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Food and Oil Pices Skyrocket

The World Economy and the Credit Crisis

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The current credit crisis is throwing into question the whole of the neoliberal, free market, order that when the post-war boom went into crisis in the mid-1970s, it was eventually resolved in the mid-1980s by a new economic order, neoliberalism. The current crisis has put that order in question, as its main pillars – low inflation, low commodity prices and stability in the international financial markets – are breaking up.

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The significance of the current turmoil in global financial markets can be seen sharply in the following quote from â€˜The rescue of Bear Sterns marks liberalisation's limit' by the chief economic commentator of the Financial Times, Martin Wolf. Wolf, who is no radical, writes
"Remember Friday March 14 2008: it was the day the dream of global free-market capitalism died.

For three decades we have moved towards market-driven financial systems. By its decision to rescue Bear Sterns, the Federal Reserve, the institution responsible for monetary policy in the US, chief protagonist of free-market capitalism, declared this era over. It showed in deeds its agreement with the remark by Joseph Ackermann, chief executive of Deutsche Bank, that â€˜I no longer believe in the market's self-healing power'. Deregulation has reached its limits…..even the recent past is a foreign country." (Financial Times 26/04/08)

The current crisis has been compared to 1929. This is not really helpful. More useful is to see it as the unravelling of the institutional arrangements which have governed global capitalism since the mid-1980s, and emerged as a response to the breakdown of the long post-war boom a decade earlier.

2. The Crisis of the 1970s and 1980s

Stable capitalist accumulation depends on two conditions. First, it requires the extraction of sufficient profits in the process of production. Second, it requires the realisation of those profits through sales in the market. This gives rise to a key contradiction – these two conditions are in conflict with one another.

The successful extraction of profits depends on keeping wages down while the realisation of those profits depends on sufficient demand being available, which in turn limits the ability of capital to lower wages. This conflict is a central reason for the periodic crises of capitalist growth.

Two of the main Marxist theories of crisis result from adopting a view which focuses on just one side of this conflict; under-consumptionism (for example the Monthly Review school in the USA) concentrates on the lack of demand which prevents realisation of profits, while the profit-squeeze theory of writers like Andrew Glyn and Bob Sutcliffe focuses on rising labour costs, which prevent the generation of profits in production. An adequate theory of crisis has to encompass both perspectives and to take account of the way in which capital can achieve a temporary resolution of the contradiction, which however inevitably stores up new problems for future accumulation.

The temporary resolution underlying the boom of the 1950s and 1960s depended on three main factors. First, state expenditure as a key source of additional demand. Second, the stable international economic environment provided by the `Bretton Woods' system of fixed exchange rates which allowed for rapid growth of world trade. Third, the development of new consumer goods technologies and markets, notably in areas like the motor industry and consumer electronics (so-called`white' goods).

This boom broke down in the mid 1970s leading to a decade of economic turbulence and two major international recessions, in 1974-75 and 1979-82. However, from the mid-1980s onwards a new framework for accumulation began to take shape.

3. The Temporary Resolution of this Crisis

The mid 1980sresolution of this conflict, modern neoliberalism, had three main components. The first was a massive explosion of debt – both household and (to a lesser extent) corporate debt. Debt has played a key role in mitigating the contradiction between the generation and realisation of profits, allowing for expanded demand even though wages have been kept down and a frontal assault on trade unions and organised labour has kept the working class on the defensive. However, there is an obvious contradiction here in that debt has to be repaid eventually and so the conflict between low wages and increased demand is likely to reassert itself with renewed ferocity at that point. Consequently, debt has only been able to play the role which it has because of the other two components listed below.

The second component was a renewed stability in the international financial system, following on from the wild exchange rate swings of the 1970s and the first half of the 1980s which resulted from the end of the Bretton Woods arrangements.

This stability has allowed for strong growth in international trade and more importantly underpinned dramatic financial deregulation and increased international investment.

The key factor leading to this stability has been the informal but durable relationship between the USA and China (and to a lesser extent other Asian countries) whereby the US deficit has been funded by surplus countries, which in turn has underpinned their export drive.
Linked with this, and important for both the US and UK, has been a rise in the returns earned by these countries on their investments abroad, which has helped them run large balance of payments deficits without their foreign liabilities mushrooming.

The third factor has been two decades of exceptionally low commodity prices. This has been a key factor in allowing central banks in the industrialised world, especially in the UK and USA, to let debt increase and to lower interest rates to boost demand, without worrying too much about inflation.

