The Enigma of Capital and the Crises of Capitalism

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OXFORD UNIVERSITY PRESS
2010
flow of capital is all about. If we can achieve a better understanding of the disruptions and destruction to which we are all now exposed, we might begin to know what to do about it.

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New York, October 2009

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The Disruption

Something ominous began to happen in the United States in 2006. The rate of foreclosures on housing in low income areas of older cities like Cleveland and Detroit suddenly leapt upwards. But officialdom and the media took no notice because the people affected were low income, mainly African-American, immigrant (Hispanics) or women single-headed households. African-Americans in particular had actually been experiencing difficulties with housing finance from the late 1990s onwards. Between 1998 and 2006, before the foreclosure crisis struck in earnest, they were estimated to have lost somewhere between $71 billion and $93 billion in asset values from engaging with so-called subprime loans on their housing. But nothing was done. Once again, as happened during the HIV/AIDS pandemic that surged during the Reagan administration, the ultimate human and financial cost to society of not heeding clear warning signs because of collective lack of concern for, and prejudice against, those first in the firing line was to be incalculable.

It was only in mid-2007, when the foreclosure wave hit the white middle class in hitherto booming and significantly Republican urban and suburban areas in the US south (particularly Florida) and west (California, Arizona and Nevada), that officialdom started to take note and the mainstream press began to comment. New condominium and housing tract development (often in 'bedroom communities' or across peripheral urban zones) began to be affected. By the end of 2007, nearly 2 million people had lost their homes and 4 million more were thought to be in danger of foreclosure. Housing values plummeted almost everywhere across the US and many households
found themselves owing more on their houses than they were worth. This set in motion a downward spiral of foreclosures that depressed housing values even further.

In Cleveland, it looked like a ‘financial Katrina’ had hit the city. Abandoned and boarded-up houses dominated the landscape in poor, mainly black neighbourhoods. In California, the streets of whole towns, like Stockton, were likewise lined with empty and abandoned houses, while in Florida and Las Vegas condominiums stood empty. Those who had been foreclosed upon had to find accommodation elsewhere: tent cities began to form in California and Florida. Elsewhere, families either doubled up with friends and relatives or turned cramped motel rooms into instant homes.

Those who stood behind the financing of this mortgage catastrophe initially appeared strangely unaffected. In January 2008, Wall Street bonuses added up to $32 billion, just a fraction less than the total in 2007. This was a remarkable reward for crashing the world’s financial system. The losses of those at the bottom of the social pyramid roughly matched the extraordinary gains of the financiers at the top.

But by the autumn of 2008 the ‘subprime mortgage crisis’, as it came to be called, had led to the demise of all the major Wall Street investment banks, through change of status, forced mergers or bankruptcy. The day the investment bank Lehman Brothers went under – 15 September 2008 – was a defining moment. Global credit markets froze, as did most lending worldwide. As the venerable ex-chair of the Federal Reserve, Paul Volcker (who five years earlier, along with several other knowledgeable commentators, had predicted financial calamity if the US government did not force the banking system to reform its ways) noted, never before had things gone downhill ‘quite so fast and quite so uniformly around the world’. The rest of the world, hitherto relatively immune (with the exception of the United Kingdom, where analogous problems in the housing market had earlier surfaced such that the government had been forced to nationalise a major lender, Northern Rock, early on), was dragged precipitously into the mire
generated primarily by the US financial collapse. At the epicentre of the problem was the mountain of 'toxic' mortgage-backed securities held by banks or marketed to unsuspecting investors all around the world. Everyone had acted as if property prices could rise for ever.

By autumn 2008, near-fatally tremors had already spread outwards from banking to the major holders of mortgage debt. United States government-chartered mortgage institutions Fannie Mae and Freddie Mac had to be nationalised. Their shareholders were destroyed but the bondholders, including the Chinese Central Bank, remained protected. Unsuspecting investors across the world, from pension funds, small regional European banks and municipal governments from Norway to Florida, who had been lured into investing in pools of 'highly rated' securitised mortgages, found themselves holding worthless pieces of paper and unable to meet their obligations or pay their employees. To make matters worse, insurance giants like AIG, which had insured the risky bets of US and international banks alike, had to be bailed out because of the huge claims they faced. Stock markets swooned as bank shares in particular became almost worthless; pension funds cracked under the strain; municipal budgets shrank; and panic spread throughout the financial system.

