The Great Depression

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The contradiction between the expansion of the financial sector and the stagnation of the underlying productive sector finally found expression in the recent meltdown. The specific trigger for the recent financial collapse was an 'innovation' of the financial sector in the US called 'securitisation'. A bank would gather up bunches of loans it had made, and sell these bunches to investors. That is, the investor would hold a piece of paper entitling him/her to a share of the revenues that would come to the bank from a particular bunch of borrowers. By this method, banks would recover from these market investors the amount they had lent as home loans to others, as well as fat fees, and would in this process be free to expand lending further. These paper securities offered investors higher returns than other places in which they could invest their money. But they were only the starting point for a huge edifice of debt and speculation. Various other securities were devised and issued by different financial institutions based on grouping together the incomes of the original securities; and further speculative bets centred on the risk of default by various groups of borrowers. Those who bought all these securities borrowed huge sums to do so. Finance boomed, and so did the economy based on this. According to some estimates, in the US, roughly 80 percent of the increase in employment and almost two-thirds of the increase in GDP in the years before the crisis broke stemmed directly or indirectly from the real estate sector.

Since the 1980s, on the other hand, wages in the US (as also worldwide) have been suppressed by neoliberal policies even as a minuscule elite has accumulated unparalleled wealth. This wage-suppression would have undermined consumption demand and led to a depression much earlier had mass consumption not been sustained by the colossal expansion of household debt. As the expansion rolled on, banks pushed loans to poorer and poorer sections (the 'sub-prime'). However, all that debt ultimately had to be serviced out of income, and the stagnation in the incomes of the working people meant that they could not sustain debt servicing. This led to a rising rate of defaults on home loans. In turn, the giant edifice of finance and speculation based on that debt came crashing down. That is, the underlying contradiction of capitalism reasserted itself.

Equally at the heart of the current crisis is the relation between imperialism, particularly US imperialism, and the Third World. One important aspect of this relation in recent years is the large capital inflows from Third World countries–China, other East Asian economies, and the Gulf oil exporters–which have sustained the US expansion. These countries accumulate large trade surpluses; their central banks invest these surpluses in the US, mainly in US government debt instruments. These flows bridge the giant US current account deficit (i.e., the deficit the US runs on trade in goods and services).

These flows of capital to the US not only fund the US current account deficit; they are so large that they even fund the giant US investment abroad*. And while foreign investment in the US is in low-return US government debt, US investment abroad earns high returns. As a result the US, despite being a huge net debtor, earns more on its foreign investments than it pays out on others' investments in the US. In the words of Kenneth Rogoff, former chief economist of the IMF, "This enormous subsidy to American taxpayers is, in many ways, the world's largest foreign aid program**. (Part of the US investment abroad is, of course, placed in the Third World. Third World central banks like India's RBI have been compelled, in turn, to invest some of this incoming flood in US government debt–a multiple bleeding.) Why then do countries like China, other East Asian countries, and the Gulf oil exporters buy US government debt? This must be seen first in the context of US global domination (an important element of which is its overwhelming military supremacy). On this basis the US has ensured the continuing reign of the dollar as the leading international currency, and therefore ensured that it makes up the bulk of the foreign exchange reserves of central banks. The US has also used its clout as the world's biggest importer to lay down terms to the world's biggest exporters.

At the same time, the present pattern of trade and financial flows also benefits the elites of certain Third World countries. Booming exports (on the basis of harsh exploitation of workers) yield them rich profits. Moreover, the flood of funds internationally helps them in several ways. Foreign capital flowing into Third World countries boosts upper-class consumer demand and corporate profits; and in a climate of easy and cheap funds, global investors are willing to bankroll the global dreams of big Third World capitalists like the Tatas and Ambanis. Even as the fact of imperialist exploitation is as stark as ever, its contours and patterns are shifting.

The savings which certain Third World countries are exporting to the US are made possible by suppressing the consumption of their own working people (i.e., paying workers low wages, taxing and underpaying peasants). The most striking instance of this pattern is that of China, which saves a staggering half of national income in this fashion. So high are China's savings that despite having the world's highest investment rate it has surplus savings to export. In the case of other developing countries, the surplus savings which they are exporting are not the result of rising savings, but falling domestic investment under the reign of neoliberal economic policies. Indeed "there is a global investment shortfall, with investment trending downwards" even during the preceding period of high growth. Thus the relation at the centre of the world economy is one of parasitism.

However, US imperialism is well past its heyday. Its last great gamble was to shore up its waning economic power by exercising its overwhelming military power. Its aim was not only the sheer plunder of oil wealth, but control of this strategic resource, and re-assertion of the dollar hegemony on which its fortunes depend. That exercise, planned to be swift and surgical, has got bogged down instead in unexpectedly strong and dogged national resistance in the occupied countries, leaving the US to foot a larger and larger military bill.

