business were the developments in the financial sector, notably the increasing use of 'derivatives' (financial products *derived* from or based on other products), which enabled something as simple as mortgage debts to be transformed into complex financial instruments.¹³

The most important part of this process was a technique known as 'securitisation', which, as the name implies, allegedly functions to make investments safer. It does this by basing investments on a diverse collection of things. For example, if you invest £1,000 in corn and suddenly find that the market for corn is flooded, the value of your entire investment will plummet. However, if instead you 'securitise' your investment by investing £500 in corn and £500 in wheat, then, if either market flopped, the damage will only be half as bad. In this way, exposure to market risks is limited – at least theoretically – as unpredictable outcomes are balanced out by predictable ones.

This technique, also known as <hedging>, formed the basis of the mortgage boom. Throughout the early 2000's, the securitisation of mortgage loans became a widespread phenomena. Between 2004 and 2006, 79.3% of all US subprime mortgages were securitised, compared with 63% overall securitisation of mortgages.¹⁴ Alongside other hedging techniques, this led to the popular belief in the financial world that mortgage debt was a virtually fail-safe investment.

It worked like this: to the lender, a mortgage contract represented a single 'income stream' comprising of a household's monthly loan re-payments plus the interest paid on top. Depending on a variety of factors, such as the household's earnings and assets owned, this income stream could be rated according to its riskiness. Once this assessment was made, the lender could sell the income stream on to investors on the so-called 'secondary market' (where mortgage debts are bought and sold). Many investors on the secondary market saw prime mortgages with healthy interest rates as a solid investment and snapped them up, but most did not want to touch the riskier, subprime loans, which looked like they could default and stop paying at any moment. Normally, these debts would only be bought up by the more daring players, such as hedge funds, who were willing to take risks in order to make bigger returns.

These 'risk-hungry' funds soon discovered that they could improve the credit rating of subprime debts, and thereby increase their desirability to other investors, by combining them with less risky, prime mortgage loans to create a new kind of derivative product called the 'mortgage-backed security' (MBS) or 'collateralised debt obligations' (CDOs).¹⁵

CDOs packaged numerous income streams together (from prime and subprime mortgages), then offered investors the chance to buy into packages of differing levels of risk corresponding to higher or lower interest rates. The highest-rated bonds (AAA) gave investors priority access to repayments, and so were unlikely to default. The next level (BBB) would be paid off and, lastly, the high-risk 'junk' bonds would pay out – providing that none of the loans in the pot had defaulted. If some of the income streams dried up, those holding the junk bonds would lose out first. This is why they were compensated with higher interest rates. So with securitisation, instead of buying single mortgages, investors could now buy bonds based on a mixed pot of safer and riskier loans, in a way that seemed to reduce the overall unpredictability of the asset while still offering a good return.

Since prime and subprime mortgage contracts were mixed into CDOs, the banks found many more buyers for subprime debt. Large investors, such as pension funds, who had previously shunned subprime debt, now bought into it in the form of these derivatives. Meanwhile, the institutions creating these CDOs were not simply buying assets at one price and selling them on for another, higher price. Instead, they were 'synthesising' brand new products that could fetch a higher price than the components parts would fetch on their own.

Because of their complexity, CDOs are difficult to value accurately, and banks took advantage of this. One common practice, known as 'ratings arbitrage', involves packaging together debts so that they appear to be far less risky than they actually are, in the hope that they will be rated above their value. If banks could convince the credit rating agencies that grade these CDOs that they were as secure as they claimed them to be, investors are likely to trust the assessments and end up paying over the odds. As Nick Hildyard puts it, "By combining risky assets (such as mortgages to low-income groups) with less risky ones (mortgages to high income groups), securitisation has been used magically to transform risky assets into attractive investments."¹⁶ Tony Jackson explains how it worked: "The issuer would design the various tranches of the CDO in such a way as to raise their aggregate ratings, with the agencies' approval. It was thereby possible to turn \$100m of loans into \$103m or \$105m with a wave of the wand."¹⁷

A high-risk package is transformed, through an act of financial alchemy, into an attractive investment.

On top of all this, mortgage-based CDOs would often be accompanied by a form of insurance against default, known as a 'credit default swap' (CDS). This is essentially a contract offering the investor protection against non-payment in return for a small premium. CDS sweetened the deal, particularly for the cautious managers of big investment funds, who now saw the risk-free returns on CDO bonds as too lucrative to refuse. In the words of Robin Blackburn,

The generally buoyant conditions of 2003–06, with low default rates and low interest rates, meant that CDO insurance was cheap. The purchaser was assured by those assembling the CDO that it came with a secure hedge and that the whole package had a 'triple A' grade from the ratings agencies.¹⁸

Hedge funds and investment banks got hold of as many cheap subprime mortgages as they could packaged them up with standard loans and sold these packages on, generating huge returns in the process. What was significant about these practices is that they allowed both the lenders and those creating CDOs to ignore the consequences of debt defaults, because they were simply passing on the risk to someone else and taking a cut of the profits. Securitisation had removed responsibility from any one player. As Mark Zandi puts it, "the risks inherent in mortgage lending became so widely dispersed that no one was forced to worry about the quality of any single loan."¹⁹ Banks and brokers knew that loans would be almost immediately shipped off their books. The hefty fees and bonuses they received for creating and selling mortgage debt provided banks and lenders with irresistible motivation to continue dishing out loans and CDOs, irrespective of the risk. As the crisis unfolded, it became apparent that more or less every type of financial institution had invested in overvalued subprime loans.

A great wave of securitization aimed to turn even the most unpromising cash prospect, or intimate personal ambition, into a tradeable. It succeeded in submerging the world's main capital markets in a deluge of nonperforming and unpriced securities.

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-Robin Blackburn²⁰

Before the 1980's, US banks kept loans they made on their own balance sheets and 'absorbed' the risk of their lending. Securitisation allowed financial institutions to magic away the risk of holding large quantities of debt on their books, while generating assets to sell to global investors at the same time. It was a technique for transforming 'illiquid' assets (loans that wouldn't be repaid for, say, 25 years) into highly liquid credit notes, which functioned – as long as market confidence in their value was high – as if they were actual money.²¹ The securitization of mortgages allowed for a fast growth of credit and lowered credit standards as banks believed they had passed on credit risk.²²

However, a further, crucial part of the picture was that banks were massively amplifying the rewards and risks of their activities by combining securitisation with another technique known as 'leveraging'. It was this that turned the failure of the mortgage lending industry into a global financial meltdown.

III. LEVERAGING: THE DOOM MULTIPLIER

Households may have been encouraged to take on more debt – mortgages or otherwise – throughout the 2000's, but borrowing by banks during this period was even more extreme – the decade between 1997 and 2007 saw household debt rise by 151%, while that taken on by

banks and other financial entities grew by 178%.²³ One reason for this is that techniques such as securitisation went hand in hand with deregulation and innovation in the financial sector.

Many mainstream economists and politicians have argued that banks' use of complex financial instruments, such as off-balance sheet securitisation and derivatives, made it 'difficult' for creditors and regulators to monitor them and be able to predict or prevent the financial crisis. However, it was precisely western governments' neoliberal policies that allowed banks to develop and use such instruments.

Since the 1970's, fiscal and monetary policies, particularly in the US and the UK, have emphasised deregulation as a means of encouraging business. This is justified with the claim that the deregulated market is more efficient at allocating resources. This led to less oversight of banks' activities and less disclosure of information about new activities undertaken by evolving financial institutions. On 27 October 1986, in a day dubbed the financial 'big bang', the Thatcher government deregulated the financial market and introduced many radical measures including the abolition of fixed commission charges and the removal of the distinction between 'stockjobbers' (market makers) and 'stockbrokers' (share traders) on the London Stock Exchange. In 1999, the Clinton government in the US repealed the 1933 Glass-Steagall Act, effectively removing the separation that previously existed between Wall Street investment banks and depository banks. Gordon Brown was a fan of 'light touch' regulation of the financial sector and a low-tax regime for foreign banks operating in London. In 2004, the US Securities and Exchange Commission relaxed the net capital rule, which enabled investment banks to substantially increase the level of debt they were taking on, fuelling the growth in subprime mortgages and mortgage-backed securities. As a result, depository banks were allowed to move significant amounts of assets and liabilities off their balance sheets into other complex legal entities, masking weaknesses in the capital base of firms or the degree of leverage or risk taken. To quote Robin Blackburn again:

Freed by deregulation, the banks found new business by converting consumer debt into tradeable securities and then selling those securities to the funds (or other banks). In order to finance this operation the banks themselves took on more debt, blithely assuming that the return on the securities would be comfortably above their cost of borrowing, and that they would anyway soon sell on the securities to someone else, in what was known as the 'originate and distribute' model.²⁴

Thus, having supposedly eliminated their exposure to defaults, the priority for banks now became to increase the volume of their CDO trading as much as possible. In order to do this, they became highly 'leveraged', taking on massive amounts of debt which they then used to expand their business of buying and selling mortgage contracts. Securitisation was part of the more general 'off-balance sheet' approach that financial companies have increasingly adopted to hide their liabilities and increase their borrowing.

Regulations, such as the G20's banking supervision agreement, known as the Basel Accords, require that banks maintain a certain amount of cash on their books which they do not lend out. This is called the 'capital reserve' and is designed to protect both the bank and its creditors if its finances start to get into trouble. Of course, these regulations are frustrating for banks, as they have to hold on to money that could otherwise be invested and used to generate higher profits. Through a combination of lobbying for more relaxed regulation and financial innovation designed to bypass what regulation did exist, the financial sector was able to carve out a business model based on extremely high debt-to-equity ratios – in other words, massive leverage – with some institutions borrowing as much as 30 times the value of their assets.

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In 1951, there was a very stable and safe bank-based system, whereby 11 percent of total bank deposits were covered by reserves. The percentage today is less than one-tenth of 1 percent.

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-D'arista²⁵

Securitisation was used to bypass the capital reserve requirement because, by turning mortgage debts into CDOs, which were then sold off, banks seemed to have recouped their loans immediately.²⁶ In reality, however, this was largely a paper exercise. Banks initially sold mortgage debt to securitisation companies that they had themselves set up.

These companies, called 'special purpose vehicles' (SPVs), would officially own the debts and create and sell bonds in the form of CDOs. While on paper it might have looked like the banks had partially removed themselves from the liabilities, in reality it was simply held by an arms-length subsidiary. For example, Citibank created SPVs holding \$100 billion worth of debt, the biggest of which, called Centauri, held \$21 billion worth of loans in February 2007. Yet there is no mention of Centauri in Citigroup's 2006 annual report.²⁷

In this way, core financial institutions had used a shadowy, secondary banking system to hide much of their exposure. By offloading liabilities onto front companies, banks and hedge funds were able to carry on borrowing without revealing the true extent of their precariousness. According to Blackburn, these 'vehicles' held "scores of billions of dollars"

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of credit derivatives at model prices, reflecting "great optimism or even sheer fantasy."28

The variety of techniques used to multiply gains and offload risk was seemingly unlimited. Liabilities were counted as assets, CDOs were used as collateral against which credit could be taken on, further derivatives were issued on them, insurance was taken out on them and they were then repackaged and sold on multiple times. This spread the 'toxic' subprime mortgage debt even further, creating an incredibly complex web of debts and a chain of dependence upon the performance of the original mortgage contracts.

During the boom, this increased dependency was championed as an efficient distributor of risk, which allowed the dangers and benefits of these assets to be spread more evenly. But when the bubble burst, it became apparent that there were too many claims upon too little underlying value. It was impossible for all of them to be fulfilled.

