

Capitalism At a Turning Point?

Introduction

It appears that world capitalism may be at a turning point in its economic development. In the past, the most conscious element of the workers' movement – Marxism – at times was unable to successfully cope with such turning points. It did not anticipate these points and was unable to adapt to them. The most famous example was the rise of World War I (except for the Bolsheviks in Russia). Again, after WW II this happened (except for a tiny group in Britain), and it was the case again in the period that opened up in the early 1980s. Basically, Marxism's perspectives were wrong and it was not able to correct them in time. In the case of the 1980s, not only did the Marxist movement not expect the economic expansion of the following 25 years, it also didn't expect the Stalinist countries to return to capitalism. In this last case, they cannot be condemned for this, since neither did the strategists for the capitalist class. However, Marxism failed to sufficiently recognize their mistakes and to adequately revise their perspectives. This caused mistakes in their estimate of the consciousness and how it would develop as well as in their program, strategy and tactics. In a sense, it caused them to march out of step with the times and led to general confusion and disorientation within their ranks.

Now, the crisis in the US housing market continues, along with the resulting turmoil in the worldwide financial sectors of the capitalist economy. It appears that the prolonged economic expansion from the early '80s to the present may be coming to an end and a new, less stable period in the capitalist economy may be opening up. Even if this is not about to happen right now, the outlines of the end of this period can be seen more clearly.

25 Year Expansionary Period

In order to get a better clearer view of what is developing, it is useful to look back at this last 25 year period and what was the basis for the economic expansion. There were a series of factors that led to this expansion:

- 1) The first was the development of high tech. As was the development of the railroads in a previous era, this was a real development of the forces of production, and it massively stimulated the world economy.
- 2) The rise of high tech was one of the factors that helped make possible the famous "globalization" of the world economy. This partially and temporarily overcame the contradiction of nation state in the era of the world economy. One statistic serves to show what happened: From 1980 to 2002, real world trade rose from 16% of real world output to 29%.
- 3) A third factor was, ironically, the weakness of the world's labor movement, especially in the industrialized countries. This was partly caused by the globalization of the world economy, which intensified the competition between workers in the industrialized countries and those in the underdeveloped world. The fact that the labor leaders continued to cling to a nationalist outlook meant that the unions were unable to deal with this increased competition. For the capitalists, this meant increased profits and increased "labor peace". This partially and temporarily overcame the tendency for the rate of profit to fall, and increased their motivation to invest in the productive forces. (It is ironic that for capitalist growth, lower wages and increased suffering is often necessary.)
- 4) Normally, a cut in workers' income would mean a significant reduction in the capitalist market, that is to say in "effective demand." However, along with this cut went an enormous expansion of credit – debt. This includes corporate debt, consumer debt and government debt. Just one example illustrates this: From 1980 to 2005, US consumer debt went from 69% of disposable (after tax) income to 127% of that disposable income. This partially and temporarily overcame tendency to overproduction.

5) The continued expansion of the '80s helped along the collapse of Stalinism. This, in itself, helped the expansion along as it opened up vast new markets for capitalism as well as new areas for capitalist investment.

Thus, we can see that while each of these was a factor in their own right, they also combined with the other factors to help the expansion along.

US Capitalism Dominant

Also, connected with this was the financial, political and military domination of US capitalism. While US capitalism used this to its own advantage, this domination was also a factor in keeping the expansion alive. This was so when we look at the world currency system. When doing this, it helps to look back in time a little bit to see what this system means and how it developed.

While capitalism has been based on an international economy for a long time, still the domestic currency systems can help to understand the world currency system. Take the United States, for instance:

Finance Capital

The 19th century in the US saw the rise of industrial and then finance capital. This century was punctuated by regular financial crises in which credit (debt) contracted and the economy ground to a near halt. The graph below of the purchasing power of the dollar illustrates this process. In order to fully understand this graph, though, it is necessary to understand the relation between the purchasing power of the dollar, the "money supply" and credit.