It became clearer and clearer that only a massive government bail-out could work to restore confidence in the financial system. The Federal Reserve reduced interest rates almost to zero. Shortly after Lehman's bankruptcy, a few Treasury officials and bankers including the Treasury Secretary, who was a past president of Goldman Sachs, and the present CEO of Goldman, emerged from a conference room with a three-page document demanding a $700 billion bail-out of the banking system while threatening Armageddon in the markets. It seemed like Wall Street had launched a financial coup against the government and the people of the United States. A few weeks later, with caveats here and there and a lot of rhetoric, Congress and then President George Bush caved in and the money was sent flooding off, without any controls whatsoever, to all those financial institutions deemed 'too big to fail'.

But credit markets remained frozen. A world that had earlier appeared to be 'awash with surplus liquidity' (as the IMF frequently reported) suddenly found itself short on cash and awash with surplus houses, surplus offices and shopping malls, surplus productive capacity and even more surplus labour than before.

By the end of 2008, all segments of the US economy were in deep trouble. Consumer confidence sagged, housing construction ceased, effective demand imploded, retail sales plunged, unemployment surged and stores and manufacturing plants closed down. Many traditional icons of US industry, such as General Motors, moved closer to bankruptcy, and a temporary bail-out of the Detroit auto companies had to be organised. The British economy was in equally serious difficulty, and the European Union was impacted, though unevenly, with Spain and Ireland along with several of the eastern European states which had recently joined the Union most seriously
affected. Iceland, whose banks had speculated in these financial markets, went totally bankrupt.

By early 2009 the export-led industrialisation model that had generated such spectacular growth in east and south-east Asia was contracting at an alarming rate (many countries like Taiwan, China, South Korea and Japan saw their exports falling by 20 per cent or more in just two months). Global international trade fell by a third in a few months creating stresses in export-dominated economies such as those of Germany and Brazil. Raw material producers, who rode high in the summer of 2008, suddenly found prices plunging, bringing serious difficulties for oil-producing countries like Russia and Venezuela, as well as the Gulf States. Unemployment began to increase at a startling rate. Some 20 million people were suddenly unemployed in China and troubling reports of unrest surfaced. In the United States the ranks of the unemployed increased by over 5 million in a few months (again, heavily concentrated in African-American and Hispanic communities). In Spain the unemployment rate leapt to over 17 per cent.

By the spring of 2009, the International Monetary Fund was estimating that over $50 trillion in asset values worldwide (roughly equal to the value of one year's total global output of goods and services) had been destroyed. The US Federal Reserve estimated an $11 trillion loss of asset values for US households in 2008 alone. By then, also, the World Bank was predicting the first year of negative growth in the global economy since 1945.

This was, undoubtedly, the mother of all crises. Yet it must also be seen as the culmination of a pattern of financial crises that had become both more frequent and deeper over the years since the last big crisis of capitalism in the 1970s and early 1980s. The financial crisis that rocked east and south-east Asia in 1997–8 was huge and spin-offs into Russia (which defaulted on its debt in 1998) and then Argentina in 2001 (precipitating a total collapse that led to political instability, factory occupations and take-overs, spontaneous highway blockades and the formation of neighbourhood collectives) were local catastrophes. In
the United States the fall in 2001 of star companies like WorldCom and Enron, which were basically trading in financial instruments called derivatives, imitated the huge bankruptcy of the hedge fund Long Term Capital Management (whose management included two Nobel Prize winners in economics) in 1998. There were plenty of signs early on that all was not well in what became known as the 'shadow banking system' of over-the-counter financial trading and hence unregulated markets that had sprung up as if by magic after 1990.

There have been hundreds of financial crises around the world since 1973, compared to very few between 1945 and 1973; and several of these have been property- or urban-development-led. The first full-scale global crisis of capitalism in the post-Second World War era began in spring 1973, a full six months before the Arab oil embargo spiked oil prices. It originated in a global property market crash that brought down several banks and drastically affected not only the finances of municipal governments (like that of New York City, which went technically bankrupt in 1975 before ultimately being bailed out) but also state finances more generally. The Japanese boom of the 1980s ended with a collapse of the stock market and plunging land prices (still ongoing). The Swedish banking system had to be nationalised in 1992 in the midst of a Nordic crisis that also affected Norway and Finland, caused by excesses in the property markets. One of the triggers for the collapse in east and south-east Asia in 1997–8 was excessive urban development, fuelled by an inflow of foreign speculative capital, in Thailand, Hong Kong, Indonesia, South Korea and the Philippines. And the long-drawn-out commercial-property-led savings and loan crisis of 1984–92 in the United States saw more than 1,400 savings and loans companies and 1,860 banks go belly up at the cost of some $200 billion to US taxpayers (a situation that so exercised William Isaacs, then chairman of the Federal Deposit Insurance Corporation, that in 1987 he threatened the American Bankers Association with nationalisation unless they mended their ways). Crises associated with problems in property markets tend to be more long-lasting than the short sharp crises that occasionally
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rock stock markets and banking directly. This is because, as we shall see, investments in the built environment are typically credit-based, high-risk and long in the making: when over-investment is finally revealed (as recently happened in Dubai) then the financial mess that takes many years to produce takes many years to unwind.

