Financial fault lines

Martijn Konings (ed.) *The great credit crash*, Verso, London, 2010

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There are almost as many theories of the nature and causes of the global financial crisis as there are toxic assets burning holes in the balance sheets of large financial institutions. The problem with many of the theories is that they haven't really explained a lot. As the late Peter Gowan noted, 'Much of the mainstream debate on the causes of the crisis takes the form of an "accidents" theory' (p. 62).[1] The refrain of capitalism's defenders has been that a generally good vehicle was crashed by the 'contingent actions' of reckless drivers. Whether it is the passing of the Garn-St Germain Depository Institutions Act in the early 1980s, the repeal of Glass-Steagall in 1999 or cavalier policies of the US Federal Reserve in the wake of the dot.com collapse, the prognosis is the same: the powers-that-be failed to adequately straightjacket the greed of financial traders. No doubt there is truth in this charge, but there is an ocean of systemic failure beneath the surface of human error.

The Great Credit Crash, edited by Martijn Konings, brings together contributions that attempt to penetrate beneath this surface. Divided into three sections, eighteen essays cover the nature, geography and politics of the crisis. Much of the focus is on the structural and long-term problems that have afflicted the United States economy and the rest of the world. Many of the contributors identify contradictions in the 'neoliberal growth model' as being at the heart of the crisis. Originating in the stagflation of the 1970s and industrial decline of the 1980s, neoliberalism sought the construction of 'new institutional mechanisms of control' (Konings, p. 6) to shore up private capital in the face of a spate of economic crises in the heart of the world system. The tremendous growth of interest-bearing financial capital—as the financial sector overtook manufacturing to become the largest sector of the US economy—was the centrepiece, many argue, of an unstable and unsustainable regime of accumulation.

1 All in-text references are to Martijn Konings (ed.), *The great credit crash*, Verso, London, 2010.

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Put simply, the growth model was characterised by credit-based consumer spending supplemented by asset-price inflation (Gowan, p. 67). It was accompanied on the one hand by lower rates of non-financial business investment (Livingstone, p. 45); and, on the other, a ‘huge system of financial arbitrage’ (Schwartz, p. 180). Due to the dominance of the dollar as the international reserve currency, the US effectively borrowed billions of dollars at low rates and invested internationally at a higher rate of return. This regime allowed the US to post above-average growth rates, thereby reversing the relative decline of American capitalism in the 1970s and 1980s compared to its principle economic rivals, Germany and Japan (Schwartz, pp. 176-177).

Problems in this regime emerged very early. First there were ‘demand side’ issues. The credit-driven consumer expansion of the economy was a response to a protracted decline in working class living standards as the US establishment attempted to boost profits by going on the offensive against labour from the early 1980s. The effective freezing of the minimum wage; the loss of well-paid manufacturing jobs and their replacement with low pay service and sales jobs; anti-union legislation; the cutting of welfare; and labour-market deregulation combined to undermine real wages, decade after decade. Johnna Montgomerie refers to a ‘politics of abandonment’, whereby the corporate sector discarded any sense of responsibility it had toward its employees (p. 107). The working class’s increasing reliance on debt was an attempt to bridge a widening gap between income and expenditure.

An explosion in credit-card and mortgage debt ensued. Between 2001 and 2007, outstanding home mortgage debt increased over 100 per cent, from US$4.9 trillion to US$9.9 trillion.[2] Consumer debt more than doubled from 1994 to 2008 (Robinson p. 298). Payday loans (which ‘advance workers a portion of the money they will be due from their next pay check’) increased from virtually zero in 1990 to a US$40 billion, generating fees of US$4.4 billion by 2005 (Dymski, p. 79). This debt was supplemented by the temporary wealth effect associated with asset-price bubbles, particularly in residential housing. The borrowing was unsustainable. Without a significant rise in income levels, the burden proved insurmountable. A crisis of effective demand was seemingly inevitable: ‘Eventually the two blades of the scissors of falling wages and the rising cost of mortgage debt had to meet, cutting the fuel line to the housing-boom machine.’ (Schwartz, p. 190)

