Financial Hurricane Batters World Capitalism

System Failure and the Need for Revolution

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The most serious financial crisis since the Great Depression shows no sign of letting up. The financial edifice of U.S. imperialism is in danger of crumbling.

The U.S. ruling class is confronting what Federal Reserve chairman Ben Bernanke describes as a crisis of "historic proportions"—and is hurriedly cobbling together desperate measures to prevent wholesale collapse. Three of the largest independent investment banks on Wall Street have ceased to exist since April. The government had to assume a major stake in the American International Group (AIG), the world's largest insurer, to prevent it from collapsing. Now the U.S. Treasury is considering taking ownership positions in major U.S. banks.

This crisis is amplifying internationally. Western Europe is facing large bank failures and governments are engineering their own bailouts. The Russian stock market has intermittently suspended operations. Financial markets in Asia have nose-dived. Mexico's economy is wobbling, as its exports shrink.

Two things stand out about this crisis. First, there is the ferocity of its global shocks and the speed with which it has spread. Second, unlike the debt and financial crises of the last 30 years, which were largely centered in the Third World, this crisis initially exploded in the U.S., the world's leading capitalist economy, and is focused in the financial centers of world capitalism.

U.S.-led finance, which plays a dominant and shaping role in the global capitalist order, has taken a huge body blow. This will have enormous repercussions, not just for the stability of the world capitalist system but for power shifts and rivalries within it.

Many progressive commentators have put the blame for this crisis on fraud and greed, or on lax regulation. All of which are certainly in play. But these explanations do not get to the essence of what is happening, to the cause of the problem. This crisis is the outcome of the fundamental workings of the capitalist system.

The analysis that follows is framed by these core points:

1. There is an essential relationship between the vast enlargement of the financial sector in the U.S., and the general phenomenon of financialization, and the deepening globalization of capitalist production of the last 15 years. And central to this dynamic has been the relationship between U.S. imperialism and China.
2. Through the course of this growth and expansion, severe imbalances have built up between the financial system—and its expectation of future profits—and the accumulation of capital, that is, the structures and actual production and

reinvestment of profit based on the exploitation of wage-labor.
3. A “dirty little secret” of this crisis is the enormous weight of militarization of the U.S. economy.
4. This crisis is a concentrated expression of the anarchy of capitalist production—the fact that production is not carried out according to any conscious, rational plan at the society-wide level, much less at the international level.

Background to Crisis

In the early 2000s, in the aftermath of the collapse of high-tech stocks, the U.S. Federal Reserve Bank sought to stimulate lending and growth. It lowered interest rates and pumped funds into the banking system. Banks had access to cheap and plentiful credit. And through deceit and aggressive marketing, they pushed mortgages on people. The Federal Reserve continued to inject low-cost funds into the banking system—helping to prop up loans and to fuel a long-term speculative housing bubble.

Banks sold these mortgages to investment banks. The investment banks in turn bundled these loans together with other loans, created complex financial products, and sold them to large investors—in the U.S. and in other parts of the world, especially Western Europe. These mortgage-backed securities, as they are called, circulated in financial markets and became the basis for other loans. The ultimate collateral for this chain of borrowing and lending was the original mortgage loans. So when housing prices fell, and as growing numbers of mortgage holders found themselves unable to pay back housing loans, much of this original collateral became nearly worthless.

This whole process is an obscene example of how under this capitalist system something as basic as human shelter becomes a financial instrument and object of speculation. This has led to a situation today where 1 in 6 U.S. homeowners owe more on a mortgage than their home is worth; where 1 in every 65 households in California is in some phase of foreclosure; and where a disproportionate number of Black and Latino families who have been victimized by predatory lending have experienced incredible losses of what little wealth they had.[1]

AIG had made enormous profits internationally by selling insurance to investors who held many of these mortgage-backed securities. These investors would be repaid by AIG, in the event that the loans that were bundled into these financial packages they had purchased were defaulted on—could not be paid back. But by mid-September, AIG could neither cover massive loan damage nor borrow sufficient funds on the financial markets to keep itself afloat. AIG was so interconnected with other major financial players that if the company went under, it would likely have taken others down.

In the face of mounting financial crisis, the imperialist state intervened. It acted as the representative of capital and as the guardian of the interests of capital. The U.S. ruling class was faced with a two-fold danger: mounting losses and bankruptcies in the financial sector; and the choking up of lending channels, which could send the economy into a rapid downward spiral.

The government basically took over AIG. And on September 19, the Treasury Secretary Henry Paulson announced a $700 billion bailout. The essence of the rescue package was that the government would buy the troubled mortgage-backed securities sloshing about in the financial system and through this get lending going again. But the announced bailout did not unblock credit markets or calm stock markets. Nor has it restored international confidence in the U.S. economy.

