Theorizing the Crisis
(Notes to accompany the slide presentation)
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The point of departure for theorizing the crisis is the actual crisis itself.

In the Contribution (1859), Marx wrote that economic transformations can be "determined with precision of the natural science." I'm not sure we're up to that standard, but it is always good to start with some sense of the empirical dimensions of the crisis in the historical context.

This graph shows global GDP/capita in the last 50 years. The data is from the IMF's most recent World Economic Outlook (October 2009, www.imf.org). There are serious issues with GDP as a measure of capitalist production, let alone as a measure of social wellbeing, but let's use it as a rough approximation.

Taking the data at face value, there are three facts that stand out. First, historically speaking, overall, in terms of its trend, the capitalist mode of production continues to exhibit a remarkable dynamism. Second, the actual postwar trajectory of capitalism looks turbulent. In fact, less turbulent than in the prewar period or in 19th century capitalist history, but with a significant upswing in the trend during the 1960s, an inflection down from the mid 1970s to the early 1990s, and another pronounced upswing from the mid 1990s that ended with the current crisis.

And third, as many people have noted, the crisis following the August 2007 financial panic is the sharpest downturn in postwar capitalist history.

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This graph, annual percent change in world GDP/capita, shows another angle.

From peak to trough, we're talking (roughly) of a drop of 6.5% in world GDP/capita, just a bit short of $500/person on average. Considering how unrepresentative these averages are, how unequally the effects of the crisis are distributed globally, across social classes, this crisis is an unmitigated catastrophe for working people.

The curvy dotted line is a 5-year moving average smoothing of the series. (Business cycles, at least in the rich countries, last 5-years on average.) One can, tentatively, argue that -- over longer periods of time -- the growth rate of output is a proxy for the rate of capital accumulation, itself correlated with the average profit rate. So we can take that curvy dotted line as indicative of the trajectory of capital accumulation and of global capital's average profitability during the period.

If we take the last 50 years and rely on these statistics, the average profit rate of global capital trended down.

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This graph shows the annual percent change in world international trade. Very dramatic drop as a result of the crisis. These data suggest a serious reversal in the "globalization" tendency that accelerated during the 1990s and 2000s. This doesn't mean that things will necessary revert to the levels of capitalist economic integration of the early postwar, but it is indicative of how the global reproduction of capital has been disrupted.

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This graph limits the series to the last 30 years, and breaks down the aggregate growth rate of real GDP into "advanced" and "emerging" economies. This is the IMF classification. Now, these data are not per capita, and poor countries have a higher population growth than the rich ones. Still, the differences in average growth rates and trend slopes are substantial. Inevitably, what comes to my mind when I look at graphs like this is Marx's cryptic statement in the preface to the 1st German edition of Capital, volume 1:

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"The country that is more developed industrially only shows, to the less developed, the image of its own future."

Of course, much in that divergence in the growth rates can be explained by China's industrialization. And one can argue endlessly about the social nature of China, but I don't think there are many people who doubt that China's remarkable growth in the last few decades was associated with the expansion of capitalist production in China. I am not saying that China industrialized in a "pure" capitalist fashion, whatever that may mean. I'd say that it's a hybrid type of capitalist production, but capitalist production nonetheless.

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This chart offers a partial picture of the economic state of the global working class. I don't have 2009 unemployment rates for the global economy or at least the largest economies, but these are the rates for the 30 OECD countries in 2007 (OECD data). The average OECD unemployment rate in 2007 was 5.6%. Now, again, peak to trough, the world economy (real GDP) contracted by 6.5% points or so as a result of the crisis.

There's a well known economic regularity, called Okun's Law, based on the U.S. economic experience. Roughly speaking, Okun's Law says that a 2% drop in real GDP (in fact, actual GDP compared to potential GDP) is associated with a 1% increase in the unemployment rate. I don't know what the level of "potential GDP" is now. What I know is that, from 2007 to 2009, real U.S. GDP declined like 2% (BEA figures) yet, over the period, the unemployment rate increased from 4.5 to 10% -- this is an increase in unemployment of 5.5%, not of 1% as Okun would have predicted.

But let us use Okun's Law to get an estimate of the impact of the crisis on global unemployment (assuming that actual GDP in 2007 was not so far off the potential in the next two subsequent years). We are talking about an average increase in global unemployment of 3.2% or so. In other words, at least 215 million people (workers and their families) have been directly, immediately affected by the job losses. That is a lot of global misery.