IV. CRUNCH TIME: THE PARTY ENDS

When interest rates began to rise in the mid-2000's, US home-owners were hit hard. Between 2004 and 2006, the Federal Reserve increased interest rates from 1% to 5.4%.²⁹ This sent repayments soaring on many mortgages. Defaults became rife as home owners found themselves unable to cover the increased cost of their debt. By the end of 2007, nearly two million people had lost their homes.³⁰ The year between January 2007 and January 2008 saw a 57% increase in the rate of foreclosures (recovering the balance of the loan by forcing the sale of the asset used as its collateral) in the US, with the poorest hit hardest. Subprime ARM loans amounted to 42% of all foreclosures.³¹ With a large proportion of subprime loans going to African-Americans (52% of subprime loans in 2005), the subsequent defaults and foreclosures have been described as "the largest loss of African-American wealth in American history".³²

As the market was flooded with foreclosed houses that were put up for sale, prices went into freefall and the property bubble finally burst. Many people soon found that they were repaying debt on houses that were now worth substantially less than their original mortgages – they were stuck with 'negative equity'. This also deterred home owners who could keep up with repayments and, as David Harvey puts it, "set in motion a downward spiral of foreclosures that depressed housing values even further."³³ By August 2008, the investment bank Credit Suisse was predicting 6.5 million US households would foreclose.

As income streams from mortgage loans started to dry up, not only did investors who had bought into them get stung, but banks and lenders who had built up a hugely lucrative business in these products found it increasingly difficult to sell CDOs. In mid-2007, rating agencies downgraded more than 100 CDO bonds. According to Blackburn, by August "mortgage-based securities were "difficult to sell" and those based on subprime mortgages could "scarcely be given away."³⁴ There was widespread fear throughout the financial sector that the value of these CDOs had been massively overestimated. The complexity of the chains of debt and the proliferation of obscure derivatives based on them led to widespread suspicion – no-one knew exactly who held what assets, how 'toxic' they were, and how much they were worth.

A major crisis of valuation ensued. Scepticism about a single class of assets (subprime loans) turned into doubts about the reliability of whole institutions, and eventually the stability of the entire financial sector was in question. Confidence between banks completely seized up and the interest rates on short-term inter-bank lending hugely increased to reflect these new uncertainties. This type of credit, known in the industry as 'commercial paper', is crucial to the day-to-day functioning of banks, allowing them to settle their accounts once trading ceases for the day. But it became so expensive for banks to borrow overnight from each other that the business models on which they operated no longer looked viable. This is why the first stage of the crisis was referred to as the 'credit crunch'; because no-one wanted to lend. By September 2007, the rate at which banks borrowed from each other was the highest in almost a decade, since the last financial meltdown.³⁵

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With mortgage defaults in the USA escalating, a slow-motion multiple pile-up began on Wall Street as one bricolaged financial vehicle smashed into another, littering the financial highway with broken deals and critically-damaged hedge funds, insurance companies and banks.

-Nick Hildyard³⁶

Losses on subprime mortgage-backed securities were initially estimated at around \$285 billion. An IMF report in April 2008 revised the numbers up, to around \$945 billion. A large

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portion of these occurred in the form of 'collateral damage', i.e. losses based not on direct investments in subprime assets but rather in derivatives related to, or companies dealing in, these products.³⁷ Large volumes of assets on the books of the financial institutions, which they had used as collateral against their highly leveraged borrowing, turned out to rest in some more or less direct way on toxic subprime debt. This threw their accounts into disarray, as assets mutated into 'toxic' liabilities. But for the banks, what was toxic about these products was not the actual assets themselves but their prices. John Lanchester explains:

The problem is that these prices are, from the banks point of view, too low. The buyers are willing to acquire them at, say, twenty or thirty cents to the dollar, so that an asset whose notional worth is \$10 million – for example, a derivative tracing its value from sub-prime mortgages – might have someone willing to buy it for \$2 or \$3 million. For the bank that price is too low. It isn't too low in the sense that they quite fancy the idea of a higher price; it's too low in the sense that, if they accept the valuation, they have a gigantic hole on the left hand side of the balance sheet. Their assets aren't worth what they're supposed to be, and the bank is no longer solvent.³⁸

As the value of CDOs was being rapidly downgraded, the scale of the problem became apparent. As Gary Dymski puts it, "these mortgages were held as securities in portfolios across the globe; so payment difficulties at the base of the financial food chain led to seismic financial-market eruptions at the top."³⁹ Having revalued their holdings of mortgage debt, many banks now found that they were practically insolvent and could not afford to borrow the cash they needed to stay in business.

The only thing left for the banks to do was desperately try and 're-capitalise' rebuild the capital reserves they needed to meet their obligations and keep afloat. According to Lanchester and others, this meant "hugely reducing new lending and hoarding capital, in order to try to boost their diminished asset base.⁷⁴⁰ But because the institutions were so heavily leveraged (in some cases owing 30 times more than they owned), in order to balance their books, they had to reduce an enormous amount of lending (up to 30 times more than the deficits they were trying to cover). For many normal people, this was felt in the increasing difficulty of getting a mortgage or a personal loan. When the heavily leveraged UK building society Northern Rock requested 'liquidity assistance' (i.e. asked for a huge emergency loan) from the Bank of England in September 2007, a chain reaction of bank collapses began, reaching its peak in autumn 2008, as one of finance's biggest player, the investment bank Lehman Brothers, announced its bankruptcy.

While it was thought that securitisation and the use of derivatives would magically eliminate risk, the opposite was in fact true. By spreading dependency on subprime loans, securitisation ensured that many more investors and institutions across the whole financial sector were affected by the collapse of what constituted only a small part of the total mortgage lending business. Furthermore, endemic speculation on credit default swaps and other derivatives amplified the contagion of 'toxic debt' even further. Financial institutions were so dependent on debt, assets and insurance obligations owed to one another that if one

large bank collapsed and reneged on all its contracts, it could cause a chain reaction taking the entire financial system down with it. This is what is meant when a bank is deemed 'too big to fail'. As institution after institution either collapsed or was rescued at a knock-down, 'fire-sale' price, it became clear that only large-scale, sustained government intervention could prevent the total collapse of the banking industry.

In the years following the crash, governments worldwide poured trillions of dollars into the financial sector to try to keep the banking system functioning. Most importantly for them, 'credit confidence' had to be restored so that banks would start lending again. Without credit flowing through a capitalist economy, all kinds of non-financial businesses (industry, technology, services, etc.) suffer, as they are unable to borrow money to invest in new machinery, materials and employees. Without these, they cannot expand as rapidly, so overall growth slows down. Not only can they not expand but, as businesses rely on debt for financing their day-to-day operation, if it becomes impossible to refinance debt that is close to expiry, then businesses would struggle to keep going. This is essentially the snowball effect that turned the credit crunch into a global recession.

The fact that states across the capitalist world stepped in to save the banks and guarantee the loans made by the private financial sector is an extraordinary measure considering the ethos of today's economy is meant to be 'let the markets rule and don't let the state interfere'. This reveals the myth of free market ideology and the alleged merits of market discipline. A free market needs a strong state in order to work.

Yet, despite the extensive bailouts and 'quantitative easing' (essentially printing money to give to banks), western governments have succeeded only in saving the financial sector, not in restoring significant growth to their economies. Even this limited 'success' has come at a high cost, with governments themselves, taking on vast amounts of debt, which has sparked a 'sovereign debt crisis', the most serious consequences of which have been felt in Europe. Governments now find themselves in the same position as banks did in 2007-2008 and are unable to convince investors to lend to them at the same cheap rates they once did. The austerity measures enacted throughout the advanced economies are a result of this, as governments slash public spending and repress wages in an attempt to convince the money markets that they are a secure, growth-friendly investment. The eurozone crisis will be the focus of our next briefing in this series.



CRISIS STORIES: FOUR EXPLANATIONS OF FINANCIAL CRISES

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* This article and other related articles can be found on the author's blog at: HTTP://NETWORK23.ORG/KAPUT

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THERE ARE NOW THOUSANDS of books, essays and articles out there that attempt to understand and analyse the causes of the current economic crisis. But most, if not all, work within a few basic explanatory frameworks or underlying 'stories'. Here we outline and compare four main ones.

The aim is not to try to present a new, 'anarchist' interpretation of the crisis, or to say anything particularly original. Rather, it is to help clarify some of the theoretical and ideological backgrounds to all the punditry, and bring some ideas and links together so that people can dig further for themselves.

First up is the mainstream 'Keynesian' story. This basically goes that corrupt and/or stupid politicians and regulators took the leash off greedy and/or irrational bankers. More sophisticated versions of this story trace things back to problems of market psychology or, as Keynes put it, the "animal spirits" of investors.

Another, alternative story is based on leftist (mainly Marxist) theories, which argue that crises come from deeper or 'structural' flaws in capitalist production. There are two main variants of this strand of arguments: underconsumptionist or stagnation theories (e.g. the *Monthly Review* school) and falling rate of profit theories (e.g. any Trotskyist party line).

All these three stories are about troubles in the developed markets of the US and the rest of the so-called first world. But could the root causes of the crisis lie in global economic shifts away from US dominance to a world where production is elsewhere? This is essentially the fourth and last story we will look at.

STORY 1: KEYNESIAN REVIVAL

In March 2009, the Rolling Stone Magazine named and shamed the "dirty dozen" behind the crisis: "meet the bankers and brokers responsible for the financial crisis - and the regulators who let them get away from it."¹ In the UK media, one of the 'punishment' suggestions doing the rounds came from a motion that was apparently debated by parliament in 1720, which proposed that bankers responsible for the South Sea bubble be tied up in sacks full of poisonous snakes and thrown into the river Thames.²

The idea that a gang of 12 bankers and officials are to blame is as crude an explanation of the crisis as you can find. But, in essence, it is not so different from more sophisticated versions of what has quickly become a 'common sense' interpretation of events.

In a January 2009 article, Joseph Stiglitz, Nobel prize winner and leading figure of the Keynesian centre-left school of economics, made his list of the key "mistakes" behind the crisis.³ Number one, in 1987, was Ronald Reagan hiring Alan Greenspan as head of the Federal Reserve, the US central bank. Rabid freemarketing Greenspan, who also topped Rolling

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Stone's list, is portrayed as the super-villain of the crisis. "If you appoint an anti-regulator as your enforcer," wrote Stiglitz, "you know what kind of enforcement you'll get."⁴

One of the main charges against Greenspan is that he deliberately inflated the housing bubble to salve the slump caused by the dot.com crash. US and other world stock markets rose continually throughout the 1990s, then jumped at the end of the decade with frenetic investment in IT stocks. When the bubble burst in 2000-1, the Federal Reserve cut interest rates, to a low of 1% by 2003, in order to keep growth and credit going. This basically transferred the bubble from stocks to housing as US consumers borrowed more and more in cheap-interest home loans.

So Greenspan is to blame for the first stage of the crisis – the housing crash. Between 2000 and 2005, US mortgage debt rose 75%; between 1995 and 2006, house prices rose 60% over inflation. The housing boom created up to \$ trillion in apparently new 'wealth' for US households. When interest rates rose again, to 6.25% in 2007, the market crashed and all that wealth evaporated.⁵

Stage two in the crisis was the credit crunch: panic about bad housing debts spread through international financial markets, causing the collapse of major investment banks such as Lehman's and a worldwide lending freeze. The second big mistake, according to Stiglitz, was how the US government "tore down the walls of regulation", setting financial markets free to develop the complex and opaque chains of derivatives and securitised bonds that left Swedish pension funds exposed to bad mortages in Milwaulkee.

If a scapegoat is needed for market deregulation, your man is Senator Phil Gramm, who led the repeal of the Glass-Steagal Act in 1999. This was a law passed after the Great Depression, designed precisely to prevent a repeat of speculative financial practices that had caused the crash of 1929. The Act separated commercial banks, which take deposits, from riskier investment banks. By 1999, depression-era fears were history and depression-era regulations were seen as anachronistic and stifling 'financial innovation' - nowadays banks could be trusted to self-regulate.