Taking a Step Back

This crisis broke out in the banking system. Its more immediate trigger was the popping of a speculative real estate bubble, cascading losses in the financial sector, and the inability of stricken financial institutions to raise capital and the unwillingness of others to lend capital.

At a deeper level, this crisis is the outcome of a particular trajectory of world capitalist growth.

There has been a massive *new wave of globalization.* One of the most significant features of world growth and expansion of the last 15 years has been the deepening integration of the world capitalist economy. This is happening both on the level of production and trade—like the parts that go into a computer being manufactured in different parts of the world; and in the case of an iPod being totally manufactured in China. And it is happening on the level of finance—where banks operate globally and are more tightly interlinked with one another through chains of borrowing and lending and even, as in the case of AIG, insuring risks of lending.

This new wave of globalization has involved direct productive and financial investments abroad. It has involved the expansion of outsourcing and subcontracting. And central to all of this has been the fuller integration of export producing countries of the Third World into the world capitalist market—and the forging of a globally-integrated, cheap-labor manufacturing economy.[2]

40 percent of the imports coming into the U.S. are accounted for by U.S. transnational corporations—and this does not even include the subcontracting done by companies like Walmart. 30 percent of U.S. corporate profits are generated overseas. China, which has evolved into the high-profit workshop/sweatshop for international capitalism, has been at the epicenter of this recent surge of globalization.[3]

From the standpoint of the needs of profitable globalization, various elements of deregulation—for instance, the lifting of barriers to rapid shifts and transfers of capital—were functional. This is why both Republicans and Democrats have promoted deregulation. Indeed, the Clinton administration in the 1990s played a decisive deregulating role. It negotiated so-called free-trade agreements with Third World countries and helped to loosen strictures on U.S. banking and telecommunications.

The trajectory of capitalist growth of the last 15 years has also involved *heightened financialization*. On this platform of more globalized production and exploitation, the financial services sector in the advanced capitalist countries mushroomed.

On a turbo-charged global playing field of ever-more mobile and massive flows of investment capital—where the stakes of winning and losing are enormous—capital requires all kinds of risk management. Investment banks and other financial institutions provide such financial services to "hedge" against interest rate variations, currency fluctuations, and other sources of volatility and loss. At the same time, financial activities became a greater source of short-term and speculative profits. In an intensely competitive atmosphere for financial market share, investment banks were creating ever-more complex and exotic financial products. Global financial assets increased from $12 trillion in 1980 to nearly $200 trillion in 2007, far outstripping the growth of world output or the expansion of trade.4

Growth in the advanced capitalist countries over the last 15 years became increasingly finance-led and credit-driven. The U.S. has been at the epicenter of this process of heightened financialization. By 2005, the manufacturing sector of the U.S. economy had fallen to 12 percent of the U.S. gross domestic product (the production of goods and services), while the financial services sector made up of finance, insurance, and real estate had grown to 20 percent. In 1982, the financial sector's share of total corporate profits was just over 5 percent; in 2007, the financial share of corporate profits had skyrocketed to 40 percent!5

Contradictions of Development

These interrelated processes of globalization and financialization ultimately led to unsustainable imbalances and instabilities. The dynamics that fueled growth have generated new barriers to profitable accumulation of capital. Strengths have turned into vulnerabilities.

These include:

- Bloating of the financial sector relative to the productive base.
- Huge run-up of debt and U.S. trade and government deficits in the U.S. necessitating massive and uninterrupted inflows of capital from around the world, with the central banks of Japan and increasingly China holding huge amounts of U.S. Treasury debt.
- Billions upon billions of dollars of paper assets that cannot be transformed into real, productive and material, assets.
- U.S. consumption and borrowing stimulating China's growth but China's breakneck manufacturing growth further fueling U.S. trade deficits and intensifying competitive pressures throughout the world economy.
- The expansion of credit spurring growth but heightening global financial fragility.

We are seeing things turn into their opposites. Financial institutions attempted to reduce risk and to profit from risk by dispersing more varied financial instruments over a wider field of investors internationally. But this process has drawn investors, these very institutions, and now governments into a vortex of vulnerability and crisis. The heightened globalization of production and markets, the closer intertwining of economies, has created conditions for faster and even more extensive ripple effects of crisis throughout the world.

A Knot of Contradictions

A strategic concern of the U.S. ruling class is the international strength of the dollar. The dollar is the world's leading currency for settling transactions, clearing debts, and holding foreign exchange reserves (trade and investment earnings that become part of the reserves of foreign central banks). The dollar has been a linchpin of U.S. global supremacy and of the whole current global economic order.

The dollar is also an investible commodity—major currencies are bought and sold and traded on international currency markets. The value of the dollar rises and falls in relation to other currencies, and in response to international political and economic trends and developments. If foreign central banks and investors were to significantly shift away from dollar holdings, this could set off a global monetary crisis and/or strengthen the position of rival currencies (like the euro) and rival powers.