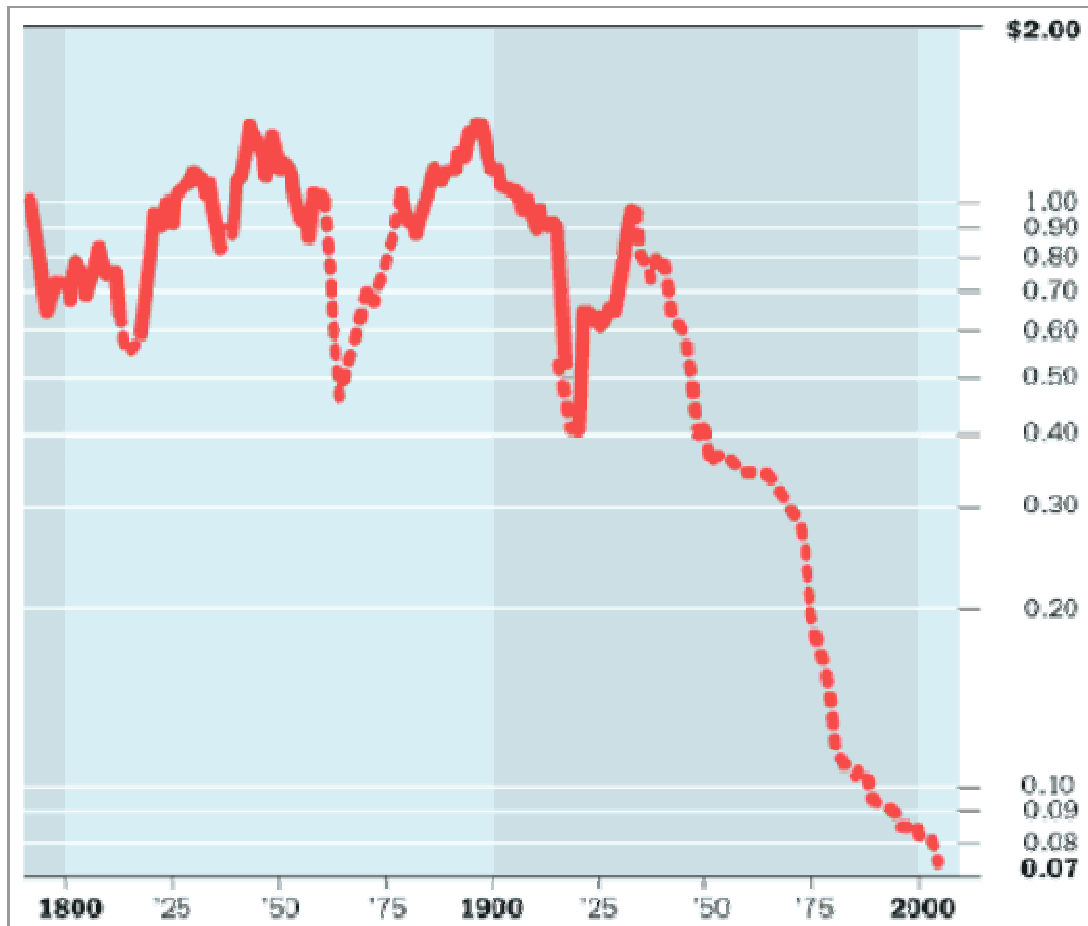
"Money Supply"

Money supply is not simply the absolute number of dollar bills (and 10s, 20s, etc.) in existence. It reflects the amount of debt present. For instance, consider the process whereby a person opens a bank account of \$10,000. The bank then turns around and loans out eight of those ten thousand dollars. The borrower therefore has an additional \$8,000, but the original depositor is still considered to have \$10,000. The money supply has been increased by \$8,000.

Another way of looking at this is that there is an additional \$8,000 out there chasing around after goods. Both individuals, for instance, may be planning to use their money to put a down payment down on a car. If there are more cars produced than before, this is no problem. However, if production doesn't rise as much as the money supply, then this will have an inflationary tendency. Another way of saying the same thing is that the purchasing power of the dollar will decline.

The long and the short of this is that when credit expands (thus increasing the money supply), the purchasing power of the dollar tends to decline (if there is not an equivalent increase in production), and when there is a contraction of credit, the purchasing power of the dollar tends to

increase (as the money supply decreases).*



Currency Regulation

When we look at this graph, we can see that all throughout the 19th century, there were regular financial panics in which credit contracted (causing the money supply to decrease and, therefore the purchasing power of the dollar to increase, among other things). In 1913, however, as finance capital came into its own, the US

central bank, the Federal Reserve Bank, was brought into existence. (The history of the political struggle to create this bank is an interesting story in its own light.) It took several decades (and a new economic crisis) for the regulators of finance capital to fully understand how to use this tool, but by the early 1930s they gained this understanding. One can see that after this, there was never a severe credit contraction again; the flip side of this was that the purchasing power of the dollar never stopped falling.