Now the US has been forced to re-focus its political energies entirely on rescuing its sinking economy, for which it needs to maintain continued inflows of capital. Even as it keeps up the grand front of global leadership, it is forced to request the cooperation of other powers in various spheres (the new Secretary of State's first foreign trip was to China, to request it to continue investing in US government debt; there she had to put the US's pet 'human rights' theme against China on the back burner). The various international economic bodies which the US dominates–the IMF, World Bank and World Trade Organisation–are reeling under the impact of the current crisis, and are in no shape to take command. The funds of the IMF and World Bank are puny compared to the scale of loan requirements. As different countries race to shore up their domestic economies against the international storm, the WTO's 'globalisation' agenda has been sidelined. Most importantly, the reign of the dollar as the leading international currency, which both rests on US hegemony worldwide and helps maintain that hegemony, will come under increasing question now because of the US's own efforts to spend its way out the crisis. As Rogoff points out, "A large expansion in debt... will certainly make it harder for the US to maintain its military dominance, which has been one of the linchpins of the dollar."***

As the crisis deepens, the strains and conflicts among different imperialist powers, as well as other capitalist countries such as China, will sharpen, and new blocs may emerge. Any US efforts to reduce its huge trade deficit would require a reduction of the market of other countries, which these countries would not give up without a fight. A period of contention for markets looms ahead.

The gravity of the present crisis is comparable only to that of the Great Depression of the 1930s. As such it has rung the death knell of the neoliberal era. Even though neoliberal ideology will survive in a modified form, and will continue to oppose the efforts of the other main school of ruling class economics (Keynesi-anism) to revive growth, it cannot in the near future enjoy the unquestioned supremacy it once had. What will replace undiluted neoliberalism, however, is not yet clear, and there is at present confusion and gloom among the ideologists of the ruling circles in the leading capitalist countries.

Capitalist states have once again openly embraced certain Keynesian instruments–such as that the State boost aggregate demand, and thus spur private investment, by deficit spending–but without accepting Keynes' darker insights into capitalism's inherent tendency to break down. Thus, while Keynes, following the logic of his theory, was forced to acknowledge the need for "a somewhat comprehensive socialisation of investment", clearly such a level of socialisation is incompatible with capitalism. The prospects are bleak for capitalism quickly emerging from the present crisis with the use of isolated Keynesian instruments.

Moreover, in the Keynesian framework, all that matters is that spending increase, workers get employment, and growth revive/continue. Keynes not only explicitly upholds the existing social order, but emphasises that what is being produced and consumed is of no relevance. However, under the reign of capitalism and more particularly under imperialism, the character of growth has become a more and more pressing question for the survival of humanity. Even as the world crisis of the capitalist accumulation process has come to a head, world crises created by the capitalist accumulation process are developing rapidly.

On the one hand, the production of the most basic necessity of life, food, is under threat - from lack of investment, from diversion of land to non-agricultural uses and agricultural output to non-food uses (eg. biofuel), and from serious degradation of the environment. On the other hand, the nature of the present economic growth is itself environmentally unsustainable. The addition of the better-off sections in some Third World countries to the category of 'world-class consumers' is bringing out just how unsustainable this is. If, by some magic, consumption in the Third World could be raised to that in the imperialist countries, and along the same pattern, it would multiply the consumption of natural resources and hugely aggravate the production of waste and environmental degradation.

This pattern of predatory and destructive consumption has been created by monopoly capitalism in order to create markets and thereby to facilitate its own accumulation of capital. It has nothing to do with people's physical needs, their sense of happiness and security, or the development of their capabilities; all these can best be fulfilled with a radically different pattern of consumption. However, that would require a different social system, one based on production for people's needs, namely socialism.

The attention of the world is focused on the dramatic developments and huge bail-out packages in the imperialist countries, and indeed the working people of these imperialist countries are set to experience great pain. But the greatest immediate impact of this crisis will be suffered in the Third World. In recent years economists, columnists and political leaders have propagated the notion that Third World economies have 'decoupled' from the developed world, and would continue to grow even as the latter stalled. The decoupling theory has now been buried. In those Third World countries which have undergone relatively greater industrial development, the fall in exports, as well as the fall in domestic demand (due to falling capital inflows), are leading to very large-scale retrenchments. Even further, the vast Third World peasantry are being ravaged by a crash in agricultural commodity prices (as demand shrinks, and as speculators pull out their investments in order to make up for losses in other financial markets). All this will only worsen the long-standing famine of agricultural investment, and in turn the world food crisis.

While it is theoretically possible that these countries will re-orient their economies to boost domestic demand and thus generate a market for continuing industrial growth, the political economy of these countries (i.e., the nature of class rule in them, how the social surplus is generated, appropriated and re-deployed) poses an obstacle to such a reorientation. For such a re-orientation would require a major transfer of resources to the working people, which would be opposed by the ruling classes.

This period of churning and decline of US hegemony, on the other hand, will offer greater opportunities for the advance of people's struggles and forces fighting for an alternative social order both in the advanced capitalist countries and even more within the Third World.

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**In 2007, of gross capital flows into the US of $2.1 trillion, $731 billion went to fund the current account deficit; US investors recycled $1.3 trillion of these inflows as investments abroad. Kristin Forbes, "Underlying determinants of global currency usage", Peterson Institute of International Economics, 2008.*

***"Betting with the house's money", Guardian, 112101. Moreover, as Krugman notes, "The saving grace of America's situation is that our foreign debts are in our own currency. This means that we won't have the kind of financial death spiral Argentina experienced, in which a falling peso caused the country's debts, which were in dollars, to balloon in value relative to domestic assets." New York Times, 19/1/08.*

****Purchasers of US government debt are increasingly worried that the runaway growth of such debt will lead to a steep fall in the dollar and thus in the value of their holdings.*

"America will need $1,000 billion bail-out", Financial Times, 17/9/08.

[Source : Aspects of India's Economy, No. 47]