These are uncharted waters for U.S. policymakers: in the scale and complexity of the crisis…in the magnitude of the rescue operations required to prevent financial breakdown…and in the rapidity with which this crisis is unfolding. A Harvard research economist put it this way: "like the sorcerer's apprentice, we have created things we do not understand and cannot easily control."6

U.S. imperialism has limited maneuvering room. The U.S. is already the largest debtor country in the world. It is waging costly wars for greater empire in Iraq and Afghanistan. And both John McCain and Barack Obama are committed to America's global "war on terror"—the umbrella under which the U.S. is waging these wars for empire.

U.S. imperialism has attempted to parlay its superior military strength into a new world order and to lock in its global supremacy for decades to come. Defense and defense-related spending totaled more than $1 trillion in fiscal 2008.7 And military-related production and research have long been deeply embedded in the U.S. economy. The whole imperialist system rests on the domination of vast swaths of the globe through savage force, with the U.S. military colossus playing a special role. The costs of forcibly preserving and extending the U.S. empire is one of the dirty little secrets of the dynamics of this crisis that scarcely gets talked about.

Here an important dialectic comes into play. "U.S. military dominance," writes Kenneth Rogoff, former chief economist for the International Monetary Fund, "has been one of the linchpins of the dollar."8 But this military dominance and the wars the U.S. is waging have increasingly come to depend on the steady inflow of foreign capital into the U.S. (to the tune of $3 billion a day). For this to continue requires that the U.S. economy and dollar remain stable. This is a major contradiction for U.S. imperialism.

U.S. imperialism is facing new competitive challenges and the emergence of potential rival constellations of imperial and big powers—vying for market shares, control over energy resources, and geopolitical position.

Emergency Capitalism

People are losing their homes. Retirement savings plans since the middle of 2007 have lost 20 percent of their value with the stock market sinking. Funding for vitally needed social programs and services at state and local levels is being pinched by the financial crisis and economic slowdown. In much of the Third World, food prices soared over the last year, this is partly related to financial speculation, and hunger has spread.9

While the futures of millions are in jeopardy, what is the paramount concern of those at the top of the pyramid of economic and political power? It is the protection of a financial system that sits atop a global system of exploitation; it is the rescue of the owners and investor beneficiaries of that system.

This is not “socialism for the rich” or a bailout for the people. It’s emergency capitalism for the capitalist class: injections of funds and guarantees, government takeovers, cost-cutting, selective liquidations, restructuring of regulations; and it’s more brutal capitalism for everyone else: austerity, more intense international exploitation, and more misery for people throughout the world.

The official story line is that this crisis issues from particular flaws and malpractices that can be corrected: “excessive greed,” “Wall Street irresponsibility,” “outdated” or “ unenforced regulations.”

The truth is that this crisis has deep structural causes in the very nature of the system—in the quest for profit, not the satisfaction of human need, and in the anarchic workings of world capitalism.

We are seeing how the means through which capitalism expands and “innovates” have led to new barriers and to gales of “creative destruction”—with trillions of dollars of asset values destroyed in the market turmoil. Through these convulsions, the imperialists seek to wrench new freedom, promoting further consolidation and monopolization. Bank of America absorbs the giant investment bank Merrill Lynch. Lehman Brothers is forced into liquidation.

Whoever wins the presidential election will be inheriting a battered financial system and huge government deficits. This will not be an era of expanded social spending, but one of more direct government intervention in financial markets and cutbacks in social spending.

A Status Report

This rolling and intensifying financial crisis serves as a profile and status report on capitalism in the 21st century:

A once-thriving subprime mortgage market…had been linked to the ability of U.S. financial institutions to market securities to European banks and of the U.S. Treasury to draw in export earnings from China…earnings generated in sweatshops…tied into subcontracting networks of Western corporations….

Real estate markets tank…. The “smart money” looks for “safe places” to shift its capital…. Some of it heads for commodity futures like rice…. So food prices spiral upward in response to the investment stratagems of people who know and care nothing about food needs and food production…. In countries like Haiti, women who can no longer afford basic staples are feeding their children mud-cakes….

A French bank, with its assets plunging in value, and the chain of global capitalist finance snapping all over, now finds itself with “non-performing loans”…. It must “improve its balance sheet” and faces pressures to reduce or eliminate trade credits to a country in Africa that depends on imports for food, and where people already spend 50 percent of their incomes for food.

Despite staggering advances in technology and human knowledge, despite the fact that the development of human society has brought humanity to a historic threshold where it is now possible not only to overcome scarcity and exploitation but also to forge social arrangements where human beings can truly flourish—despite all of this potential, social and economic life are under painful duress and the ecosystems of the planet gravely threatened. It is not for lack of resources or knowledge.