There were also ‘supply side’ problems. With the transformation of the banking sector through the rise of shadow banking (institutions that provide loans but don’t take deposits and are not subject to the same regulation as banks) the largest financial institutions were able to ‘generate financial risks without absorbing them’ (Dymski, p. 72). During the boom, financial institutions had developed ingenious ways of spreading the risk associated with loans made to ‘unreliable’ borrowers. These institutions knew there would be losses, but they decided to sell them on as part of new financial instruments. Investment banks, with the assistance of credit ratings agencies, sold pieces of paper, ironically termed

2 Kevin Phillips, *Bad money*, Viking, New York, 2008, figure 2.6, p. 51.

'securities', dressed up as secure assets to other financial institutions and investors. The promise of an income generated by mortgage repayments of US borrowers underpinned these securities. So they were only 'secure' to the extent that people could actually repay their loans.

The theory was that losses would represent only a small portion of total loans so, if the risky bits were chopped up and sold with other loans that were going to be reliably paid back, there wouldn't be any problems. The banking sector was transformed from a 'lend-and-hold' model to an 'originate-distribute-and-underwrite' one (Dymski, p. 95). There were frenzied efforts to lend as much money as possible, in order to cash in on the bubble. In particular, predatory loans aimed at the most vulnerable were aggressively sold to the naïve and desperate. Such 'customers' were often unaware of the level of interest rates, the prospect of rate hikes after an initial teaser period, and the penalties for late or prepayment (Dymski, p. 81). For mortgage lenders it didn't matter if the people they lent to didn't understand the terms or consequences of a loan, mortgage payments simply became someone else's problem.

Much of the oil for these slick operations came from the rest of the globe: 'The structural power of the US is buttressed by its ability to capture massive amounts of global capital flows… [T]his privileged position has allowed the US, over the last ten years, to spend 5 to 7 per cent more than it produces and import twice as much as it exports' (Soederberg, p. 236-37). As the profit rate of *Fortune* 500 companies dropped decade after decade from the 1960s (Veltmeyer, p. 266), the capital flowed from the rest of the world into interest-bearing bonds and securities. This sustained the flow of imports from China and expanded the supply of credit to US citizens.

The US growth machine increasingly depended on the health of financial markets. US government debt to foreign banks reached US$4 trillion by mid-2009 (Hudson and Summers, p. 247). The dollar may be the US currency, but as former Treasury Secretary John Connally once quipped to Asian and European policy makers, 'it's your problem'. The collapse of the neoliberal boom, however, was a US problem too. Herman Schwartz estimates that 'one-third of US growth in the 1990s and virtually all growth in the mid-2000s can be attributed to the translation of increased household wealth into extra demand' (p. 194). There is now a cloud over the medium term prospects for an economic revival in the United States.

Global dimensions

The crisis became everyone's problem; all countries were caught up in the mess, to varying degrees. The defaults began to rise as house prices fell (by the end of 2008 they had dropped nearly 28 per cent).[3] The portion of bad loans—'toxic assets' as they became known—also rose. A massive problem developed. The securities, like the houses that

3 Carmen Reinhart and Kenneth Rogoff, 'The aftermath of financial crises', draft paper prepared for presentation at the American Economic Association, 19 December 2008, p. 3.

borrowers had purchased, were worth less than their advertised value. Complicating things was the fact that these assets had been sold on numerous times—and not simply in the US. European banks bought up billions in high-risk assets, suffering the same consequences as their US competitors (Nesvetailova and Palan, p. 200). Instead of a few bad loans being spread around so that no one buying securities would take a significant loss, the opposite began to occur. Everyone was taking a loss as more and more assets became toxic. What began in the US infected the entire North Atlantic financial sector. Yet the bad loans were only the tip of the iceberg. To make matters worse an entire system of betting on which loans were bad had developed among financial institutions (these bets were seen as a form of insurance and called Credit Default Swaps). Losses were compounded as a series of major institutions bet the wrong way without having the money set aside in case they got it wrong.