There is, therefore, nothing unprecedented, apart from its size and scope, about the current collapse. Nor is there anything unusual about its rootedness in urban development and property markets. There is, we have to conclude, some inherent connectivity at work here that requires careful reconstruction.

How, then, are we to interpret the current mess? Does this crisis signal, for example, the end of free market neoliberalism as a dominant economic model for capitalist development? The answer depends on what is meant by that word neoliberalism. My view is that it refers to a class project that coalesced in the crisis of the 1970s. Masked by a lot of rhetoric about individual freedom, liberty, personal responsibility and the virtues of privatisation, the free market and free trade, it legitimised draconian policies designed to restore and consolidate capitalist class power. This project has been successful, judging by the incredible centralisation of wealth and power observable in all those countries that took the neoliberal road. And there is no evidence that it is dead.

One of the basic pragmatic principles that emerged in the 1980s, for example, was that state power should protect financial institutions at all costs. This principle, which flew in the face of the non-interventionism that neoliberal theory prescribed, emerged from the New York City fiscal crisis of the mid-1970s. It was then extended internationally to Mexico in the debt crisis that shook that country to the core in 1982. Put crudely, the policy was: privatise profits and socialise risks; save the banks and put the screws on the people (in Mexico, for example, the standard of living of the population dropped by about a quarter in four years after the financial bail-out of 1982). The result was what is known as systemic ‘moral hazard’. Banks behave badly because they do not have to be responsible for

the negative consequences of high-risk behaviour. The current bank bail-out is this same old story, only bigger and this time centred in the United States.

In the same way that neoliberalism emerged as a response to the crisis of the 1970s, so the path being chosen today will define the character of capitalism’s further evolution. Current policies propose to exit this crisis with a further consolidation and centralisation of capitalist class power. There are only four or five major banking institutions left in the United States, yet many on Wall Street are thriving right now. Lazard’s, for example, which specialises in mergers and acquisitions, is making money hand over fist and Goldman Sachs (which many now jokingly refer to as ‘Government Sachs’, to mark its influence over Treasury policy) has been doing very well, thank you. Some rich folk are going to lose out, to be sure, but as Andrew Mellon (US banker, Secretary of the Treasury 1921–32) once famously remarked, ‘In a crisis, assets return to their rightful owners’ (i.e. him). And so it will be this time around unless an alternative political movement arises to stop it.

Financial crises serve to rationalise the irrationalities of capitalism. They typically lead to reconfigurations, new models of development, new spheres of investment and new forms of class power. This could all go wrong, politically. But the US political class has so far caved in to financial pragmatism and not touched the roots of the problem. President Obama’s economic advisers are of the old school – Larry Summers, director of his National Economic Council, was Secretary of the Treasury in the Clinton administration when the fervour for deregulation of finance crested. Tim Geithner, Obama’s Treasury Secretary, formerly head of the New York Federal Reserve, has intimate contacts with Wall Street. What might be called ‘the Party of Wall Street’ has immense influence within the Democratic Party as well as with the Republicans (Charles Schumer, the powerful Democratic senator from New York, has raised millions from Wall Street over the years, not only for his own political campaigns but for the Democratic Party as a whole).
Those who did the bidding of finance capital back in the Clinton years are now back at the helm. This does not mean they are not going to redesign the financial architecture, because they must. But who are they going to redesign it for? Will they nationalise the banks and turn them into instruments to serve the people? Will banks simply become, as influential voices even in the Financial Times now propose, regulated public utilities? I doubt it. Will the powers that currently hold sway seek merely to clean up the problem at popular expense and then give the banks back to the class interests that got us into the mess? This is almost certainly where we are headed unless a surge of political opposition dictates otherwise. Already what are called ‘boutique investment banks’ are rapidly forming on the margins of Wall Street, ready to step into the shoes of Lehman and Merrill Lynch. Meanwhile, the big banks that remain are stashing away funds to resume payment of the huge bonuses they paid before the crash.

Whether we can get out of this crisis in a different way depends very much upon the balance of class forces. It depends upon the degree to which the mass of the population rises up and says, ‘Enough is enough, let’s change this system.’ The average Joe and Jean (even if he or she is a plumber) has good reason to say that. In the United States, for example, household incomes since the 1970s have generally stagnated in the midst of an immense accumulation of wealth by capitalist class interests. For the first time in US history, working people have failed to share in any of the gains from rising productivity. We have experienced thirty years of wage repression. Why and how did this come about?