All of what has been described in this article is the result of the relations and domination of capital, the result of the workings of a system driven by vicious competition and the blind accumulation of profit based on exploitation—and backed by massive military force.

In the heartland of capitalism, there is financial meltdown. In the Third World, millions are already suffering the ravages of a global food crisis. This system is a horror and a failure. Is it necessary for humanity to live this way?

The October 10 edition of *The Washington Post* carried an article with the title and question "The End to American Capitalism?" In forums and in the media, leading bourgeois policymakers and analysts have discussed whether this crisis, careening beyond control and threatening greater economic calamity, suggests that there is something fundamentally amiss about capitalism. And the emphatic answer given is the same: "the system may not be working optimally, but there is no alternative, only gradations and variations of capitalism."

But there is another way. It is possible to take hold of the productive resources of society and to develop and deploy them in a rational, planned, and society-wide way to meet human need and to safeguard the planet. It is possible to establish a radically different kind of state power and to create a society and institutions that unleash people's creativity and that promote initiative and diversity in an atmosphere that brings out human community.

The question of socialism, of communism, of revolution could not be more relevant...and more urgent.

To be clear, revolution is not a catchword for lots of new things or lots of change. Revolution has very specific meaning: the people getting rid of the system; depriving the old ruling class of their political-economic-military power; and creating a new power with new aims and objectives and the means to enforce those aims and objectives.

As serious as this crisis is, with all the havoc it is wreaking, the system will not automatically collapse of its own weight and disorder. Absent revolution, capitalism will put itself back together—in its own image and at unimaginable social cost.

And for all the agony that crisis inflicts, this will not automatically and spontaneously translate into progressive, radical, and revolutionary sentiment and consciousness. Other forces are in the field doing ideological and political work: reactionary populists like Lou Dobbs ("blame the foreigners and illegal immigrants") and Sarah Palin whipping up a social base for religio-fascism. The Obama candidacy is channeling disenchantment and the thirst for change right back into the political system's suffocating embrace ("change we can believe in" is nothing other than change acceptable to the powers that be).

This is a highly fraught situation. Things can change very quickly. The system is revealing much about its basic nature. Bigger jolts may come and outrage may suddenly grow and give rise to resistance from all kinds of quarters. We have to grasp the potential of the situation. We have to be out there bringing forward understanding and bringing forward a vision of a liberatory world. We have to rise to new political and ideological challenges in the belly of the beast.

ENDNOTES

1. Data from James R. Hagerty and Ruth Simon, "Housing Pain Gauge: Nearly 1 in 6 Owners 'Under Water,'" Wall Street Journal, October 8, 2008; RealtyTrac, "Foreclosure Activity Up 14 Percent in Second Quarter," Realtytrac.com, July 25, 2008. A study published earlier this year estimates the total loss of wealth suffered by Black, Latino, and other minority households on account of bank subprime-lending of the last eight years to be the greatest loss of wealth for people of color in modern U.S. history (United for a Fair Economy, Foreclosed: State of the Dream 2008).

2. Among informative studies of the origins and development of a globally integrated cheap labor manufacturing economy, see Michel Chossudovsky, *The Globalization of Poverty and the New World Order* (Quebec: Center for Research on Globalization, 2003); and on globalized manufacturing in relation to financialization, see William Millberg, "Shifting Sources and Uses of Profits: Sustaining US Financialization with Global Value Chains," *Economy and Society*, Vol. 37, No. 3 (August 2008), pp. 420-451.

3. Data from Milberg, "Shifting Value Chains…"

4. Jeffrey Garten, "We Need a New Global Monetary Authority," Financial Times, September 25, 2008. On financialization as a means also to contain financial disorder and to impose profit maximizing discipline on capital, see Christopher Rude, "The Role of Financial Discipline in Imperial Strategy," in Leo Panitch and Colin Leys, eds., *Socialist Register 2005: The Empire Reloaded*, London: Merlin Press, 2004.

5. Kevin Phillips, *Bad Money* (New York: Viking, 2008), p. 5; Robert Wade, "The First-World Debt Crisis of 2007-2010 in Global Perspective," *Challenge: The Magazine of Economic Affairs*, July-August 2008, p. 33.

6. David Dapice, "Bad Spell on Wall Street," Policyinnovations.org, January 24, 2008.

7. Leaving out the wars in Iraq and Afghanistan, defense spending has doubled since the mid-1990s. See Chalmers Johnson, "Why the US has really gone broke," mondediplo.com (English edition), February 5, 2008.

8. Kenneth Rogoff, "America Will Need a $1,000bn Bail-Out," Financial Times, September 17, 2008.

9. On the global food crisis, see "The Global Food Crisis and the Ravenous System of Capitalism," *Revolution #128, May 1, 2008.*

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