The repeal of Glass-Steagal was just part of what Stiglitz calls a "change in an entire culture". A few other highlights: in 1998, after the spectacular collapse and rescue of derivative-trading hedge fund Long Term Capital Management (LTCM), there were proposals for the regulation of the new derivatives markets. These proposals were just dropped. Proposals to regulate the ratings agencies – which are 'independent' private companies that credit score bonds and derivatives and get paid in commission by the investment banks – were also dropped. In 2002, after the Enron and WorldCom accounting scandals, the response was the weak Sarbanes-Oxley Act. In 2004, regulation was changed to let US banks get into debt worth 30 times what they hold in capital, up from 12 times as was previously the case.⁶ Summing up, Stiglitz says: "The truth is most of the individual mistakes boil down to just one: a belief that markets are self-adjusting and that the role of government should be minimal."

KEYNES, AGGREGATE DEMAND AND ANIMAL SPIRITS

Stiglitz speaks for the left-of-centre side of mainstream economics, broadly identified with the legacy of British economist John Maynard Keynes (1883-1946). One much-noted intellectual outcome of the crisis is the resurgence of this Keynesian school of economics.⁷ Keynesianism can mean different things to different people, but the central idea is pretty easy to characterise: markets are good, but they need taming by government.

Keynes' greatest work, *The General Theory of Employment, Interest and Money*, was published in 1936, well into the great depression.⁸ The question that had baffled the previous 'classical' orthodoxy was how an economy can linger in a state of persistent unemployment.⁹ For pre-Keynesian economists like Arthur Pigou, lasting 'involuntary' unemployment should be impossible: competition for jobs should push wages down; firms then hire more people until the system is back in 'full employment equilibrium', producing at maximum capacity.

Similarly, in the capital market, after a panic like the stock market crash of 1929 or the housing pop of 2007, market interest rates jump as lenders pull out their money; but once the smoke clears, those high interest rates should attract savers back into the market, bringing the supply of capital back up. In short, markets are meant to adjust automatically, prices (wages and interest rates) move incentives to bring the system back to full capacity. Otherwise the blame is put on artificial 'distortion' of markets by external factors – for example, governments interfering with interest rates and capital markets, or working class militancy forcing high wages, which stops the labour market moving 'naturally'.¹⁰

Keynes argued that falling wages are not necessarily enough to encourage employers to hire more workers. If there are no buyers, then there is no point in producing more goods, and therefore no point in hiring more people to make stuff. The essence of Keynes' theory is that demand comes first; the level of output is determined by the total level of aggregate demand in the economy.¹¹ Output may or may not be as high as the economy is capable of producing in full employment, and usually it is not.

Keynes broke aggregate demand down into three main components: consumption spending by 'consumers'; (private) investment by 'entrepreneurs'; and government spending. The source of the problem was usually the investment part: consumers' plans are "fairly stable", he argued,¹² but investors have to make long-term decisions based on the future direction of the economy – for example, what types of goods, and in what quantities, people will want to buy in the future. Here, Keynes attacked the neoclassical view of economic decisions being made by rational agents; the future is radically uncertain, and our ideas about the future performance of investments are subject to "extreme precariousness".¹³ This essentially means that investment has more to do with confidence than calculation. Investors are largely guided by a convention – which is largely false – of "assuming that the existing state of affairs will last indefinitely". It is also guided by "spontaneous optimism", or what Keynes called investors "animal spirits".

To sum up, production and employment are determined by aggregate demand. There is no reason why aggregate demand should stay high enough to keep the economy running at full speed. And behind aggregate demand lies the non-rational pack psychology of investors.¹⁴

KEYNESIANISM MARK I

Over the years, Keynes' theory has been widely interpreted, reinterpreted and misinterpreted. Some within the more left-wing 'post-Keynesian' tradition followed up with further analyses of crises. One argument worth mentioning here is Hyman Minsky's "financial instability hypothesis", which claims that periods of prolonged prosperity lead to unstable financial systems.¹⁵

The mainstream economics that emerged after the Second World War, sometimes called 'neoclassical synthesis',¹⁶ was a more conventional marriage of core elements of the old neoclassical theory with Keynesian insights. For other 'left-Keynesians', such as Joan Robinson, the synthesis was better described as "bastard Keynesianism".¹⁷

In terms of policy, as opposed to theory, the Keynesian consensus typically involved a number of common elements.¹⁸ First, markets are volatile and sticky, so they need hands-on regulation. Second, when private investment fails, the government can step in via fiscal policy (i.e. tax and spending) and, if necessary, with big spending programmes, as with the European welfare states. Third, at the international level, capital flows are stabilised with a global financial architecture – that is, the Bretton Woods system, which fixed currency exchange rates until 1971, and institutions such as the World Bank and the International Monetary Fund (IMF).¹⁹

Twenty years after Keynes' death, the doctrine still seemed to dominate. In 1965, the *Time* magazine ran a famous cover story with the headline "We are all Keynesians now", a quote it attributed to arch-conservative economist Milton Friedman, the godfather-in-waiting of neoliberal economics.²⁰ The article celebrated unparalleled growth and confidence in the US economy and the post-war peak of US dominance: "Washington's economic managers scaled these heights by their adherence to Keynes's central theme: the modern capitalist economy does not automatically work at top efficiency, but can be raised to that level by the intervention and influence of the government."

Two editions later, the *Time* published Friedman's letter complaining that he had been quoted out of context.²¹ Within a decade, Keynesianism was dead and Friedman was the reigning prophet of the new 'monetarist economics'.



THE CRISIS OF NEOLIBERALISM

In deeper versions of this story, the roots of trouble go back to the 1970s, when economic orthodoxy shifted away from Keynesian management. What happened was that the post-war 'long boom', or two decades of continued growth, had come to an end.

In 1971, the US pulled out of the Bretton Woods by suspending the convertibility of the dollar to gold, thus breaking the worldwide system of fixed currencies. In October 1973, the Organisation of Petroleum Exporting Countries (OPEC) quadrupled the price of oil, prompting the first of the '70s 'oil shocks'. Stock markets collapsed, triggering recession.

The US crawled out of recession in 1975, but it failed to recover previous high growth rates, and slipped back into recession again in the 1980s. The now-conventional Keynesian policy techniques failed to pull developed economies out of worsening 'stagflation', a combination of stagnant production and inflation. This failure created an opening for a new orthodoxy that fitted nicely with the interests of capital.

The handiest term to describe this new orthodoxy is probably 'neoliberalism'.²² As Stiglitz sums up in another article, this is "that grab-bag of ideas based on the fundamentalist notion that markets are self-correcting, allocate resources efficiently, and serve the public interest well. It was this market fundamentalism that underlay Thatcherism, Reaganomics, and the so-called 'Washington Consensus' in favor of privatization, liberalization, and independent central banks focusing single-mindedly on inflation."²³

One important element of this package was Friedman's monetarism – or more precisely, the 'new classical' economics that adapted his ideas. According to monetarism, crises are really just about the money supply. Roughly, this means that, with more cash in circulation, consumers and producers would keep on spending and producing for themselves, with no need for government prodding.²⁴ This was the supposed theory behind Greenspan's money management.

Thus neoliberal economic policy effectively reversed the Keynesian compact, turning the clock back to the 1930s. Back came the Pigouvian creed that markets would run smoothly if left untouched – a handy justification for hacking away the 'distortions' tying up markets: wage and price agreements, state-run industry, the dark power of trade unions, trade barriers put up by third world governments to try and protect new domestic industries, and financial regulation.

A PARADIGM SHIFT?

All the four stories discussed here agree on some basic points. The immediate (short-term) causes of the crisis were the credit bubble and deregulated financial markets. If you look a bit further back (medium term), these can be seen as creations of neoliberal economic policy: monetary policy blew bubbles; deregulation, and a 'culture change' in markets, unleashed volatility and complexity. But a key question that divides the stories is just how and why these shifts came about. Laissez-faire economics was supposedly 'disproved' by the Great Depression. So how did it make a comeback in the 1980s? Is it just about intellectual fashions, memory loss, or – to give it more theoretical sophistication – a 'paradigm shift' in economics?²⁵

The Keynesian theorists stop here. For example, another big name is Stiglitz' fellow Nobel prize winner Paul Krugman. In his book on the crisis, he focuses on the run of 'emerging markets crises in the 1990s, arguing that these should have served as warning signs. But why didn't 'we' pay attention? Krugman complains that 'we' have been myopic and forgetful; now we have to "relearn the lessons our grandfathers were taught by the Great Depression."²⁶

In a way, this kind of accounts of policy shifts mirror Keynes' own story about investment. In the short-run, crises are about psychology: the fluctuating market psychology of investors suffering radical uncertainty about the future. In the longer term, they are also about psychology: shifts in the "animal spirits" of politicians and economists, suffering from short-sightedness and short memories.²⁷

STORY 2: STAGNATION

Next up are the 'underconsumption' crisis stories, in particular the Marxist 'stagnation theory' developed by writers at the US magazine *Monthly Review*.²⁸ The core theory was built in the 1940s by Paul Sweezy, then refined by Sweezy and Paul Baran in the 1960s in their classic *Monopoly Capital*,²⁹ which was dedicated to Che Guevara. In a new book entitled *The Great Financial Crisis*, John Bellamy Foster and Fred Magdoff apply these ideas to the credit crunch.³⁰

We saw above how Keynesians trace the problem back to the end of the long boom. Foster and Magdoff's story starts before the Great Depression. Early 20th century capitalism was sinking into a terminal decline, from which it only managed to scrape thanks to World War II, the ultimate fiscal stimulus. Thus, the recent crisis was not just expected but long overdue.

WHOSE NORMALITY?

Let us take a step back for a minute and ask: what are we talking about when we talk about crises?

For neoclassicals before and after Keynes, it is the 'natural' or 'normal' state of capitalist economies to run at full speed. In the 1930s, Keynes' question was: how is it possible that the economy stays lingering in a crisis? Why doesn't it pick up again? More generally, why do capitalist economies sometimes break down?

But this question has a big underlying implication: that, most of the time, the system works. These days, at least in some parts of the world if not all of it, we are used to capitalism 'working'. It may be unequal, alienating and unjust but it does manage to feed, cloth, house people, keep more people alive, with material living standards higher than those of a few generations ago.³¹ And it keeps itself alive too. This basic idea that capitalism works, more or less efficiently, is a deeper, more fundamental part of the economic common sense than in doctrines such as neoliberalism or Keynesianism.

But it has not always been that way. Not long ago, when capitalism was new, it appeared magical: a vast uncoordinated and complex system where no individual or group can control or see what's going on. Thus, even Adam Smith, the first great explainer of capitalism's success, had to occasionally rely on the mysterious metaphor of the "invisible hand" of the market.

Yet there have always been heretics who thought they saw structural flaws in the system. Sweezy's stagnation theory is actually a more modern version, incorporating ideas from both Marx and Keynes, of underconsumption stories that go back at least to Malthus and Sismondi in the early 1800s.³²

UNDERCONSUMPTION

Capitalism is a vast complex system: on the one hand, millions of producers make decisions about what stuff and how much of it to produce; on the other, billions of consumers decide what to buy. Why should we expect all these decisions to match up? Underconsumptionists think that, systematically, they do not.

The basic idea of the underconsumption theory is that capitalists produce more than they can sell; production in the economy grows but the demand for consumer goods does not grow fast enough to keep up with production.³³ For example, imagine the economy is rocketing away, growing at 10% every year, but everyone just keeps on consuming the same amount every year. Then all the extra stuff produced is unwanted. The excess of supply to demand makes prices fall. Falling prices slash into profits until companies start going bust, leading to a crisis.

This story seems to go against the fundamental consumerist intuition that everyone, all the time, just wants to consume more. Why don't people consume more? The reasoning, from Malthus on, is about class. The poor will consume all they can afford, but they cannot afford much. What counts is not what they want but what they can get, which is called 'effective demand'. And the lion's share of production goes to capitalists who, being not just rich but thrifty protestant-ethical types, save a high proportion of their income.³⁴

The idea is that the savings of the rich should get invested in new capital goods (more raw materials, new machines, etc.) which will be used to grow the economy. But if consumer demand fails to keep up, the economy builds up more and more means of production, but less and less as a proportion of its total value gets used by final consumers.