*- Measurement of the money supply is taken in three forms – M1, M2 and M3. M1 measures money in the most “liquid” accounts – those accounts such as checking accounts, from which money can most easily be withdrawn. M2 includes M1 and some slightly less liquid accounts. M3 includes M2 plus certain international deposits. For our purposes, it doesn’t really matter which measuring stick we use, since it is the overall trend we are looking for, but with one proviso: International deposits have increased as a proportion of the total US money supply. This means that the growth of M2 actually underestimates overall money supply growth. It is interesting that the Fed recently stopped publishing the M3 figures.

Another way of putting this is that a slow, steady inflation has continued ever since then.

This is not a real problem for the capitalists, just so long as this doesn't get out of control. Money is the means of measuring relative (exchange) value – the proportion in which different commodities will be exchanged with each other (including the commodity of labor power). Since capitalist production is for the market, this means that the capitalist has to be able to predict what the purchasing power of the dollar (or yuan or peso or euro) will be in the future. As long as inflation is regular, the capitalist can take this into account when he or she makes a contract for future sales or purchases.

International Currency Systems

The rise of finance capital and rise of imperialism brought about the necessity for international currency stability. Not only did the capitalist have to be able to know what the future purchasing power of his or her own country's currency would be, he or she also had to have some idea what that would be in relation to different currencies. Obviously, if the value of the dollar drops sharply and unpredictably in relation to the euro for instance, and a German capitalist is selling goods in the US which are made in Germany, then they will have no real idea what kind of price they will be getting in euros at the end of the day, since the sale is in dollars which will then be converted into euros.

Capitalism has to have a stable and reliable world currency system. If it doesn't then the capitalist class cannot count on future prices and profits, which really means that they cannot produce. Or at least this will sharply limit what they can produce.

At first, most major currencies were measured in relation to the British pound. This reflected the dominance of British capitalism. By the end of WW II, US capitalism came to replace the British. Naturally, this had to mean that the dollar would replace the pound.

Bretton Woods

In 1944, at the Bretton Woods conference, this accomplished fact was recognized by the treaty of that name (Bretton Woods Accord). Under this treaty, all the major capitalist world currencies were measured in terms of the dollar; their value was set within a certain narrow band in relation to the dollar. In turn, the value of the dollar was set at \$35 to an ounce of gold. The US agreed that it would give gold at this price to any foreign central bank that wanted to cash in its dollars.

Naturally, as is befitting of any national capitalist class, the US capitalist class used this situation to gain an advantage over its allies (who were also its rivals). It started to flood the world with dollars. In effect, it forced the other capitalist countries to help finance the concessions the US capitalist class was making to its own working class. Also, it forced the other capitalist countries to help finance US imperialist adventures, including the Vietnam War.

“Bretton Woods II”

By the late '60s, this arrangement threatened to come apart, and in 1971 US capitalism took another step: It reneged on its promise to exchange gold for dollars. As analysts put it, then-President Nixon “closed the gold window.” World capitalism was stuck holding dollars. The value of the dollar was left to “float”, meaning that the world financial markets would determine its value relative to other currencies (as well as to gold).

Flooding the World with Dollars

US capitalism then took even further advantage of this and further increased the money supply of dollars. The recent period (1980 to the present) really exemplifies this process. The process was that the US imported massive amounts of goods, sending dollars out all around the world. The foreign holders of these dollars then turned around and invested these dollars in US Treasury notes (among other things), thus lending the money back to the US. They recycled the dollars into the US in the form of loans.

There is not another country in the world which could have gotten away with this. What would have happened (and what has happened) is that the currency of any other country would have been unacceptable in the world currency markets. It would have collapsed in value. Even that country's domestic capitalists would have been converting their money into other currencies and shipping it out of the country by the shipping container load. Massive, uncontrollable, triple and even quadruple digit inflation would have occurred. (In fact, this is exactly what has happened in several Latin American countries in the past.)

Unique Position of the Dollar

Why didn't this happen with the dollar?

In the first place, each foreign capitalist who held dollars, and even more important, each central bank, was terrified of starting this process. The minute they started cashing in their dollars for yuans or euros, others would have followed suit. The value of their remaining dollar holdings would have collapsed before they could get rid of them all.

Second, and even more important, this would have completely destabilized the world currency system, leading to a financial and economic crisis.

Inflationary Pressures

A side effect of this has been to increase the pressures for inflation. From 1980 to 2007, the US gross domestic product rose by 111%. During those same years, the money supply as measured by M2 increased by 362%. The growth in the amount of dollars was well over triple the growth of US production. This process was not confined to the US. In the EC, the GDP increased 27% between 2001 and 2007, while the money supply as measured by M3 grew by 35%. In China, from 1999 to 2005, those figures are an 87% increase in their GDP and a 142% increase in M2. (It should be noted, however, that the figures for the Chinese economy are not considered to be completely reliable.)