This framework did not take root globally at a single point in time, but arose in a more spontaneous way. Notably, the second most important capitalist economy, Japan, followed a trajectory of its own, as a result of the specific characteristics of Japanese capitalism in the 1970s and 1980s, and has stagnated throughout most of the last two decades.
Western Europe remained unstable for longer than the USA. However, from the mid-1990s onwards Europe participated in the general framework outlined above and this provided an important basis for two key successes for the European capitalist class during this period – the absorption of Central and Eastern Europe into the capitalist world economy and the institution of a common currency, the Euro. Particular regions continued to experience crises, notably Latin America, South East Asia and Russia, but these were successfully localised by capital and did not bring overall global expansion to an end, although the instability of 1997-98 briefly opened up such a possibility.

Each of the three factors outlined above is integrally linked with the other two in a mutually reinforcing system. The growth of debt requires low inflation and international financial deregulation, which in turn requires exchange rate stability. The export boom in China and elsewhere has depended on debt fuelled demand in the US and other countries. Low commodity prices have resulted from the process of globalisation' and imperialist expansion which has required deregulated debt finance and stable exchange rates. {{4. The Current Crisis}} The depth of the current crisis for capital arises because all three of the factors listed above have been thrown into question. The build-up of debt is extremely serious in itself, partly because of the size of the debt, partly because thesecuritisation' of it has spread it around the system so widely.

However, despite the over-valuation of the housing market in the US and other countries, problems in that market would not threaten the system globally were it not for the role of debt in the current pattern of capitalist accumulation more generally.

What is dangerous for capital is the conjunction of major problems in credit markets with renewed exchange rate uncertainty, especially the fall in the value of the dollar (and also a steep decline for both the US and UK in returns on foreign investments) and with what appears to be the end of the era of low commodity prices – shown most clearly by increasing prices for oil and other fuels and for food.

The difficulties are shown up most clearly in the key policy weapon which capital has depended on over the last three decades, control over interest rates. The US has cut interest rates sharply to deal with the build-up of bad debt, but such cuts run the risk both of speeding up the decline of the dollar and of raising inflation (which in turn will go up in the US if the dollar falls IMF economist Kenneth Rogoff has quoted the poet Robert Frost: Some say the world will end in fire. Some say in ice'. For Rogoff, fire here is financial ruin, ice is inflation. {{5. Can Capital Resolve the Crisis?}} Discussion of possible outcomes of the crisis runs the risk of being very speculative. However, it is important for socialists to consider some of the arguments which indicate possible resolutions of the crisis which might be attempted. Any attempt at such a resolution will involve distribution of the costs of the crisis. Capital will try to shift as many of these costs as possible onto labour and its success in doing so will depend on working class resistance nationally and internationally. Some of the key issues that have been raised are the following: â€¢ Demand from China and elsewhere may substitute for US demand: One possible resolution of the crisis might be a slowdown in the US and similar countries and a shift towards internal growth in China and other surplus economies, based on domestic consumption and investment rather than exports. This would clearly be possible in principle in a globally planned economy. It is much harder to achieve in the unplanned, spontaneous world of contemporary capitalism. â€¢ The crisis may be just a crisis of liquidity not of solvency: A number of observers argue that the credit crisis results mainly from liquidity problems and panics in the financial markets and that the amount ofgenuinely' bad debt is still quite limited. In addition corporate profits in the non-financial sector remain high. This latter point is probably the most optimistic element for capital in the current situation. However, this argument neglects the extent to which non-financial profits have been dependent on a degree of debt-based consumption which now looks unsustainable.

â€¢ Commodity price rises may mainly be caused by speculation: There is probably a strong element of speculation in recent oil and raw materials price rises (with speculators fleeing from the dollar). But the seriousness of the ecological crisis and the relatively long-term nature of recent price rises seem to indicate that speculation is only playing a minor role here.

â€¢ A fall in the dollar and sterling will raise US and British exports: It has been argued that exchange rate changes will restore balance to the world economy and that already US exports are rising as the dollar falls. Again, there is some truth to this. But reliance on this mechanism is very risky for capital because of (a) the substantial losses it would involve for countries like China which have purchased US dollar assets in recent years (b) the inflationary impact of such falls on the British and American economies (c) the possibility of renewed exchange rate turbulence of the kind seen in the 1970s and 1980s and (d) the fact that even balanced growth resulting from such exchange rate changes is likely to be at a much lower level than what we have seen in recent years.

â€¢ A better structure of regulation can solve the problem: One strand of thought in recent discussions sees an improvement in the regulatory structures of capitalism as key to solving the crisis. Martin Wolf in the article quoted above is an example of this. However, this is controversial; other analysts have strongly opposed responding to the crisis through increased regulation.

All of the above means that any attempt to resolve this crisis, at least in the short-run is fraught with dangers for capital – and consequently, the crisis opens up significant opportunities for socialists.