The underconsumptionist intuition is that this unending accumulation is unsustainable. As Rosa Luxemburg, the original Marxist underconsumptionist, asked, "who are the new consumers for whose sake production is to be ever more enlarged?"³⁵

MONOPOLY CAPITAL

Baran and Sweezy revamped the story, arguing that 20th century capitalism had taken on a whole new form: 'monopoly capital'. In its early stages, capitalism had been highly competitive, the main danger to the system being that competitive struggle between 'small, family-based firms' would push down the rate of profit (see Story 3). By the early 20th century, monopolistic corporations had taken over and were able to exert great power over markets and, indeed, states. These big businesses are highly productive and use their monopoly power to keep prices up. The result is a huge and growing profit surplus in the hands of a small number of monopolists.³⁶

Baran and Sweezy also incorporated Keynesian ideas of aggregate demand. There is still a class consumption issue but the bigger problem now is the lack of investment opportunities for all this surplus. New technologies that revolutionise production (trains in the mid-19th century, cars in the mid-20th and so on) provide serious investment outlets, but they do not come along every day.³⁷

To be more precise, the problem is insufficient demand for investment in the productive part of the economy. Monopolists do find investment outlets for their surplus, but these are increasingly just 'waste' – that is, investment that does not contribute to eventual production of consumer goods.³⁸ A main theme of the theory is distinguishing between a stagnant productive economy and a growing parallel phantom economy of 'non-productive waste'.

A classic example is military expenditure. A great escape route was the Second World War, which absorbed enormous amounts of investment in armaments and post-war reconstruction. The long boom was in no small part due to war production – Eisenhower's military-industrial complex – keeping stagnation at bay.

Another waste outlet is 'sales effort', such as advertising industries. Keynesian government spending can also provide an investment channel. By the end of the 1960s, however, these "countervailing tendencies" were no longer enough to contain over-accumulation. The return of crises and recessions in the 1970s are taken to demonstrate Baran and Sweezy's claim that "the normal state of the monopoly capitalist economy is stagnation."

FINANCIALISATION

The greatest waste pipe of all was still to come. The younger generation of *Monthly Review* writers saw the phenomenon of 'financialisation' as important enough to define another new stage in capitalist history: monopoly-finance capital. Foster and Magdoff use profit figures to show how capital swarmed into the financial sector: in the mid-60s, financial profits were between 15% and 20% of total profits from all US industries. In the 2000s, they grew to 35% and 40%.³⁹

And this is where the stagnation story ties up with the Keynesian story. Both tell similar tales about how financial markets grew out of bounds in the last few decades. The key difference is that, for mainstream Keynesianism, it is a case of irrationality let loose by bad policy; for stagnation theory, financialisation is a symptom of deeper malaise. Indeed, if capitalists had not created financial bubbles to absorb surplus, the system would have plunged into crisis and stagnation even sooner.

THE CREDIT BUBBLE

If a big part of the problem is weak consumption demand because workers do not earn enough income to spend, why don't capitalists just raise wages? After all, all that extra surplus is just going to waste. This is a classic case of a 'collective action problem' or 'social dilemma': while it makes sense for the system as a whole to increase workers' income, at an individual level, it is in no one's interest to be the first to raise their workers' wages. Here the 'invisible hand' fails to guide the uncoordinated decisions of bosses.⁴⁰

However, financialisation did provide a way to raise consumption, at least in rich countries, where much of the surplus channelled into finance went into an explosion of consumer credit. Real wages barely moved in the 1980s and 90s but consumerism thrived on cheap mortgages, car loans and credit cards.⁴¹ In 1975, US consumers borrowed a total of \$736.3 bn, or 62% of disposable income after tax. In 2005, they borrowed \$11.5 trillion, 127% of disposable income, or over 90% of US GDP.⁴²

Of course consumer credit was part of a wider debt spree, in which government and financial institutions also increased their borrowing. In the 1970s, total US debt was around one and a half times the GDP. In the 2000s, it was three times the GDP. At the same time, industry was somewhat left out of the credit bubble – non-financial corporate borrowing did grow but fell as a proportion of total borrowing, from 33% in 1975 to under 20% in 2005.⁴³

TESTING THE STORIES

The big difference between the two stories outlined above is the question: which came first, stagnation or financialisation? If the stagnation theory is correct, there should be evidence of a long-run trend to stagnation in the productive economy before financialisation got underway. Is this so?

As a first clue, Foster and Magdoff point to long-term decline in real growth rates. In the 1930s, the US economy grew by an average of 1.3% per year. In the 40s, growth ratcheted up to 5.9%, then stayed high through the long boom with 4.1% in the '50s and 4.4% in the '60s. Since then, rates have been falling: 3.3% in the '70s; 3.1% in the '80s and '90s; and 2.7% on average between 2000 and 2007.

But growth rates do not really get to the bottom of things. National accounting figures include both 'productive' and 'non-productive' income, and the whole thesis is that non-productive income can step up as real production declines.

So how exactly do we distinguish production from waste? Not all finance spending is simply waste – financial markets play an essential role in capitalist production, moving capital from lenders to borrowers. But Foster and Magdoff argue that much of the extra capital piled into 'financial speculation' never got channelled anywhere near investment in industry.

One indicator they use to show that is the level of net private non-residential investment: from over 4% of GDP in the 1970s to under 2% by 2006. And this investment declined even as profits were going up – which stagnationists see as a telling sign of the lack of productive investment outlets. Foster and Magdoff also use statistics on utilisation of industrial capacity: from around 85% at the start of the '70s to 78% in 2007.⁴⁴

There does not seem to be a clear piece of evidence to swing us either way. One big caveat, though: all the *Monthly Review* analysis is centred on the US. It seems quite plausible that, in the US, growth, profits and investment have shifted from productive industries to financial services. But could it not be that this is largely because production has been off-shored to where labour is cheaper? How do global shifts in production affect the stagnation thesis? As Foster and Magdoff themselves recognise, we need a global analysis.⁴⁵ And this is the focus of Story 4.



STORY 3: THE LAW OF FALLING PROFIT RATES

Marx's argument about falling profit rates and crisis was only published after his death in the third volume of *Capital* in 1894. Its initial reception amongst his followers was not overwhelming, and its importance within the master's own work is another big factional debate involving frantic exegesis of posthumously published notebooks. Adherents point to one famous note where Marx calls it "in every respect the most important law of modern political economy". It causes "explosions, cataclysms, crises", until eventually "these regularly recurring catastrophes lead to their repetition on a higher scale and finally to [capital's] violent overthrow."⁴⁶

In this section only a few applications of this idea are applied to the current crisis. There are, quite likely, more interesting ones out that are not discussed here. First, though, we have to try

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and grasp the underlying theory. Anwar Shaikh is used here a main guide.47

LA LEY, TU LEY

In a production process, workers use 'means of production' (raw materials, equipment and machines) to create a finished product. Marx breaks down the value of the total product into three parts: "constant capital" is the value of the means of production used up in the process; "variable capital" is the value of the goods that workers need to sustain themselves; and "surplus value" is the value of the surplus product – what's left over and kept by capitalists.

In Marx's theory, all value comes from human labour, and the value of a commodity is a measure of the time required to produce it.⁴⁸ Means of production are commodities produced by human labour in previous production processes, so "constant capital" is the value of "dead labour" from the past. Variable capital and surplus value together make up the new "living labour" added in this production process.

Marx's capitalists, rather like the Malthusian ones, are not much bothered about consumption; they are intent on chasing profits. One way through which they can increase profit (effectively, surplus value) is by increasing working hours (total living labour). Another is by cutting labour costs (variable capital) so they can take more of the living labour as surplus.⁴⁹

There is fierce competition. One main way capitalists compete is by expanding their production. But there is a basic upper limit on living labour – there are only so many workers around and so many hours in the day. So once this limit is reached, the only way to expand production is by investing surplus in increased means of production to increase the productivity of labour. In Marx's day, this meant, above all, the mechanisation of industry: while the labour force stays more or less constant, more and more machines are involved in production. This is the tragic driving force of the story: competition pushes capitalists into an arms race of capital accumulation.⁵⁰

But if mechanisation or, more generally, accumulation of means of production is about increased productivity, how does it lead to lower profits? The core argument is this: first, increasing the quantity of the means of production used in the system means increasing the total cost of the means of production. Thus, in value terms, it means increasing constant capital, and therefore what Marx calls the "organic composition" of capital, or the ratio of constant capital to living labour.⁵¹ The extra machines do increase productivity, there is more output for the same number of workers. Total production goes up, and so does the surplus product. But mechanisation cannot increase the *surplus value*; only increasing human labour and working hours could do that. There is more stuff produced, but that is cancelled out by the fact that the value of commodities actually goes down. It simply takes less time to make them.

The all-important 'rate of profit' is the ratio of surplus value to total capital, constant and variable.⁵² Variable capital has already been pushed down to the minimum, surplus value does not change, and now constant capital is rising. So the rate of profit has to fall.

Thus, the competitive pressure on capitalists drives them to increase their capital costs and reduce their profit rates, until eventually some weaker capitalists' profits are pushed all the way down to zero, and they go bust. Or else, seeing low profit rates, they hold off from investing, hoping for better times that will never come.

HOLES IN THE THEORY

There are two big gaps in the theory. But this does not necessarily mean it is wrong; just that the gaps need filling in.

First, there is an analysis of competition missing. In real markets, however, there are monopolies, oligopolies, cartels, barriers to new capitalists entering markets, whether because of fixed start-up costs, legal or political obstacles, corruption and so on. In other words, markets are not 'perfectly competitive', as economists would like us to believe. All these imperfect market realities give capitalists breathing room to keep profits up. This is what led Sweezy and the stagnationists away from falling profit theory.

Second, there is a big unjustified jump in the accumulation argument. Marx's point is that surplus value does not rise even though there is more surplus product, because the values of commodities go down across the economy as new technologies make production quicker. But the fall in values also affects means of production, so raw materials and machines get cheaper too. If the productivity gain is big enough, it can outweigh the accumulation effect – even though the quantity of the means of production goes up, the cost actually falls and the organic composition of capital goes down.

Marx is basically assuming that, when capitalists invest in new machines and technologies, all they do is add bulk to the system. Is that right? On the other hand, does capital investment involve major productivity advances that actually increase profitability? It is doubtful that there is a general abstract answer to this question; it really depends on the specifics of a given economy, at a given time.

Marx himself, in his notes on this question, is sure that the rising organic composition of capital is "self-evident" or even "tautological".⁵³ But plenty of economists, even Marxist ones, have not managed to follow his self-evident reasoning.⁵⁴

Marx did not develop his theory into a systematic account of how crises actually develop, leaving plenty of room for his followers to fill in the details.⁵⁵ In fact, the falling rate of profit theory hardly appeared in late 19th century and early 20th century Marxism, where the main camps were reformers, who downplayed crisis theory altogether, and underconsumptionists like Luxemburg. The Polish-Austrian economist Henryk Grossman is widely attributed with reviving it on the eve of depression in 1929.⁵⁶ Left communist Paul Mattick (1904-1981) became the leading interpreter and populariser in the US, arguing during the height of the long boom that Keynesianism had not resolved capitalism's troubles.⁵⁷ Currently, the law is the official orthodoxy for many Trotskyist parties.

Amongst all these positions, there are a couple of key points of contention. Is it an iron law that the rates of profit must fall, or is it just one tendency amongst others? And is the law/tendency about boom-bust business cycles or is it about something more? On the one hand, it can be used to explain boom and bust cycles: rates of profit fall until capitals get busted or withdraw from investment; then in the ensuing slump capital accumulation stops, unused machines rust, and bankrupcies ease competition; so the rates of profits rise again and the cycle starts back up.

But for most Marxist theorists, there is also a deeper ('secular') trend behind the cycles: temporary shake-outs are a countervailing force, but capital accumulation still builds up over the long term, and profit rates trend down. Crises repeat "on a higher scale" until the whole system shakes apart. So let's take look at how some contemporary Marxists interpret the crisis today.