The reason this did not result in major inflation within the US was the massive international competition within the US market. Every foreign producer was competing for a share in this lucrative market. However, there was one major sector of this market which was hardly subject to international competition: The US housing market. There is a limited supply of land, and housing pretty much has to be produced within the country. As a result, there was massive inflation in this sector.

Finance Capital, Credit & Speculation

It should also be noted that there are two main sectors of capital – industrial and finance capital. In the modern era, finance capital has come to dominate. As Alan Woods has noted, this process has increased in this present period. In the period from 1950-60, earnings of the banking sector in the US represented something between 10-15% of total company earnings. In 2006, that figure was something between 30-40%. Not only that, but there was a tendency of an actual merger between finance capital and the state itself in some cases. In many of the oil exporting nations, the oil industry is nationalized. Other major industries are also nationalized in some of the former Stalinist states (including China). Their exports have led to massive investment funds – “sovereign investment funds” – owned and controlled by the state itself. These funds (also called “black box funds” because outsiders really don't know where they are invested), amounted to \$2.5 trillion in 2007 – greater than the entire amount of hedge funds in the world. This figure is projected to grow to \$12 trillion by 2015.

The hand maiden of credit and trade is speculation, and along side of increased production, there was massive speculation during this period. The inflation of the US housing market entails this, obviously. But also, as explained, this process partially and temporarily overcame the tendency towards overproduction.

Recognition of Accomplished Fact

It should also be stressed that the role of the dollar was not simply agreed to through rational discussions at a conference in Bretton Woods. On the contrary, that conference simply recognized and codified what was already an accomplished fact. That fact was accomplished and then recognized through, among other things, two world wars as well as a revolution (the Russian Revolution). The various different national capitalist classes had to be convinced of the might of US capitalism through actual, concrete experiences; it had to be tested and proven on the economic, political and military battle grounds before it was accepted.

Once established, however, this role of the US as carried out in part by the role of the dollar, helped to create a certain world capitalist order in which international production, trade and finance could be carried out; it helped partially and temporarily overcome the contradiction of the nation state in the era of the world economy. (Just because this was accepted doesn't mean that there are not continued conflicts. After all, there are limits to this power, and US capitalism's rivals must continually test these limits.)

New World Currency Order?

This makes all the more significant a recent article in the Financial Times entitled "The Last Lap of the Dollar." According to this article, the role of the dollar as the world's measure of all other currencies is now ending. One possible outcome that it predicts is a tripartite role for the dollar, the euro and the yuan. On the one hand, this will be a much less stable arrangement. (This, in turn, will simply reflect less stable world relations between the capitalist powers.) On the other hand, if the role of the dollar was only arrived at through wars and upheavals, then it is safe to say that any new arrangement will also involve the same process. This means an end to the relative economic (and therefore also political) stability of the recent period.

Factors Turning into Their Opposite

All the factors that created this economic period are either being weakened by other factors or are turning into their opposite.

- The growth in high tech, which continues and has meant an actual increase in production, is being countered by the early effects of global warming, especially as seen in world food production, which significantly decreased in 2007, leading to something like a 1/3 reduction in world grain and corn supplies and a 52% increase in world wheat and vegetable oil prices.
- The globalization of the economy is being weakened by the early effects of peaking oil supplies. This has led to a doubling in transport costs in 2007 alone.
- The weakening of the unions and resulting cutting of wages is now starting to weaken effective demand. For instance, the Japanese economy has seen the beginnings of a recovery in recent years. However, this recovery has been extremely limited. The main reason is that most of the hiring done has been for temporary workers, at a vastly reduced wage, thus reducing the domestic market.
- The massive expansion of credit and debt is now having the opposite effect from before, as seen in the housing crisis in the US.
- The opening of new areas for capitalist development (especially China and Russia) is now meaning the rise of new rivals, thus destabilizing world relations, meaning less secure profits. This can be seen throughout Latin America, especially in Venezuela, where Chinese capitalism is making significant inroads.

Housing Crisis & Speculative Bubbles

The ongoing crisis in the US housing market is but the latest collapse of a speculative bubble in this economic period. Previously, there were the collapses of the dot com boom and of stock market booms. What makes this collapse more severe is that in each previous collapse, the Federal Reserve Bank pumped massive dollars into the economy and also lowered interest rates. Both of these actions put downwards pressure on the dollar. At some point, it was inevitable that

they could only go so far without risking an outright collapse of the dollar. It seems that that point may have been reached now.