The only upside to this situation, to the extent one exists, is – of course – that the views of Marxists about the conflict-ridden and crisis-prone nature of capitalism have been amply vindicated, after the ideologists of capital claimed that, thanks to the buildup of macroeconomic theory, policy making skill, and a dash of luck, capitalism was now experiencing a Great Moderation.

We can only hope that, after decades of demonization, the political and ideological environment may now be more favorable and receptive to the diffusion and critical development of Marxist ideas.

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I look now, retrospectively, at the sequence of events leading to the crisis. We start at the present situation (1).

The current situation follows from (2) the massive freezing of credit, which has turned into a slow but devastating process of deleveraging or unraveling of the global debt markets. Especially in the rich countries, banks, other businesses, and households -- more painfully those at the bottom of the social ladder -- are doing major surgery to their balance sheets. According to estimates by the McKinsey Global Institute, using historical benchmarks, it is expected that the deleveraging process will be protracted (6-7 years) and that debt/GDP ratios will drop 25%!

I must say that this disintegration of the credit markets could have been much worse were not for massive government interventions. First, we have a series of bailouts & gov't guarantees intended to prop up or partially nationalize private financial institutions. (The U.S. and U.K. cases stand out.) Then, public spending has increased substantially. The IMF data show a 12.4% increase in the deficits/GDP ratio in the "advanced economies." Then we have massive monetary injections by central banks.

The unraveling of the credit markets followed (3) the August 2007 financial panic and the subsequent instability in the global financial markets, as a result of the collapse or near collapse of large financial institutions, like Lehman Brothers, Bear Sterns, WaMu, AIG, Citi, etc.

In turn, the financial panic resulted from (4) the burst of two mutually reinforcing, huge, global bubbles: a bubble in asset prices (especially real estate, but also stocks and, belatedly, commodities) and a huge credit bubble. Again, these two bubbles reinforced each other: inflating asset prices fostered leverage, and leverage fed back into asset demand. Now they are both unraveling also in mutual reinforcement.

Although, as I said, these bubbles were global in nature, they were proportionally the largest in the rich capitalist countries. Again, according to the McKinsey Global Institute, in the core of the capitalist world (U.S., Japan, Germany, France, Italy, Switzerland & Canada), debt/GDP went from (roughly) 210% in 2000 to > 300% in 2007. In large emerging economies (China, India, Brazil & Russia), over the same period, debt/GDP stayed flat at around 100%.

This suggests that there's a chance of some "decoupling." Clearly, the poor economies are exposed to global systemic risk, which increased tremendously as a result of these bubbles. But still, the emerging economies may be able to limit part of the negative impact of the global crisis.

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What caused the twin bubbles?

One fundamental factor was the slow, but sure, restoration of profitability, since the mid 1980s, a feat accomplished by a series of massive political defeats inflicted on the global working class. I am referring of course to the outcome of the crises of the 1980s in vast regions of the world, more conspicuously the U.S., Europe, Latin America, and Africa; fiscal "austerity" & tight money since Volcker; the capitalist expansion in China & Asia; the political & ideological triumph of neoliberalism in the UK & the U.S; the disintegration of the Soviet Union and Eastern European socialism; the defeat of the revolutionary wave in Central America; the challenges of governance and exhaustion of the left in southern Africa after the Apartheid collapsed, etc.

Another factor, not unrelated, was the accumulation of massive reserves of foreign exchange in Asia and oil-exporting countries, that got recycled via U.S. & European credit markets into household consumption & business investment spending.

Historically speaking, one thing leads to another, and causes are always multiple. I will just list what I regard as the most conspicuous factors (no time to weave them into a clear "narrative"): The gradual erosion in capital profitability experienced in the late 1960s, when the share of U.S. in global capitalist output was overwhelming, resulted not only from the exhaustion of the postwar boom profitability, caused by a higher wage share & higher capital composition. To say the least, it was precipitated by the drag on U.S. public finances caused by the Vietnam War. The collapse of the Bretton Woods monetary arrangement spanned the foreign exchange markets. The systemic risk of balance-of-payments crises was not longer insured under Bretton Woods, countries and businesses (e.g. multinational companies) had to hedge themselves individually. Again, this demand led to an earlier expansion of international banking and foreign exchange markets.

International banking was turbo charged by the accumulation of oil export surpluses during and after the first oil crisis in the early-mid 1970s: large masses of money capital from oil export surpluses were recycled via the international banking system. The so-called "financialization" – the disproportionate growth of financial markets and institutions dates back to that time. In my opinion, the material pressure exercised by these interests, the interests of large masses of capital on national states, international organizations, mass media conglomerates & the academic establishment explains to a large extent the legal, political,

and ideological turnaround associated with the deregulation of financial activity, liberalization, and the subsequent predominance of "neoliberalism."