ROBERT BRENNER

The economic historian Robert Brenner is probably the biggest name amongst Anglophone Marxist academics to take a falling rate of profit line.⁵⁸ But Brenner does not follow Marx's "organic composition" argument. Instead he develops an alternative based on "overcapacity" and price competition. From the late 1960s, new producers (Germany, Japan and the so-called Asian Tigers) entered world markets for manufactured goods with new, low-cost production techniques, competing with established leaders like the US and causing price drops and lower profits all round.⁵⁹

Despite this, Brenner's work is widely used by more orthodox falling rate theorists; they disagree with his explanation of the root cause but many of them rely on his profit rate statistics, and have very similar analyses of how the falling rate of profit goes on to cause crisis.

On Brenner's figures, profit rates were basically steady throughout the 1940s, '50s and '60s, then suddenly began to drop dramatically from 1973. There have been temporary pick-ups since then, but rates have never recovered to their post-war levels. Brenner calls this period the "long decline".

The basic transmission channel through which falling profit rates cause crashes is, for Brenner and most others, *under-investment*. The key function of the rate of profit is directing investment as capitalists invest in ventures where there are high returns. When profit rates fall, capitalists cut back investments; even if they have accumulated capital to invest, they may hold off waiting for profit rates to rise again.

The second channel, as Brenner notes, is to do with consumption. Capitalists responded to falling profit rates in the '70s by upping the class conflict; that is, the politics of neoliberalism. Wage cuts; cuts to the welfare state 'social wage; extended working hours and so on. These assaults on labour explain the temporary raises in profit rates, e.g. from the end of the recession in 1982. But they did not solve the problem. In fact, in the long run, they made things worse by pushing down workers' consumption demand.

These two effects (on investment and consumption) add up to a general long-term drop in aggregate demand. "The persistent weakness of aggregate demand has been the immediate source of the economy's long-term weakness." From here the story is virtually identical to the stagnationist story. The symptoms of under-consumption and under-investment are the same, only in this story they are caused by falling profitability rather than monopoly power.

It is the same story with financial bubbles filling the demand gap. If anything, what differentiates Brenner from Foster and Magdoff in the final part of the argument is how much responsibility he loads on the state: "the continuation of capital accumulation has come literally to depend upon historic waves of speculation, carefully nurtured and rationalized by state policy makers — and regulators! — first the historic stock market bubble of the later 1990s, then the housing and credit market bubbles from the early 2000s."⁶⁰

CHRIS HARMAN

In the UK, Chris Harman of the Socialist Workers' Party (SWP) is the main Trotskyist proponent of the theory.⁶¹ Harman upholds the orthodox organic composition line but uses Brenner's figures for recent profit rates. His analysis from then on is fundamentally the same: investment gap; attack on labour; consumption boosted with credit bubbles. Harman's emphasises the role of state expenditures (i.e. the SWP's 'state capitalism' thesis) in sustaining the post-war system.

He also has a special place for "monopoly capital", or the "concentration and centralisation" of capitals. Unlike Sweezy, however, this does not relieve the competitive pressure that drives accumulation. What it does do is push the secular decline. In the old days, crises acted as 'purges' by wiping out weak capital. Now if big corporations fall they tear 'black holes' at the heart of the system; they are 'too big to fail', so they get bailed out. State capitalism delays the crisis, but that only makes the inevitable much worse when it comes.

FRED MOSELEY

A dissenting voice within the same tradition, Fred Moseley is a Marxist economist who accepts the falling rate theory but thinks that the current crisis does not fit the pattern.⁶² Moseley agrees with Brenner that profit rates halved from the 60s to the '80s, but estimates that, by 2006, they had recovered to within 10% of the post-war peak. The current crash was immediately preceded by years of rising profits. The wage squeeze was one main cause, but productivity also has picked up since the '80s.

In fact, as Moseley points out, even on Brenner's estimates, profits have recovered more than half of their "long decline". So why should the crisis come now in a profitability upturn? Moseley concludes that this is a "Minsky crisis" rather than a Marx crisis. In other words, the issue is accumulation of debt not capital.

MORE MARXISTS...

There are plenty more variants. A good place to start is interviews with nine Marxist economists with different views, including Brenner and Moseley, which can be found at www. workersliberty.org/marxists-crisis.⁶³ Yet the question remains: Have profit rates been falling? Is there a general correlation between profit rates and crises? Is there a correlation between profit rates and the "organic composition of capital"?

There is a range of Marxist studies on profit rates in the run-up to the Great Depression and post-war.⁶⁴ For more recent history and the run-up to this crisis, Brenner seems to be the main source for proponents. Though this article does not offer any final conclusions, there are a few methodological points to be made.⁶⁵

First, at least for some Marxist theorists, it is integral to the theory that it works in labour value terms. All the statistics on profit and capital are in money prices, so there is a fundamental translation question of turning values into prices. Second, as with stagnationism, many think the issue of productive/non-productive labour is central. Marxist scholars can get very different results depending on how they define productiveness in their calculations. And last but not least, all the studies use statistics only from the big industrialised countries or, in some cases, just from the US.

STORY 4: GLOBAL SHIFTS

All the stories discussed so far have been about the first world and, above all, the US. For mainstream Keynesianism, it is a tale of animal investing and careless deregulation in the financial markets of New York and London. For the Marxists, it is about structural weaknesses in over-mature first-world capitalism. However, it seems that 'common sense' perceptions of the crisis developed quite differently in Latin America to how they did in the global north. Crisis stories there commonly mention something to do with shifts in global power relations – often a spin on the theme of the declining 'hegemony' of the US.⁶⁶

At first, the crisis was just something happening somewhere else. Latin American politicians were still happily gloating at 'yankee suffering'. In September 2008, when asked by reporters for a comment on the crisis, Brazil's president Lula replied: "What crisis? Go ask George Bush."⁶⁷

The theoretical crutch for complacency was the "decoupling thesis": that so-called developing economies, in particular Latin America, were becoming stronger and more independent than ever before. Growth was rapid; governments had big currency reserves; local financial markets made these countries less dependent on international capital; and the US was deeply in debt and stuck in money-burning wars. China was the ascendant power, increasingly trading directly with South America and bypassing US control, with the other BRIC (Brazil, Russia, India and China) countries rising behind it.

But that seems to have been false optimism. Latin America is now also sinking into recession;⁶⁸ Asia is still growing but at a much slower rate; Eastern Europe looks like a train wreck; and the much hated IMF is back on the scene.⁶⁹

It is true that the importance of the US in global production is diminishing, but this is not happening overnight. In 1970-5, according to IMF statistics, US GDP was 22.5% of the world's total output; in 2001-5, it was 20.5%. China's rise is more obvious than the US's fall: in 1976-80 the world's most populous country only produced 3% of the world's income; in 2001-5, this was 14%, expanding rapidly with an annual growth of 13% in 2007.⁷⁰

But while the US produces relatively less, it actually consumes more. The difference is made up in imports. The US is the world's "consumer of last resort", and production elsewhere is seriously dependent on US import demand. In the same period, 1970-5, the US exported 15.7% of all world exports and imported 15.6% - a balanced trade. In 2001-5, it exported 11.6% but imported 19.7%.⁷¹

Thus, the main route of contagion for the crisis is the drop in US demand, which affected exports from manufacturers like China and India. In turn, this lowered their demand for 'commodities' (raw materials, oil and other fuels) which then hurt the economies of commodity exporters like Russia and Latin America.⁷²

Although the decoupling thesis proved false, there are still good reasons for looking at whether the causes of the crisis are not just internal to the US. While US hegemony is not over just yet, recent events could well precipitate it.⁷³

One crude global crisis story came again from Lula at the G20 summit in March 2009: the slump was "caused and encouraged by the irrational behaviour of white people with blue eyes"⁷⁴ – a racialised twist on the "animal spirits" idea. Yet, it is not hard to tell deeper stories about geo-economic shifts since WW2, which have been accelerating in recent decades.

Looking at the Anglophone literature, including Marxists and other radicals like Brenner and the stagnationists, it is remarkable how little attention is given to the world outside. Analysis such as Graham Turner's, which does take a global perspective,⁷⁵ is rather an exception. And although Turner's economics is fundamentally Keynesian, his story uses a lot of the familiar elements of the Marxist and stagnationist theories in explaining the "middle-term" of the causal run-up to crisis – that is, what led to loose markets and credit bubbles.

A LABOUR SHIFT

The basic issue here is the globalisation of labour. Towards the end of the long boom, production started moving out of high-wage, first-world countries into low-wage, third-world countries. US corporations led the process by off-shoring industrial jobs from the 1960s onwards. In the US and the UK, the process accelerated in the 1980s under Reagan and Thatcher, but even more so in the late '90s and early 2000s. The UK still had 4.2 million

manufacturing jobs in 1997; 1.3 million of these disappeared in the next ten years. The US lost over a fifth of its manufacturing workforce in the same period.

In the last section, we saw how Robert Brenner traces the entry of Germany, and then Japan, into post-war markets previously dominated by US manufacturing. But this was nothing compared with the scale on which China and India are now doing the same.⁷⁶

The shift in labour has two main components: first-world corporations offshoring their own operations, and new third-world corporations entering global markets with a competitive advantage derived from low labour costs. The labour shift is also mirrored by a capital shift from the first to the third world. Again, this is twofold: 'direct investment' in physical capital by first world firms, and 'portfolio investment' of global finance in third-world corporates.

In terms of goods markets, the result can be seen in drastic changes in trade balances. In 1989, the trade balance between the US and China was close to zero. In 2007, the US had a trade deficit with China of \$256 billion.⁷⁷ US trade with Mexico was balanced when the North Atlantic Free Trade Agreement (NAFTA) was signed in 1993. In 2007, it was \$74bn in deficit. In addition, there is a double hit to first-world trade: first-world industry loses out in competition not only for its own local consumers, but also for growing third-world markets as global southern countries build trade links with each other.

Note that this story could, once again, be seen as involving a kind of collective action problem. Perhaps many first world capitalists do not actually want to see the long-term decline of production in the lands where they were born. But following individual profit motives by globalising production leads there all the same.

VENDOR FINANCING

Meanwhile, all these deficits are funded by borrowing. This is what is sometimes called the 'vendor financing' model. China does not have a strong local consumption demand for its goods. In simple terms, Chinese people are too poor, so it is more profitable for Chinese companies to sell their products to the first world at higher prices than those local consumers could afford.

But if the US is not producing stuff to trade, how can US consumers pay for these extra imports? By getting into debt, obviously. Most of the US credit bubble is domestic – for example, borrowing to buy houses. But a significant part of it is borrowing to pay for imported goods.

What this means is that, strange as it may seem, poor countries are lending money to rich countries to finance their lavish lifestyles. Chinese corporates, backed by the Chinese state accumulating its huge reserves of dollar bonds, are buying up US assets to keep US consumption rolling.⁷⁸ Meanwhile, though the crisis is likely to cause some rebalancing of all this, local consumption stays low: the incomes of the poor do not increase fast enough to boost

consumption, while the rich save a larger proportion of their new booty. Private savings rates in 'emerging' and 'developing' economies have in fact risen from 23.5% of income in 1991 to 33.5% in 2007.⁷⁹







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Thus, a key distinction between the global shift thesis and the first world-centred stagnationist and profit rate stories we looked at before is this: In those stories, production (or real ('productive production') just disappears. There is no profit in it any more, so capitalists simply hoard their savings or burn them in phantasmal waste production. In the global shift story, production has not vanished; it is still happening but has gone to China (and Russia, India, Brasil and so on).

The main effects of this on the first world are, first, that wage competition from cheap third world labour creates unemployment and helps force first world wages down in what productive jobs are left – the neoliberal wage squeeze or race to the bottom; and second, as in the other stories, that credit bubbles grow as a way to keep consumption up even as wages drop.