In this particular case, housing prices were escalating at double digit rates per year. Home buyers were rushing into the market so that they wouldn't be left out of this bonanza. Also, the longer they waited, the more a home would cost them. This "inflationary expectation" further accelerated the process.

What did it matter if the buyer could scarcely afford the home? In a year or so, they could refinance, based on the increased value of the home. Once this process started to stall, though, then millions of buyers were in trouble.

There has been a lot of talk in the media about sub prime loans, almost all of which have adjustable mortgage rates. These loans, made to people who are greater credit risks, have an initial low interest rate. After several years, this interest rates adjusts up and the buyer's monthly house note vastly increases. These loans were made on the assumption that house prices would continue to escalate. If they did, then the borrower would have a certain amount of equity in the house based purely on this increased paper value. They could then get a new loan, with a lower monthly payment, and thus the house would be affordable. At the same time, home owners were taking some money out of the house – getting new loans based on their increased equity. They were using this money to buy cars, clothes, etc. This process played a big role in keeping the US economy rolling along.

The problem was, though, that the inflation of housing prices could not continue indefinitely.

It should be stressed that the great majority of these adjustable rate mortgages were made relatively recently. The great majority of the loans whose payments will be adjusted up are yet to happen. This means that the housing crisis will get worse before it gets better.

New Period Opening Up?

It is too early to be certain, but it seems that we are seeing the end of an entire economic (and therefore also political) period. In the short term, a recession seems increasingly possible in the US (and possibly globally). In December of 2007, unemployment reached 5% in the US. (Such a recession, if it happens this year, would probably seal the fate of the Republicans in the coming elections.) As pointed out, in previous similar situations, the Federal Reserve had more room to maneuver by cutting interest rates and pumping more dollars into the economy. These steps tend to lower the value of the dollar, though. This is now a serious concern for them. It is why the Fed was so reluctant to cut interest rates when the housing bubble first broke in 2007.

Given the massive debt that has arisen, a recession could have very serious consequences for the US and the world economy. Militarily, US capitalism is obviously overextended. This is also true financially, as far as the the dollar is concerned. Previously, this extension of power lent a certain order to the world; now its overextension is having the opposite effect.

It is important to avoid the mistake of seeing every problem in the economy as meaning the end of the expansionary cycle. However, it is also important to be able to see the handwriting on the wall when this cycle comes to an end. There is increasing evidence that this is what is happening now. Not only that, but the means of lessening the severity of the problems have been weakened.

Increased Friction and Fragmentation

In the longer term, we can see more clearly the meaning of the rise of the rivals to US capitalism. Included in this would be the further increase in frictions and a tendency towards military conflicts and wars. In the absence of a mass, anti-capitalist movement of the working class, it will also mean increased fragmentation within societies. This will mean increased ethnic and communal struggles (mainly in the underdeveloped world). We see this, for instance, in an increased separatist movement within the Sind province of Pakistan (partly as a reaction to the

assassination of Bhutto). In the industrialized world, a similar development will be seen in increased attacks on immigrant workers.

Global Warming

Especially in the underdeveloped world, global warming will exacerbate this tendency. Reduction in food production will exacerbate these ethnic rivalries. Also, if the seas rise significantly, it will tend to make low lying lands unlivable (for example in Bangladesh). If this happens, it will tend to cause huge migrations and increased frictions.

Also part of this process will be increased blunders by the capitalist class. Falling victim to its own propaganda, it marched into Iraq with a relatively small number of troops, believing it could easily pacify and dominate the country. Even its own representatives now recognize that this was a blunder. In the economic arena, it is liable to make similar blunders. It actually believes that the "free market" can resolve all problems. Following the collapse of the stock market in 1929, it held a similar belief and had to learn from experience that some form of state intervention was necessary. However, the US capitalist class has forgotten that lesson and again believes that the housing crisis and resulting financial turmoil can be corrected by just letting nature (the "free market") run its course. (See the quotes in the appendix from Andrew Mellon and Alan Greenspan, for instance.) Similar blunders can be expected in the future. This will also be true as far as its attacks on the working class.

Working Class Movement

Within the world's working class, among older workers, many of those who best represent the socialist traditions of the past have taken a step backwards in the recent period. They have resigned themselves to what appeared to be an inevitable process. Horrified at the fragmentation in society, and also feeling forced economically to take action, some of these sectors will be forced to step forwards once again.