Eastern Europe, one of the most deregulated regions of the world, was decimated by the crisis. Michael Hudson and Jeffrey Summers provide a case study of Latvia. A lab of neoliberal development for the last twenty years, the country was touted as a model that 'Old Europe'—with its antiquated social welfare states, high taxes and excessive regulation—should emulate. Anti-union provisions, a flat tax, mass privatisation and the like were supposed to have made Latvia and other East European economies more dynamic. In reality the country was a mere satellite for the developed economies, a haven for money laundering and tax evasion, dependent on foreign credit (p. 249). Prior to the crisis as much as 90 per cent of GDP growth was attributable to a real estate bubble and the financial services sector (p. 255). The crisis exposed this structural weakness. When foreign funds dried up unemployment more than doubled. The fastest growing developing economy in Europe contracted by almost 18 per cent and required an IMF and EU bailout.

The Global South, provider of more than half a trillion dollars to the developed economies over the eight years to 2005 (Soederberg, p. 237), was also hit hard. Exports dropped as recession spread across the Atlantic economies. Secondly, remittances (money sent by family members working in other countries) dropped because of higher developed world unemployment. There was, thirdly, a flight of capital as first world companies withdrew funds to patch up their balance sheets back in the relative safety of the industrialised economies.[4]

Latin America saw a 40 per cent reduction in its financial wealth in 2008, but Veltmeyer's prediction that 'Latin America is experiencing the beginning of what is likely to be a profound and prolonged recession' (p. 268) has not been borne out. The rise in unemployment was less severe than in Europe and economic growth was around 6 per cent in 2010.[5] In part this has been the result of the sustained primary commodities boom,

4 Food and Agriculture Organization of the United Nations, 'More people than ever are victims of hunger', press release, 19 June 2009, www.fao.org/fileadmin/user_upload/newsroom/docs/Press%20 release%20june-en.pdf, accessed on 26 April 2011.

5 Gabriela Aguilar, 'Through dynamic growth Latin America and the Caribbean absorbed the crisis' social impact', press release No:2011/122/LAC, World Bank, 2011.

driven by Asian demand. In particular, the continued dynamism of the Chinese economy has helped stabilise sections of the world economy. This is not simply a post-crisis phenomenon. As Walden Bello explains, by the late 1990s China was bucking the trend of sub-par investment performance globally. Its relationship with the US—producer of consumer goods and extender of credit with which to purchase those goods (and, as noted above, to engage in financial speculation)—was one of the key foundations of the economic order over the last decade (Bello p. 282). The Chinese ruling class depended on subordinating the consumption of the working class and the giant peasant population to facilitate mass investment in industry. Over the last decade consumption as a share of GDP dropped from 46 to 35 per cent, while the share of investment increased 8 per cent.[6]

The low cost of labour translated into low-priced Chinese products. Chinese industrial output thereby helped ease inflationary pressures in its major export markets. Lower inflation in turn contributed to the strength of the financial sectors of the importing economies by helping to hold up the value of money (Schwartz, p. 183). Yet China also contributed to what Bello sees as a ‘crisis of global overproduction’, which has existed for the best part of four decades in the world’s manufacturing heartlands. Moreover, he argues that overproduction is inherent to the system: capitalism has a tendency to develop the forces of production faster than it develops the consumptive capacity of the population. This is the basis of system-wide crisis. However, the crisis of overproduction itself can be seen as a symptom of the decline in profitability that Veltmeyer noted in his essay. The falling rate of profit, a result of greater and greater investment in plant and machinery compared to value-creating human labour, leads to a decrease in productive investment. This is the basis of slower economic growth and higher unemployment. The consequence is a build-up of unsold commodities and the movement of capital into areas like financial speculation in search of higher returns.

Debt-reliant consumer spending has partially masked the underlying problem. With the expectation that US consumers will spend less as they pay down their debts, a key question is whether China will be able to restructure its own economy to increase the consumption of the population, which would help soak up the glut of manufactured commodities. Bello argues that to do so ‘would require a fundamental policy shift, and the government would have to go against the interests, both local and foreign, that have congealed around the strategy of foreign-capital-dependent, export-oriented industrialisation.’ Such an outcome is ‘highly fanciful’ (pp. 287-88). With the IMF concluding that ‘emerging economies are more “coupled” than ever with advanced economies’ and that their domestic markets will not grow in the coming period, Bello seems to be right.[7]

6 Eswar Prasad, ‘Rebalancing growth in Asia’, *Finance and development*, 46 (4), December 2009, www.imf.org/external/pubs/ft/fandd/2009/12/prasad.htm, accessed on 26 April 2011, pp. 18-19.