Like other Keynesians, Turner sees this second step as largely about deliberate bubble-pumping by governments and regulators.⁸⁰ Corporates cause first-world demand to drop by shifting jobs and capital away; friends in officialdom try to mop up after them with low interest rates.

The third thing the housing and credit bubbles did to fill the gap in manufacturing income was to boost a whole new service sector, largely linked to financialisation. To put it in Marxist terms, the first world shifts production to the third world but helps make up for it by boosting 'non-productive' employment at home.

The UK is a prime example of this: employment rose despite the decline in manufacturing, on the back of the City's positioning as the low-tax, low-regulation 'financial hub' of Europe. According to Office of National Statistics (ONS) figures cited by Turner, in 1997 there were 4.9 million jobs in business service, finance and insurance, and the around same number in distribution (retail), hotels and restaurants. The growth in these other service sectors in the UK was largely parasitic on spillover from the financial boom. In 2007, there were 7.15 million finance jobs and 7.1 million in retail and entertainment.

THE WEST STILL CREAMING THE PROFITS

There could be another tentative link to add to Turner's version of the story. In his account, financialisation (though he does not use this term) was policy-driven from central banks. But it could also be a 'spontaneous' response from capital. As in Brenner's story, increased manufacturing competition pushes down profits in productive industries; first-world capitals

cede some of this ground to new industrialists but redirect their funds into finance, which offers better profit opportunities.

The point is that, although the US and other developed economies are losing their grip on productive capital, they still hold the reins of finance. The investment funding of third-world expansion still largely flows through New York, London and Tokyo. Financialisation is the way first-world capitalists can still cream off surplus from global production even as they lose direct control of industry.

Thus, if we were to incorporate the profit rate or stagnationist investment gap analysis into a global shift story, the starting point is to look at movements between at least three global 'mega-sectors'. First world productive industry loses profitability and investment in competition with third world productive industry. But the first world non-productive sector is also there to grab those profits and investment.

DOES IT STACK UP?

To recap, in this story, the opening of global labour markets does the job that capital accumulation did in stagnationist and Marxist theories: it causes the decline of first world industry, prompting a shift into financialisation with all its bubbly instability. Turner tells it within a mainstream Keynesian framework but one could equally bring this global analysis together with underconsumptionist or profit rate theories. One would then have to look at how these alleged structural forces play out in the whole shifting world system, not just the US and other industrialised powers.

I think the shifts mentioned here are difficult to doubt. The question is their magnitude: are these shifts big enough to explain what has happened, all of it, or maybe at least some of it? And does there have to be one master theory beneath it all? Perhaps there are suggestions to take home from all these different stories. Here are a few observations.

If you are not a Marxist, you do not, in principle, need to believe that economic explanations must derive from the laws of production. Both production and market distribution systems are complexes of social relations embedded in deeper webs of power, custom and, indeed, psychology. Facts about any of these interlaced systems could be involved in explanations of economic events. Psychological or 'group-psychological' phenomena, such as culture shifts in markets, trader herd dynamics and social memory loss in Minsky's "periods of prolonged prosperity", are very important factors to consider. Although one can be sceptical about the Marxist falling rate of profit theory and find Marx's own organic composition argument dubious, it does point out the role that profit rates can play.

The last story may fit our 'intuitions' more than the other stories, yet it is really striking how few first-world commentators have worked global themes into their stories. It may be that the global changes discussed above are not big enough yet to rock the system and cause real power shifts. But if these trends continue in the same direction, they may well do so. The only

foreseeable exit routes from globalisation are either a major return of protectionist policies in response to this crisis; or perhaps the end of cheap fuel may finally bring global trade to a halt.

Where will it all lead? In many contexts, Minsky's way of talking about "capitalisms" (in plural, rather than capitalism as a monolithic singular) is helpful: "Whereas all capitalisms are flawed, not all capitalisms are equally flawed." In many respects, the global economic system we have now is not the same capitalism of 1914 or 1848. Capitalist systems are a family of adaptations, not a monolith. It would be very surprising if this crisis led to the end of capitalist markets and property relations forever. But maybe it may well precipitate changes that mean the system we have to contend with in a few years' time is a quite different capitalism to the one we have known in recent decades.



HOW IT WORKS (OR DOESN'T) INTERVIEW WITH A BANK TRADER*

* The interviewee, who works in commodity trading, prefers to stay anonymous.

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What does a typical day at work involve for you?

I bet on price fluctuations – buying low and selling high is the aim of the game. A day at work typically involves sitting down with the analysts looking at the supply and demand of the commodity we're trading. We look at the price curve for futures contracts for the next five years, trying to find points where everything doesn't tie up; i.e. where supply doesn't meet demand. That's where the opportunity for a trade is, because the price is lower or higher than it should be. At the end of each day, you look at your profit and loss and see how you've done.

I have six screens in front of me. You have all different kinds of contracts listed for delivery right now, next month, next year and then all the way up to five years. For each kind of contract, you have a row of numbers for the bids and the offers, showing the best price, then the second-best price, then the third and so on. You look at the best bid and the best offer – that's where the market is, because you'll always be selling to the highest bidder and buying the lowest offer. If I want to sell a load of X, I have to 'hit' all the bids. Or if I want to buy, I have to 'lift' all the offers. Of course, if someone wants, say, 40 contracts' worth of a commodity, you can't just look at the best offer, because that's only for the first one. You should really look between that one and the 40th to get your price.

We have a trading desk and a sales desk. The trading desk deals directly in the market with other big banks and the big physical players; i.e. commodity producers and consumers. But we also have customers, generally smaller guys with less credit and less access to markets. They have much more tailored requirements for specific periods in time. Manufacturers, for example, can't just go to the market asking for precise amounts of materials or energy when they need them, because these things are traded in bulk and the price is always changing. Sales desks at banks are there to create bespoke packages for these customers.

For example, a customer has to sell 2,375 barrels of oil. We will buy it from them at an agreed price and then go to sell that volume in the market at a small premium. The market standard clip size is 1,000 barrels of oil, however, so we can only properly hedge 2,000 of the 2,375 barrels in the market and are left with a physical position. The margin we make on the 2,000 barrels we have hedged should cover the risk that prices move down on our remaining 375. This is basically how banks' 'flow' or 'sales' business works.

How much money do you work with? Where does it come from?

In what I trade, the notional value of each contract is about half a million pounds. I typically trade around a 100 of these contracts in a day, but that's both buying and selling. So at the end of the day, I might end up with a net position of somewhere between just five and 20 contracts overall. The profit you make on one of these contracts in a day is about 1% at best, so that's about £5,000 on each one. So, despite 'churning' contracts with notional values of tens of millions of pounds, the profits on a good day are unlikely to be more than £100k. When I started trading, my target for the year was £2 million profit, which I made. That works out at about £8,000 for each business day, which is a standard target for a junior trader. It sounds like a lot, but the costs of all the trading equipment, IT guys, support staff for each trader, etc.

supposedly comes to about $\pounds 1$ million a year, which you have to cover first. So if you're not making a million, you're not breaking even.

We make thousands of trades in a day as a business, so at the end of each day, we balance our trades with all of our partners. So if we've bought 100 contracts from another bank, across all our trading desks, and they've bought, say, 90 from us, we don't actually transfer the millions required to buy all 100 contracts and take the value of the 90 from them. Instead, we just balance the trades and clear the difference. So during the day, while we're trading, it's all done on credit. Then the money to clear our trades comes from the balance sheet, which, in a big bank, includes current account holdings. So ultimately, it is partly the current account holder that's funding the trades we do. That was the problem with banks being so over-leveraged before the credit crunch. We're only looking at a 1-2% margin on our trades, so the numbers aren't that big. But if you take on massive amounts of debt to increase the amount of trading you do, you can make more. There were instances before the crunch where banks were so leveraged that losing just 3% on their trades in a day could wipe out all their liquidity.

What level of speculation is involved in your job? Are you given incentives to take risks?

It used to be much more about proprietary trading [speculating on trades rather than making money from sales], say about 75% speculation to 25% sales and flow trading. Things have changed so much now. It's more like 20% prop to 80% sales. But the general bank model has always been about sales, with prop trading desks in the minority. Prop trading is a term you can't really use any more, for a number of regulatory reasons, although that's what it used to be all about. Now the focus is much more on long-term prospects, which means sales. But the culture does vary from bank to bank.

Bonuses are paid on the back of your profit and loss at the end of the year, and nothing else. Once you're a trader with your own book, you're not rewarded for being a good team member. When I started, it used to be a percentage paid in cash. Now it's a smaller percentage in cash and the rest in deferred cash and shares that they'll pay to you in instalments over three years.

There's a load of guys who aren't very good and go from job to job losing lots of money. If it goes wrong, they know they can just leave and get work somewhere else. But the culture of extravagant payments and boozy lunches isn't tolerated any more. Things have tightened up. It definitely still exists but it's more in check now. It's got more corporate and less cowboy.

Do you use derivatives and other financial instruments in your trading? What are they for?

You can't trade commodities without derivatives. Most commodity trading is forwards, or futures, which means you agree to buy something at some future point for a certain price. There's nothing that funky about it. We don't use CDS or anything like that. There are more exotic and complex commodity products, but we only get involved in that when a customer wants them. There's a different team that does that stuff. I don't really understand a lot of it. They put together structured notes which combine 30-year bonds and oil etc., and then sell it to investors.

What about tax avoidance? Are you aware of it happening around you?

There is personal tax avoidance and it tends to be more common among the higher net-worth individuals. Every now and again you get a cold call at work, from a financial advisor, offering to help you pay 10% tax a year. But it only works for those earning over £500k.

How do you perceive the social effects of your work?

There's a genuine role for commodities trading, in helping producers and consumers to hedge their supply and demand prices respectively. And improved liquidity, which banks provide, should help the market achieve the true price of commodity. These efficiencies in price that the market brings should in theory mean that consumers pay fairer prices for, say, their electricity bills or petrol at the pump. So in that sense, the job has a positive effect and is necessary. In reality, energy companies aren't great at passing these savings on the customer; they're the ones profiting in a far bigger way than banks involved in commodities.

Would you say this view is shared by the people you work with or the industry more generally?

Old-style banking has changed, and that's change that has come from the top. But there are still lots of problems and banks hold way too much power. Most people in finance are also completely cut off from reality. They have no concept of how much money they're dealing with. Then again, you can't really think about it; otherwise you wouldn't be able to keep your head and do your job.

In terms of the attitude of bankers, a lot of the bad reputation in the public/media coverage have been deserved, especially in the past. However, gone are the days when people expected a massive bonus whether they made money or not, expected to be taken to dinner and a strip club every other night by some broker. If you're shit, you get fired now and there's not that many jobs out there. So attitude and professionalism have improved.

How did the crisis affect your work? Have things changed much as a result of the crisis and the bailouts?

Well, it's become much more client-focused, where you sell someone a bespoke product, then go and buy it in the market, hopefully at a cheaper price, and make a small margin. The balance sheet regulations haven't been fully implemented yet. In a way, that would really make people think carefully about the trades they're putting on.

For a few years, my team made insane profits, just from sitting there with excel spreadsheets and models and working out all the inefficiencies in the market. Physical commodity players weren't as savvy as they are now, so there was a lot more money to be made. These days the market counterparties are a lot more sophisticated, so it's a lot harder.

What do you think the problems of banking and finance are? What do you think needs to change within the system?

The main problem at my level has been the incentives, which meant people did well even when they performed badly. If you made lots of money for the bank, you got a big bonus at the end of the year; if you lost money, the worst that happened was that you get fired. And those who got fired seemed to always come back to a job somewhere else, and then often do the same thing again. So you're incentivised to take massive risks and, if it pays off, you're a hero. Also, you used to get paid in cash for your profits that year, so your risk-taking was very short-termist.

Things have changed. There aren't as many trading jobs out there, so that automatically makes you more vigilant in trading. And bonuses are paid out over 3-5 years now. If you leave or get fired, you lose your deferred cash/shares, which means you are more tied in to the longer-term goals of the institution.

Do you think regulation and financial taxes can be effective?