This will be connected with a revival of willingness to fight amongst a layer of younger workers. This revival will play a huge role in stimulating the older workers. Amongst other things, the traditions that the older workers carry will seem more in step with the times once again. And the younger workers' energy, audacity and openness to new ideas (including about the environment) will play a huge role in any new movement. This process will also be marked by an increased questioning and a more serious search for an understanding to the world situation.

Marxism

It will mean a significant increase in the opening for the explanations of Marxism, provided that Marxists are prepared to both connect with the real struggle as it actually develops and that they are able to give a serious explanation of developments.

Period of 1970s

While there are important differences, there could be some similarities with the period of the '70s and early '80s. That was when the post WW II boom came to an end and class struggle increased. However, mainly due to the role of its leadership, the world's working class was unable to overthrow capitalism, and capitalism was able to stabilize itself and a new period of capitalist growth followed.

New Arenas for Growth?

Can there be such an outcome again? Are there potential new arenas for capitalist growth?

On the one hand, there is the potential for a significant rise in "green" technology. In the United States, for instance, solar electric production increased by 30% in 2004-5 alone. The rise of the stock price of First Solar, Inc. shows the potential for profits in this sector. In 2006, First Solar went public and its stocks sold for \$20 per share. By the end of 2007, its stock was selling for \$215 per share. (Whether the rise of this sector will mean that serious effects from global warming won't be felt is another question.)

In addition, there is Africa. This is the continent that has hardly experienced the development of the economy of this period. Presently, there is the beginnings of investment into Africa, especially from China. If this process continues, it could mean a new arena for capitalist investment and for the capitalist market.

In both these cases, of course, the effects will very possibly be limited by the effects of global warming as well as of peak oil. More important, however, such a future capitalist development can only be achieved at the cost of massive repression and suffering. It is up to the workers' movement, along with its most conscious element – Marxism – to create the conditions to transform society. Only on this basis can the suffering from environmental pollution be limited and future disasters prevented. Only on this basis can the looming problems be resolved.

Statistics

Global

Gross World Product

1980 = \$26.8 Tr (in 2004 \$s) = \$ 6,042/person; 2004 = 55.9 Tr. = 8,753/person= 108% increase

Real world trade as a % of world output:

1980 = 16%

2002 = 29%

World stored supplies of wheat = 12 weeks
consumption

Corn supplies = 8 weeks

Average 2000-05 = 11 weeks

Average 2000-2005 = 18 weeks

(source: UN Food and Agricultural Organization)

Wheat & oil seed up 52% or \$130/ton in last year.

2X increase in shipping costs in last year. (*The early effect of peak oil.*)

Apx. 70% of China's \$ holdings are in T notes and other gov't. notes. It's (& others') recycling of US \$s made possible the housing bubble by keeping interest rates low through adding \$s to US economy.

in the eurozone: the ratio of financial assets to gross domestic product jumped from 180 per cent in 1995 to 303 per cent in 2005. Over the same period it grew from 278 per cent to 359 per cent in the UK and from 303 per cent to 405 per cent in the US.

Sovereign Investment Funds ("Black Box Funds")

2007 = \$2.5 tr.; 2015 (projected) = \$12 tr.

Total estimated loss from "credit contraction": \$300-500 billion = 1% of total global output

US housing crisis

Sub prime lending

1996 = \$0

2004 = \$450 bn.

2006 = \$624 bn. = apx. ¼ of all new mortgages

Total value of mortgages in US: 2000 = \$4.8T; 2006 = \$9.5 T

US homeownership levels

historic level 60%

2005 = 70%

Number of foreclosures expected:

2007: >1 million; 2009: 20 million

US

11/29/07 US federal debt = \$5.1t = only 35th largest in world as % of GDP

Per cent of US public debt in hands of foreign governments: 1988 = 13%; 2007 = 25%

US public debt: 1980 = \$930 bn.; 2007 = \$9 tr. = almost 10X increase

Banking sector earnings as % of total US company earnings:

1950-60 = (apx.) 15-20%;

2006 = 30-40%

US Gross Federal Debt

US GDP, 1980-2007: increased by 111%;

as % of GDP: 1980 = 33%; 2007 = 70.2%

US money supply (M2): 1980-2007: increased by 362%

US consumer debt as % of disposable income:
1980=69%; 1990=83.8%; 2000 = 96.8%; 2005 = 127.2%

European Community

GDP: 2001-2007: increased by 27%; EC money supply, as measured by M3 grew by 35% between 2001 and 2007; most recent figures indicate that it is growing by over 10% at an annual rate.