7 David Uren, ‘Busting the myth of “decoupling”’, *Australian*, October 11, 2010.

Politics and resistance

The human consequences of the financial crisis and its aftermath have been terrible. Mortgages on over six million houses have already been foreclosed in the US,[8] while almost 40 per cent of homes today are sold because owners can't pay their mortgage or have negative equity.[9] The number of unemployed people in the most developed countries is 15 million higher than in 2007.[10] The poor—disproportionately young adults, Blacks, Latinos, and the elderly—are suffering the most (Dymski p. 80, Montgomerie, p. 104).

The response of the capitalist class to the crisis has been decisive. First they engaged in a mass bail-out of financial institutions, handing over trillions to wealthy bankers while leaving the most vulnerable to fend for themselves. In an attempt to divert attention from this gross injustice, they engaged in what Susanne Soederberg calls 'the politics of smoke and mirrors' via spectacles such as the G20 London Summit. This gathering of the leaders of the countries with the largest economies pledged to 'do whatever is necessary' to, among other things, 'strengthen financial regulation to rebuild trust' and 'overcome this crisis and prevent future ones.'[11] In fact, Soederberg argues, world leaders left the previous regulatory architecture in place. The Summit's purpose was, like the bank bailouts, to shore up the very system that failed in the first place.

With financial sector debt taken over by states, through the bailouts, governments have turned at differing speeds and to differing degrees to austerity, pushing the burden of repayment on to the working class and the poor. It is a double hit: workers have to both pay off the debt on their own houses and the debt racked up by the institutions that advanced and profited from the mortgages in the first place.

Steve Fraser asks the question: 'Where are all the rolling insurgencies, the break-away political parties, the wave of strikes and boycotts, the infectious communal upheavals, the chronic sense of enough is enough?' (p. 317) It is no surprise that large-scale resistance was not immediate. On one hand, as Fraser himself notes, the material and ideological assault of the last several decades has left the working class demoralised and disorganised, transformed 'into a disaggregated pool of contingent labour, contract labour, temporary labour, and part-time labour' (p. 319). The political left is fractured, racism and nationalism have flourished; consumer culture has led to the dead-end of channelling 'desire into forms of expressive self-liberation', by which Fraser seems to mean a retreat into lifestyle politics and a search for individual fulfilment counterposed to collective action (p. 323). The acute form of the current crisis created something of a paralysis—and

8 *New York times*, 'The Foreclosure Crisis', editorial, October 14, 2010.

9 Suzanne Kapmer, 'US housing barometer points to danger', *Financial times*, March 24, 2011.

10 International Labor Organization, *Global employment trends 2011: the challenge of a jobs recovery*, Geneva, International Labor Office, table P2, p. 74.

11 'Global plan for recovery and reform', Communiqué from the London G20 Summit, 2 April 2009, www.g20.org/Documents/final-communique.pdf, accessed on 26 April 2011.

in country after country there were ideological campaigns stressing that ‘we are all in this together’ and ‘shared sacrifice’. As Samuel Brittan, writing in the *Financial times,* noted

> The trick of the … establishment is to turn discussion from ‘whether to’ into ‘how to’ questions. The media debate is on which government services to cut or on the balance between spending cuts and tax increases. Once the discussion has been channelled into these trenches the establishment has won.[12]

In Britain, 64 per cent could agree that “the scale of the cuts is essential for the government to balance its books”, according to a BBC Newsnight poll conducted in July 2010.[13] Yet the situation is contradictory. A clear majority in the same poll could also agree that ‘the government is trying to cut too severely’. In several European countries the same pattern emerged, while sizeable minorities or majorities accepted the need for austerity, large numbers approved of strike action and street demonstrations against the cuts. The situation is far from static. As Italian revolutionary Antonio Gramsci wrote: ‘Mass ideological factors always lag behind mass economic phenomena… therefore, at certain moments, the automatic thrust due to the economic factor is slowed down, obstructed or even momentarily broken by traditional ideological elements.’[14]