A third, more modest, but decisive factor due to its serendipitous timing, was the sharp reduction of military spending in the U.S. and NATO from the mid to the late 1980s, as a percentage of GDP, and from the early to the late 1990s in real absolute terms. This boost in the finances of the U.S. federal government, contributed to reducing the long-term benchmark interest rate, which led to a massive appreciation of the banks' balance sheets, thus allowing to finally recapitalize after their long slug working out the fiascos of the 1980s' S&L and Latin American debt crises.

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What were the sources feeding air into the credit & asset price bubbles? Let me limit my remarks now to the most fundamental tendencies inflating these bubbles, tendencies that are inherent to capital. I'll just add a sentence or two to link those inner tendencies to their outward manifestations in the historical context of interest.

(1) The profit motive

I already mentioned that the concentration and centralization of capital, the accumulation of large masses of global capital translated into a massive amount of political pressure against the early postwar welfare state and relative economic security of working people in the rich capitalist countries, and most everywhere.

(2) Inequality and (3) the crisis-ridden dynamics of capital

The accumulation of large reserves of foreign exchange by the BRICS and other emerging capitalist powers and their recycling through the credit systems in the capitalist North has been explained, plausibly in my opinion, by Stiglitz as the result of the collapse of monetary cooperation after the collapse of Bretton Woods (http://web.gc.cuny.edu/economics/SeminarPapers/Fall,2006/international_monetary_reform-joe%20stglitz.pdf). Each country had to look after itself. Latin America learned its lesson the hard way, through the crisis of the debt in the 1980s.

Domestically, inequality has much to do with the subprime crisis. Conventional economists have noted the parallel between the Latin American debt crisis and the subprime crisis. They've noted that poverty in the rich countries (and in central and Eastern Europe) provided global capital with local victims (http://www.aeaweb.org/articles.php?doi=10.1257/aer.98.2.339).

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I will now take a step back and allude to Marx's work on crisis similar to the current one. And, curiously, a crisis like the current one exhibit many parallels to the mid 19th century crises that Marx studied closely. A good thing about this crisis (if anything) is that it's making it easier for us to read one of Marx's most difficult manuscripts, those that were

edited and published by Engels as volume 3 of Capital (especially section V, on interest-bearing capital).

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For Marx, the possibility of crisis lies in the separate acts of C-M and M-C.

The conditions that make the crisis necessary lie in the expansion of credit: credit fosters disproportions & gets the basic relations underlying the profit rate out of whack, push industrial & commercial capital (and nowadays household finances) to their "absolute limits."

The conditions that lead to the crisis are related to the evolution of profit rate: the operating cause of the crisis is the fall in the profit rate.

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This is the rationale for Marx's view of the role of falling profitability:

A boom leads to the gradual erosion of the profit rate, because it unleashes forces that slow down the exploitation rate and speed up the increase in capital composition.

Prolonged booms reduce unemployment, allowing for some respite in real wages. They also build up the capital stock at times when relatively low interest rates revalorize capital assets.

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Credit turbo-charges the entire process by centralization capital and purchasing power, and making it available to capitalists and (in our times, also massively) households, which leads to overproduction & overaccumulation.

An expanding credit system fosters a increasingly complex yet delicate network of mutual interdependences, payments depend on payments, etc.
The gradual erosion of the profit rate winds up reducing the ability of borrowing capitalists (and borrowers in general) to service or roll over their obligations.

At a point, reality catches on and large disturbances in robust areas (or small ones in delicate areas) of the system can precipitate the crisis.
During the crisis, there's a sudden rush for money as a means of payment and, as capital devalorizes in a downward spiral, as a store of value.

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Then credit unravels: the overreactions reinforce the unraveling of the entire reproductive process. This is what is now called "deleveraging."

In the critical times, the interest rates skyrocket. To avoid bankruptcy, capitalists sell off their commodities at bargain prices. The rush towards money as a means of payment and

value storage metastasizes, with a deflationary effect (which increases what is now called the "real" interest rate).

Marx (and Engels) viewed the role of the central bank as decisive at these times. If banks made efforts to maintain credit, and the central bank to increase the availability of money, some of the worst effects of the crisis can be avoided. Think of Bernanke dropping money from his helicopter.

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Curiously for Marxists, the crisis global capitalism is now experiencing has a lot of commonalities with the crisis in the early and mid 19th century in Europe & the U.S.

This crisis is making it so easy for us to read (and re-read) Capital, volume 3!