From 1999 to 2005, the EC averaged a 6.9% positive account balance as a % of the GDP. (That is, their foreign account was on average in the black by 6.9% of their GDP.)

12/18 – ECB announces loan of up to almost 350 bn Euros to European banks shore up their reserves.

China

GDP: 1999 = 8 trillion yuan; 2005 = 15 T. Yuan = 87% increase

Money supply (as measured by M2): 1999 = 117638 million yuan; 2005 = 284832 million yuan = 142% increase

(Note: Some economists do not consider China's economic figures to be accurate; they believe that the GDP figures are significantly overstated.)

Famous Last Words

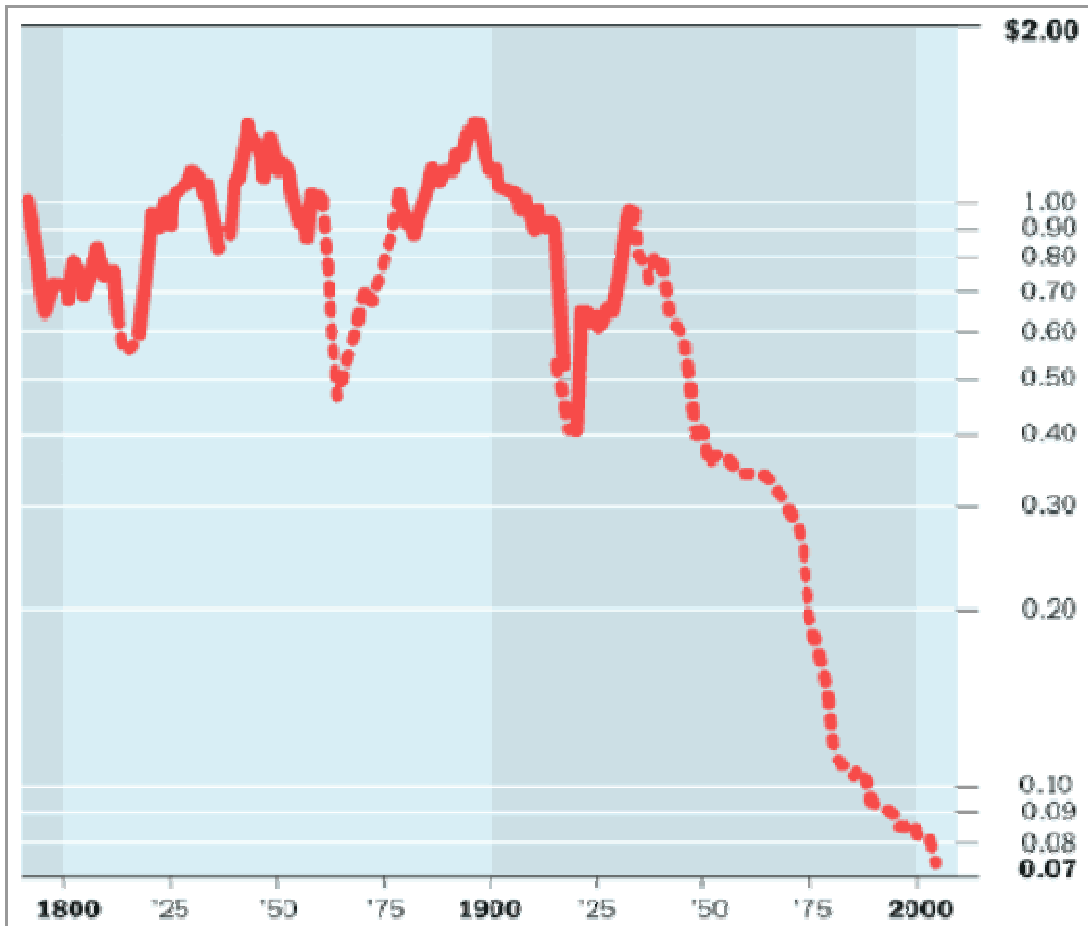
"It is well enough that the people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning." Henry Ford, Sr. (as quoted in "Secrets of the Temple" by Wm. Greider)

"Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate. It will purge the rottenness out of the system." Andrew Mellon, Secretary of Treasury, 1930.