Those traditional ideological elements are not simply the ruling class press, politicians and economists. The most important reason for passivity has been the weakness of *organised* labour. Aronowitz argues that the problem in the US goes beyond the union leadership’s politics of class collaboration. Their complete reliance on the Democratic Party and the Congress to throw them a bone, something he describes as ‘the politics of distraction’, means that unions lack autonomy from capital and the state. This is the result of decades of deal-making with employers and government, the purging of communists and socialists during the cold war, and the continued suppression of rank and file militancy to this day. The union leadership’s belief that systemic opposition to capitalism ‘is tantamount to political and economic suicide’, left the US working class ‘invisible in the public sphere and to itself as a class’ (p. 337-38). While this is an overstatement—the 1997 UPS strike, for example, was both a victorious rebellion and a national news story—there is no doubt that at the time the book was sent to the publishers, US labour was still very much on the defensive.

Yet the very elements noted as factors contributing to the early passivity also generate instability. The declining rate of unionisation doesn’t axiomatically mean lower levels of struggle (France, with one of the lowest unionisation rates in Europe is testament to this). While the loss of experienced shop stewards and the aging of the membership are

12 Samuel Brittain, ‘Are these hardships necessary?’ *Financial times*, June 18, 2010.

13 Nigel Stanley, ‘An important poll on the cuts’, 27 July 2010, www.touchstoneblog.org.uk/2010/07/an-important-poll-on-the-cuts/, accessed 12 October 2010.

14 Antonio Gramsci, ‘The modern prince’ in Antonio Gramsci *Selections from the prison notebooks*, International Publishers, New York, 1971, p. 168.

problems, there is also potentially less bureaucratic hindrance from officials and organised reformists who carry on about the fines, laws and restrictions associated with taking industrial action and the need to 'box clever' etc. Those who are more politically backward, disorganised and less disciplined can move into action more freely, having fewer concerns about the ramifications of their actions. These factors, together with high levels of youth and long term unemployment, mean that the situation is more unpredictable and possibly more explosive.

Konings emphasises, in the opening essay of the book, that 'Power always has constraining effects, but it can never fully eradicate the subjective powers and agency of the oppressed... [T]he real moment of political possibility lies… in the lived experience of the contradictory effects of power.' (p. 29) Militant resistance to austerity has spread in several European countries while significant struggles have erupted in the US. North Africa and the Middle East have seen the daily indignities associated with rising food prices, high unemployment and dictatorial regimes channelled into a revolutionary wave that has lifted the confidence of the mass of the population, inspiring people the world over.

Governments' policies will increasingly push workers and the poor to fight for their rights—and their survival. Further, if victories begin to mount, the confidence to demand more will be the greatest spur to further action—as the dynamic of the Arab revolutions demonstrates.

But the success or otherwise of resistance to neo-liberalism—and ultimately the victory of the revolutionary movements such as those in Tunisia and Egypt—will depend on whether mass parties with a socialist vision are built. Panich and Gindin conclude in the final lines of the volume, 'However deep the Crisis and however widespread the outrage, this will require hard and committed work by a great many activists… It ain't over till it's made over.'

The great credit crash offers a wealth of information and perspectives, but it has weaknesses. The issue of whether the contradictions of a particular model of accumulation—neoliberal capitalism—are the core of the problem, or whether there is a deeper crisis in the system, which led to the turn to neoliberalism, is one of the most intriguing debates at the moment. Do we need a non-neoliberal capitalism, or do we need to get rid of capitalism altogether? This question is barely alluded to in this volume. Many of the contributors endorse some form of underconsumptionist theory of crisis, but there is no essay critiquing these perspectives. Although contributors stress the global (or at least North Atlantic) nature of the crisis, the political contributions are primarily North American and, especially in the wake of the struggles against attacks on workers in Wisconsin during February and March 2011, their tone seems too pessimistic. Konings has nevertheless put together a volume worth reading.

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