I like the idea of the Robin Hood tax but really don't think it could work. Say I do a 200 or 300 trades a day. If you add a 1% tax on each of these transactions, it massively reduces the profits made at the end of it all. Considering a 1% move in prices would be an excellent (or awful) day at the office, adding a 1% tax to each transaction (a Robin Hood tax) would make it impossible to do business. Last year, the brokerage fees on my transactions were 0.1%, and that added up to about 5 to 10% of total profits. So even though a 0.05% tax doesn't sound like much, it's a game-changer in terms of profitability. People would have to get fired for it to work.

People aren't going to leave London. They're not going to make a massive operation in Singapore or Geneva. It's a threat they like to make but banks throwing their toys out of the pram and saying "we're leaving" needs to be taken with a pinch of salt. There are few other places with softer tax regimes that would be so attractive to banks.

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l For more on this issue, see Corporate Watch's report Corporate Law and Structures: Exposing the Roots of the Problem (2004), available at www.corporatewatch. org/download.php?id=43.

2 Available at www.corporatewatch.org/?lid=4171.

3 *Explaining the Crisis*, Aufheben 19, 2011, available at http://libcom.org/library/aufheben-19-2011.

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1 http://online.barrons.com/article/ SB953335580704470544.html

2 http://articles.latimes.com/2006/jul/16/business/fioverheat16

3 Robin Blackburn, 'The Subprime Crisis', *New Left Review* 50, March-April 2008, available: http:// newleftreview.org/II/50/robin-blackburn-the-subprimecrisis.

4 http://www.tradingeconomics.com/united-states/ interest-rate

5 Mark Zandi, Financial Shock: A 360 Degree Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis, Financial Times, July 2008.

6 Costas Lapavitsas, 'Financialised Capitalism: Crisis and Financial Expropriation', Historical Materialism17 (2), 2009, pp.114-148.

7 Gary A. Dymski, 'From Financial Exploitation to Global Banking Instability: Two Overlooked Roots of the Subprime Crisis' in Martijn Konings (eds.) *The Great Credit Crash*, Verso, 2010, p.87.

8 http://www.guardian.co.uk/business/2007/sep/30/5

9 Dymski, p.73

10 Blackburn, p.74.

11 Ibid.

12 Unless referenced otherwise, all statistics in this and next paragraphs are from Costas Lapavitsas, 'Financialised Capitalism', p5. 13 For a full breakdown of the players and products of the financial world, see our *Nuts & Bolts Guide*, available in print and online at http://www. corporatewatch.org/download.php?id=43.

14 Lapavitsas, 'Financialised Capitalism'.

15 For more detailed definitions of these terms, see our '*Nuts & Bolts guide*' available in print and on our website.

16 Nicholas Hildyard, A (Crumbling) Wall of Money, Corner House, October 2008, available: http://www. thecornerhouse.org.uk/resource/crumbling-wall-money.

17 Tony Jackson, 'Crazy crisis may herald the end of new derivative folly', *Financial Times*, 24 December 2007.

18 Blackburn, p.75.

19 Zandi, Financial Shock.

20 Blackburn, p.91.

21 See The Wine & Cheese Appreciation society of Greater London's article 'Financial Crisis 2008, *Kittens* #0, pp.2-3.

22 Englebert Stockhammer, 'Neoliberalism, Income Distribution and the Causes of the Crisis', discussion paper, Research on Money and Finance. no. 19), 2010, p.3.

23 Based on figures from various sources cited above.

24 Blackburn, p.67.

25 D'arista, p.46.

26 Gillian Tett, *Derivative Thinking*, *Financial Times*, 2 June 2008.

27 Hildyard, A (Crumbling) Wall of Money.

28 Blackburn, p.64 and 70.

29 http://news.bbc.co.uk/1/hi/7521250.stm

30 David Harvey, *The Enigma of Capital and the Crisis of Capitalism*, Profile Books, 2010, p.2.

31 Lapavitsas, p.8.

32 Hildyard, p.7.

33 Harvey, p.2.

34 Blackburn, p.70.

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35 http://news.bbc.co.uk/1/hi/7521250.stm

36 Hildyard, p.10.

37 Figures from Blackburn, p.70.

38 John Lanchester, *Whoops!: Why everyone owes* everyone and no one can pay, Penguin, 2010, p.28.

39 Dymski, p.72.

40 Lanchester, p.30.

CRISIS STORIES P. 22-42

1 http://www.rollingstone.com/politics/story/26868968/ the_dirty_dozen/1

2 According to UK Liberal Democrat party shadow chancellor Vincent Cable in this article in the New Statesman: http://www.newstatesman.com/ business/2008/10/economic-nationalism-state

3 http://www.vanityfair.com/magazine/2009/01/ stiglitz200901

4 Greenspan has gone rapidly from near-deity of the markets to ultimate bogeyman. One finance bestseller now is William Fleckenstein, *Greenspan's Bubbles*, McGrawHill, 2008.

5 For US housing bubble figures and analysis, see Center for Economic and Policy Research (CEPR), http://www.cepr.net.

6 One regulatory highlight that Stiglitz doesn't mention: even as the crisis was spreading in 2008, governments were implementing the Basle II international capital accord, which meant to globally agree the capital requirements banks have to hold against their assets. For securitised bonds, regulators gave up altogether trying to independently assess the risks of securitisations and allowed banks to work out their own capital requirements, based on models from the rating agencies, which are paid by the same banks.

7 Wikipedia article on "Keynesian resurgence", with tons more links: http://en.wikipedia.org/wiki/2008-2009_Keynesian_resurgence. For a left-wing view critical of the idea, see John Bellamy Foster in this interview: http://www.countercurrents.org/ ashley200309.htm 8 Online copies available at http://www.marxists.org/ reference/subject/economics/keynes/general-theory/ and http://homepage.newschool.edu/het//texts/keynes/ gtcont.htm.

9 Keynes labels the predecessors he is attacking the "classics". Most historians of economics use a different terminology - Smith, Ricardo and other early economists are "classical"; economists after the "marginalist revolution" of the 1870s are "neoclassical".

10 According to A.C. Pigou in *Theory of Unemployment* (1933), "With perfectly free competition among workpeople and labour perfectly mobile, the nature of the relationship [between wages and labor demand] will be very simple. There will always be at work a strong tendency for wage rates to be so related to demand that everybody is employed. Hence, in stable conditions every one will actually be employed. The implication is that such unemployment as exists at any time is due wholly to the fact that changes in demand conditions are continually taking place and that frictional resistances prevent the appropriate wage adjustment from being made instantaneously."

11 The "classics" tended to think the contrary: that "supply creates its own demand", known as Say's Law. Across the economy as a whole, the more stuff that gets produced, the more stuff there is to sell and buy, so there is always enough demand to meet the total supply. See http://homepage.newschool.edu/het//profiles/say.htm.

12 Keynes, General Theory of Employment, Interest and Money, part III.

13 Keynes, *General Theory*, chap 12. This is one of the most famous and also best written chapters in the book, and worth reading. Available at http://www.marxists. org/reference/subject/economics/keynes/general-theory/ ch12.htm

14 Yes, this is a vast oversimplification. One good starting point for more secondary reading on *General Theory* is this essay from the New School: http:// homepage.newschool.edu/het//essays/keynes/gtregime. htm. Keynes made his own simplification of his crisis theory (though in an earlier stage) in his article on 'The Great Slump of 1930', available at http://www. gutenberg.ca/ebooks/keynes-slump/keynes-slump-00-h. html.

15 A pdf summary of Minsky's theory can be found at http://cas.umkc.edu/econ/Oeconomicus/VolumeIV/ Winter2001/Tse.pdf



16 First labelled as such by Paul Samuelson in his influential textbook *Economics* (1955). For a run-through of developments in mainstream macroeconomics after Keynes, see the Concise Encyclopedia of Economics: http://www.econlib.org/ library/Enc/KeynesianEconomics.html.

17 For Robinson and the debates over interpreting Keynes, see J.E. King, *A History of Post-Keynesian Economics since 1936* (2002).

18 The details of how Keynes' theory relates to 'Keynesian' policy is another fertile area for debate. See http://homepage.newschool.edu/het//essays/keynes/ publicpolicy.htm.

19 How close the actual international financial institutions are to Keynes' own proposals is another issue. See for example: http://www.monbiot.com/archives/2008/11/18/clearing-up-this-mess/.

20 http://www.time.com/time/magazine/ article/0,9171,842353,00.html.

21 What really said was: "In one sense, we are all Keynesians now; in another, nobody is any longer a Keynesian." He added that maybe the second half of that sentence was the more important.

22 There are plenty of debates about what neoliberalism means. One of the best-known references is Marxist geography professor David Harvey's A Brief History of Neoliberalism (2005). Here's a 2008 article by Harvey on neoliberalism and the crisis: http://www. counterpunch.org/harvey03132009.html For a Trotskyist criticism that the term is given too much weight, see Chris Harman: http://www.isj.org.uk/ index.php4?id=399. The term itself originated in Latin America, where it was, pretty literally, kick-started by the Pinochet dictatorship (1973-1990) in Chile. Famously, in 1975 the US-backed junta handed over economic policy to a bunch of Friedman students called the "Chicago Boys". Naomi Klein's book Shock Doctrine has made this story fashionable again. See also this 2004 article in Dollars and Sense: http:// dollarsandsense.org/archives/2004/0904cypher.html. One good book on Latin American neoliberalism in English is Duncan Green's Silent Revolution (1995).

23 http://economistsview.typepad.com/ economistsview/2008/07/stiglitz-the-en.html.

24 A key part of the theoretical argument was Friedman and Anna Schwartz's analysis of the Great Depression

in their book A Monetary history of the United States, 1867-1960 (1963), which largely blamed monetary policy errors by the Federal Reserve.

25 Many writers apply Thomas Kuhn's idea of "paradigm shifts" to Keynesianism and monetarism. Note, though, that Kuhn himself was writing about natural sciences and not economics, which is particularly heavily tied up with political interests.

26 Paul Krugman, *The Return of Depression Economics*, 2nd edn., 2008, p.189.

27 As far as I know, no one has developed an explicit "animal spirits" theory of economic policy paradigms yet.

28 http://www.monthlyreview.org.

29 See also this 2000 *Monthly Review* essay for a summary and reassessment: http://monthlyreview. org/400jbf.htm.

30 Magdoff and Foster, *The Great Financial Crisis*, Monthly Review Press, 2009. Apart form the introduction, the book basically reprints essays which you can read on the MR website for free:

http://www.monthlyreview.org/0506jbf.htm (ch1 - the household debt bubble), http://www.monthlyreview. org/1106fmagdoff.htm (ch2 - the explosion of debt and speculation), http://www.monthlyreview. org/1206jbf.htm (ch3 - monopoly-finance capital), http://www.monthlyreview.org/0407jbf.htm (ch4 - the financialization of capital, http://www.monthlyreview. org/080401foster.php (ch5 - the financialization of capital and the crisis)

http://monthlyreview.org/081201foster-magdoff.php (ch6 - back to the real economy).

31 Perhaps the biggest problem is that it works too well, at increasing growth and consumption year after year, without regard for environmental constraints that could bring the whole thing to an end very soon.

32 A very good run-through of crisis theories including undeconsumption is Anwar Shaikh's 1978 'An Introduction to the history of crisis theories', available at http://homepage.newschool.edu/~AShaikh/ crisis_theories.pdf. Shaikh is a Marxist economist of the falling rate of profit tendency, but without dogmatism. See also this New School essay on the Malthus-Ricardo debate about underconsumption, Say's Law and



"general gluts": http://homepage.newschool.edu/het// essays/classic/glut.htm. There is a much-cited book by Micheal Bleaney called *Underconsumption Theories* (1976).