"the selling climax... is necessary to end the current crisis." Alan Greenspan, 2007

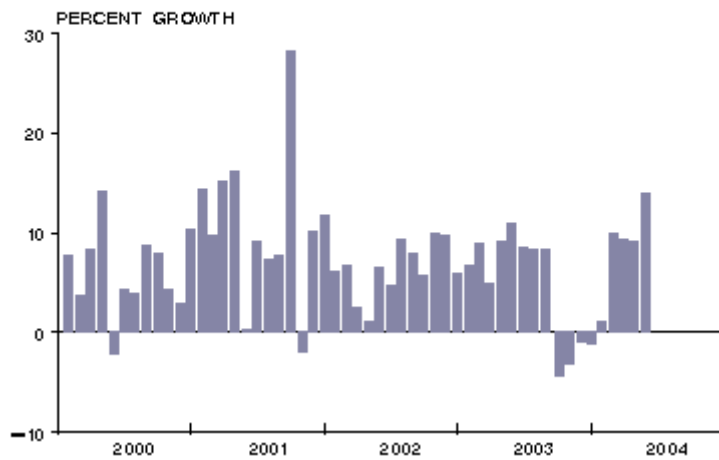
From Bloomberg.com **4/07**: *"Prices of U.S. imports rose last month by the most in almost a year, led by gains in crude oil and natural gas that **are likely to keep the Federal Reserve from cutting interest rates.**"* This means that the market pressures are for increased interest rates; growing turmoil forced the move in the opposite direction.

Purchasing Power of the Dollar



M2

M/M ANN, SEASONALLY ADJUSTED, PERCENT GROWTH



Composition of Money Supply

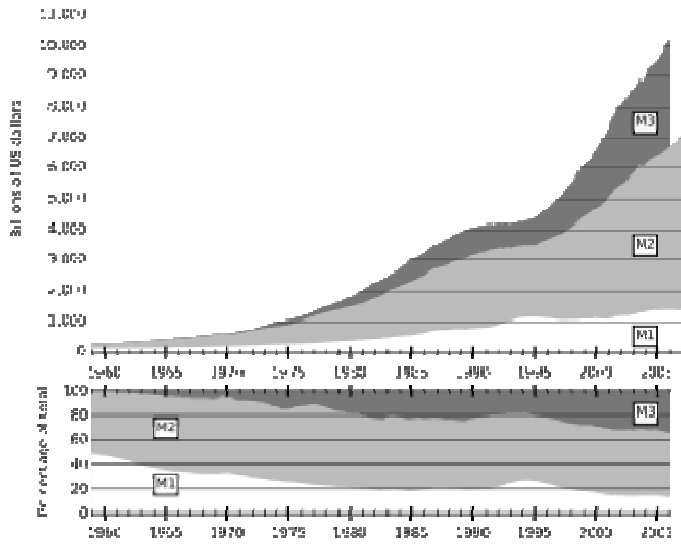
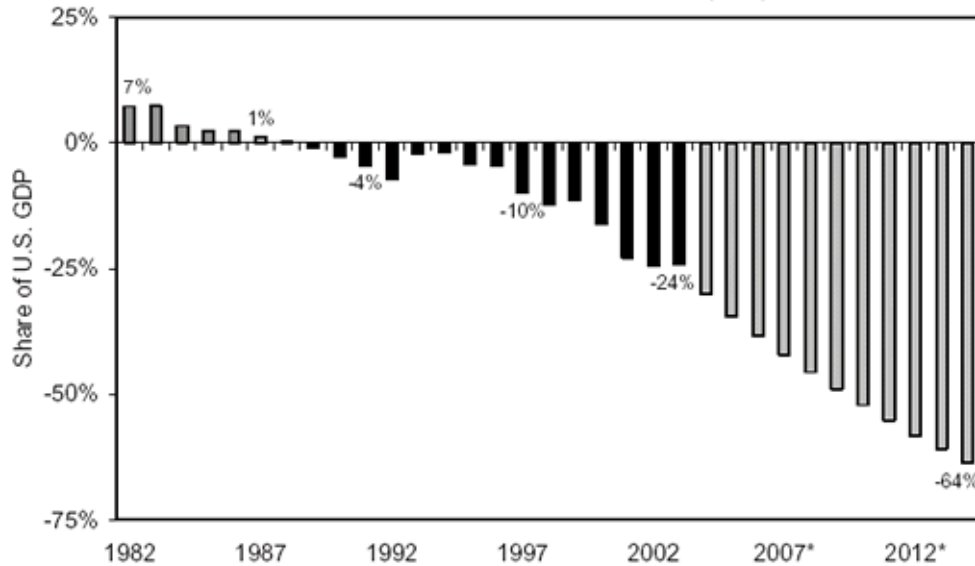


FIGURE 1

Year-end Net International Investment Position (NIIP), 1982-2012



* Forecasted value.

Sources: Bureau of Economic Analysis (BEA) and author's calculations.