33 Underconsumption means exactly the same as overproduction: more stuff is produced than is consumed.

34 Malthus used this story not to argue for socialism or higher wages but in favour of a spend-thrift landlord class.

35 Rosa Luxemburg, *The Accumulation of Capital*, ch.25, available at http://www.trotsky.org/archive/ luxemburg/1913/accumulation-capital/ch25.htm. Here Luxemburg is arguing against Marx, who was arguing against earlier forms of underconsumption theory. As Anwar Shaikh puts it, for Luxemburg, Marx had demonstrated that extended reproduction without corresponding increased consumption is "algebraically possible", but she felt it was not "socially possible".

36 Actually the 19th century had more and worse crises than the 20th. There was only one "depression" in the last century; in the 19th there were three in the US (1807-12, 1937-42, and the "long depression" from 1873). See also Geoffrey H. Moore, "Recessions" in *Concise Encyclopedia of Economics*: http://www.econlib.org/library/Enc1/Recessions.html; and NBER statistics on length of recessions: http://www.nber.org/ cycles.html.

37 The MR writers don't see the IT 'revolution' as a force on the scale of post-war 'automobilisation'.

38 Defining 'non-productive' investment is a very big topic for Marxist economics; pretty much all writers agree that war production and advertising are included but disagree over such things as luxury consumer goods.

39 The Great Financial Crisis, p.93. See also: http:// www.monthlyreview.org/080401foster.php

40 On collective action theory, see http://plato.stanford. edu/entries/free-rider/.

41 Is this correct about wage movements? See Report by Paul Mason (BBC Newsnight economics correspondent, and certainly one of the most interesting economics journalists around) on his blog: http://www. bbc.co.uk/blogs/newsnight/paulmason/2008/10/after_ the_death_of_high_wages.html

42 Ch1 - the household debt bubble: http://www.

monthlyreview.org/0506jbf.htm ,

43 Ch2 - the explosion of debt and speculation: http:// www.monthlyreview.org/1106fmagdoff.htm.

44 *Ibid.*, pp.131-3. See also http://monthlyreview. org/081201foster-magdoff.php.

45 Ibid., pp.21-2.

46 Marx, *Grundrisse*, Notebook 7, Penguin, 1973, p.750, available at http://www.marxists.org/archive/ marx/works/1857/grundrisse/ch15.htm#p745

47 Shaikh, "An Introduction to the history of crisis theories", available at http://homepage.newschool. edu/~AShaikh/crisis_theories.pdf. Shaikh also discusses the earlier falling rate theories of Smith and Ricardo.

48 More accurately, the "socially necessary labour time" associated with the commodity, i.e. it is not the actual amount of labour that went into any particular commodity that determines its value, but the time that would be necessary to produce that good using the standard technologies available.

49 This can also be expressed as increasing the rate of exploitation - the ratio of surplus value (S) to variable capital (V) E = S / V.

50 This is another "collective action problem" - see note 40. It would be better for capitalists if they could get together in a cartel and agree to stick with a certain level of investment. But competition forces capitalists into a vicious cycle that hurts them all.

51 The 'organic composition' is Q = C / (S + V), where C is constant capital. Also sometimes written Q = C / L, where L+ S + V is living labour value. There is a distinction to be made between the "organic composition" and the "technical composition of capital", which is the ratio of the quantity of means of production to the quantity of the goods produced by living labour in the new production process. That is, organic composition is in terms of values, while technical composition is in terms of physical quantities.

52 The rate of profit is R = S / (V + C).

53 Marx, *Theories of Surplus Value*, part III, ch.23, sec.2, available at http://www.marx.org/archive/marx/works/1863/theories-surplus-value/ch23.htm.

54 Including Shaikh himself, and also analytical Marxist economist Erik Olin Wright, who has a thorough sevenpage (pp.131-8) discussion of this question in his 1978

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book *Class, Crisis and the State*, available free on his website: http://www.ssc.wisc.edu/~wright/.

Note, however, that this criticism is not the same as the "Okishio Theorem", which Shaikh and others refute.

55 Here's a note (from the Socialist Party of Great Britain) on Marx's published newspaper articles on financial crises: http://www.worldsocialism.org/spgb/ overview/finance.pdf.

56 Henryk Grossman, *Law of the Accumulation and Collapse of the Capitalist System* (1929), available at http://www.marxists.org/archive/grossman/1929/ breakdown/index.htm. See also Rick Kuhn's biography: *Henryk Grossman and the recovery of Marxism*, available at http://dspace.anu.edu.au/ handle/1885/44510. And here's a short interview with the biographer: http://radicalnotes.com/content/ view/40/39/.

57 Mattick's archive page at marxists.org is http://www. marxists.org/archive/mattick-paul/index.htm.

58 Brenner web page is http://www.history.ucla.edu/ people/faculty?lid=37. Brenner was widely known for his work on the theory of the origins of capitalism (the "Brenner debate"). His books on recent economic history include *The Economics of Global Turbulence* (2006) and *The Boom and the Bubble* (2002). And here is a recent (March 2009) interview with him: http:// www.solidarity-us.org/node/2071.

59 Anwar Shaikh critiques Brenner's price competition argument from the standard Marxist perspective. See http://homepage.newschool.edu/~AShaikh/ Explaining%20the%20Global%20Economic%20 Crisis.pdf. And here is John Bellamy Foster's critique of the stagnationists: http://findarticles.com/p/articles/ mi m1132/is 2 51/ai 55084080/

60 Robert J. Brenner speaks with Jeong Seong-jin, 'Overproduction not Financial Collapse is the Heart of the Crisis: the US, East Asia, and the World', *The Asia-Pacific Journal* 6-5 2009.

61 'The rate of profit and the world today', July 2007, http://www.isj.org.uk/?id=340; and 'The slump of the 1930s and the crisis today', Jan 2009, http://www.isj. org.uk/?id=506. For a simpler version, see this Feb 2008 article: http://www.socialistreview.org.uk/article. php?articlenumber=10263.

62 The AWL Interview here is a very clear summary:

http://www.workersliberty.org/story/2008/03/19/ marxists-capitalist-crisis-1-fred-moseley-long-trendsprofit. His main work is *The Falling Rate of Profit in the Postwar United States Economy* (1991). See also this later paper: 'The Rate of Profit and the Future of Capitalism', available at http://www.mtholyoke. edu/~fmoseley/RRPE.html. And another summary article: http://www.permanentrevolution.net/entry/1812; and a reply to Harman: http://www.isj.org.uk/?id=463.

63 Thanks to Alliance for Workers Liberty - Star of Lenin for being the only Marxist groupuscule website I found that gave juxtaposed a wide range of Marxist opinions not just their own party line.

64 Joseph Gillman, *The Falling Rate of Profit* (1956) was one of the first studies. Apart from Brenner and Moseley, see Gerard Duménil and Dominique Lévy, *The Economics of the Profit Rate: Competition, Crises, and Historical Tendencies in Capitalism* (1993) and "The Profit Rate: Where and how much did it fall? Did it recover? USA 1948-1997" (2002): http://www. jourdan.ens.fr/levy/dle2002f.pdf. Anwar Shaikh's major empirical work (with Ertugrul Ahmet Tonak) is *Measuring the Wealth of Nations* (1996). The first chapter is online: http://homepage.newschool. edu/~AShaikh/wealth.pdf. There are some other empirical papers on Shaikh's website too: http:// homepage.newschool.edu/~AShaikh/. Harman gives more references in his papers cited above.

65 Also Moseley sets out the methodological differences between him and Brenner very clearly in the AWL interview referenced above. See the Shaikh reference above for a detailed discussion of some of the methodological questions in estimating Marxian quantities.

66 To get a rough idea of the differences in left-leaning discourse in Brasil and US/UK, if you read Portuguese, you could look at the contributions on the crisis to leftie intellectual magazine Le Monde Diplomatique Brasil (http://diplo.uol.com.br). They either feature some thesis on shifting global 'hegemony' (perhaps as one amongst others). For example, Ignacy Sachs, 'the crisis: window of opportunity for tropical countries?', http://diplo.uol. com.br/2009-01,a2762. This account of the crisis is influenced by Sachs along with Magdoff and Foster: http://diplo.uol.com.br/2009-01,a2772. Alternatively, like "global power" theorist Jose Luis Fiori, they see it as a necessary target of critique: http://diplo.uol.com. br/2008-03,a2313.



67 Or Argentina's president Cristina Kirchner's rousing speech, also in September: "the first world, which has been presented to us as something to aspire to, is collapsing like a bubble while we the Argentinians, modest and humble, hold firm with our national project."

68 World Bank forecasts (probably overestimates) from April 2009: world growth for 2009 -1.7% (first global slump since WW2); Latin America -0.6%; China +6.5% (down from 9% in 2008); South Asia +3.7% (down from 5.6%).

69 In November 2008, it made its first crisis loan to Ukraine, followed by Iceland (the first IMF loan to a West-Euopean state since 1976) and Pakistan. So far no loans have been made to Latin America, but it is still early days.

70 *IMF World Economic Outlook Report 2007*, especially ch.4 ('Decoupling the train? Spillovers and cycles in the global economy'), available at http://www. imf.org/external/pubs/ft/weo/2007/01/pdf/text.pdf. India went from 3.5% to 5.7%, while Brazil actually stayed constant at 2.7%. Faster Latin American growth in the 2000s is only now making up for the crises of the 80s and 90s. The IMF report has lots more empirical research on "decoupling", i.e. to what degree the economies of other countries, and the world in general, are effected by US recessions, and how.

71 *Ibid*. European exports dropped from 28.1% to 23.2%; China's increased from 1.2% to 7.2%; India's from 0.7% to 1%. European imports decreased from 29.1% to 22.5%; China's increased from 1.3% to 6.2%; and India's from 0.8% to 1.2%.

72 Other links include falling remittances from migrant workers and the effect through the financial markets of the global credit crunch. Even though the crisis did not come this time from the 'emerging markets', scared international lenders pull out capital from 'riskier' markets.

73 Of course things still have a way to play out, but this year's IMF World Economic Report (April 2009) shows how growth falls so far from this crisis have mainly hit the US and other rich countries. See http://www.imf.org/external/pubs/fl/weo/2009/01/pdf/text.pdf.

The enormous increases in borrowing to fund bail-out plans should in the long term weaken the US and other rich states. One piece of data that can look like it contradicts this is the fall in US treasury bond rates, even as the US increases borrowing. But this is explained by the short-term phenomenon of investor "flight to safety" in a crisis. Over the longer term, the US state can only become less 'safe' as it heaps on more debt.

74 http://news.bbc.co.uk/2/hi/business/7967546.stm.

75 Graham Turner, *The Credit Crunch*, Pluto Press, 2008. See especially chapters 4 and 6. Turner's political slant (it seems to be advocating protectionist social capitalism against 'free trade') is dodgy, and lots of the book appears to be written hurriedly. But all the same, it's the only one out there (in 2009) with good global analysis and data. His economics is basically mainstream Keynesian. He's part of the Left Economic Advisory Panel (LEAP) associated with the left of the UK Labour party.

76 Japan's movement into export markets was phenomenal: since 1950-65, it has expanded exports by over 14% a year on average; and by 21% a year in 1965-71 (Robert Brenner, *The Boom and the Bubble*, p. 98). Its share of world GDP in 1971-75 had reached 8%, and world exports 8.5%. But China's production now is 14%+ of world GDP, and that could just be the beginning for a much larger economy.

77 The US imported from China \$256 billion worth of stuff more than it exported from it.

78 The full picture of how this works also involves international currency markets: net exporters like China generally try to keep their currencies down, which involves central banks buying up dollar assets and building reserves. See Turner ch.4 for more details. And here is a quick beginner's guide to US trade deficit finance from Dollars & Sense magazine: http://www. dollarsandsense.org/archives/2004/0304dollar.html.

79 See IMF, World Economic Outlook, April 2009, available at http://www.imf.org/external/pubs/ft/ weo/2009/01/pdf/text.pdf.

80 "But the cost of this economic strategy [globalisation of labour], largely endorsed by Western governments and embraced by developing economies, has been higher debt levels in the West, as central banks seek to offset the downward pressure on wages back home." pp.80-81.



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