One of the major barriers to sustained capital accumulation and the consolidation of capitalist class power back in the 1960s was labour. There were scarcities of labour in both Europe and the US. Labour was well organised, reasonably well paid and had political
new technologies because higher labour costs could be passed on to the consumer as higher prices (resulting in steady inflation). The 'Big Three' auto companies in Detroit typically did this. Their monopoly power was eventually broken when the Japanese and Germans invaded the US auto market in the 1980s. The return to conditions of greater competition, which became a vital policy objective in the 1970s, then forced labour-saving technologies. But this came fairly late in the game.

If all of that failed then there were people like Ronald Reagan, Margaret Thatcher and General Augusto Pinochet waiting in the wings, armed with neoliberal doctrine, prepared to use state power to crush organised labour. Pinochet and the Brazilian and Argentinian generals did so with military might, while both Reagan and Thatcher orchestrated confrontations with big labour, either directly in the case of Reagan's showdown with the air traffic controllers and Thatcher's fierce fight with the miners and the print unions, or indirectly through the creation of unemployment. Alan Budd, Thatcher's chief economic adviser, later admitted that 'the 1980s policies of attacking inflation by squeezing the economy and public spending were a cover to bash the workers,' and so create an 'industrial reserve army' which would undermine the power of labour and permit capitalists to make easy profits ever after. In the US, unemployment surged, in the name of controlling inflation, to over 10 per cent by 1982. The result: wages stagnated. This was accompanied in the US by a politics of criminalisation and incarceration of the poor that had put more than 2 million behind bars by 2000.

Capital also had the option to go to where the surplus labour was. Rural women of the global south were incorporated into the workforce everywhere, from Barbados to Bangladesh, from Ciudad Juarez to Dongguan. The result was an increasing feminisation of the proletariat, the destruction of 'traditional' peasant systems of self-sufficient production and the feminization of poverty worldwide. International trafficking of women into domestic slavery and prostitution surged as more than 2 billion people, increasingly crammed
into the slums, favelas and ghettos of insalubrious cities, tried to get by on less than $2 a day.

Awash with surplus capital, US-based corporations actually began to offshore production in the mid-1960s, but this movement only gathered steam a decade later. Thereafter parts made almost anywhere in the world – preferably where labour and raw materials were cheaper – could be brought to the US and assembled for final sale close to the market. The ‘global car’ and the ‘global television set’ became a standard item by the 1980s. Capital now had access to the whole world’s low-cost labour supplies. To top it all, the collapse of communism, dramatically in the ex-Soviet Bloc and gradually in China, then added some 2 billion people to the global wage labour force.

‘Going global’ was facilitated by a radical reorganisation of transport systems that reduced costs of movement. Containerisation – a key innovation – allowed parts made in Brazil to be assembled in cars made in Detroit. The new communications systems allowed the tight organisation of commodity chain production across the global space (knock-offs of Paris fashions could almost immediately be sent to Manhattan via the sweatshops of Hong Kong). Artificial barriers to trade such as tariffs and quotas were reduced. Above all, a new global financial architecture was created to facilitate the easy international flow of liquid money capital to wherever it could be used most profitably. The deregulation of finance that began in the late 1970s accelerated after 1986 and became unstoppable in the 1990s.

Labour availability is no problem now for capital, and it has not been so for the last twenty-five years. But disempowered labour means low wages, and impoverished workers do not constitute a vibrant market. Persistent wage repression therefore poses the problem of lack of demand for the expanding output of capitalist corporations. One barrier to capital accumulation – the labour question – is overcome at the expense of creating another – lack of a market. So how could this second barrier be circumvented?

The gap between what labour was earning and what it could spend was covered by the rise of the credit card industry and increasing indebtedness. In the US in 1980 the average household owed around $40,000 (in constant dollars) but now it’s about $130,000 for every household, including mortgages. Household debt sky-rocketed, but this required that financial institutions both support and promote the debts of working people whose earnings were not increasing. This started with the steadily employed population, but by the late 1990s it had to go further because that market was exhausted. The market had to be extended to those with lower incomes. Political pressure was put on financial institutions like Fannie Mae and Freddie Mac to loosen the credit strings for everyone. Financial institutions, awash with credit, began to debt-finance people who had no steady income. If that had not happened, then who would have bought all the new houses and condominiums the debt-financed property developers were building? The demand problem was temporarily bridged with respect to housing by debt-financing the developers as well as the buyers. The financial institutions collectively controlled both the supply of, and demand for, housing!

The same story occurred with all forms of consumer credit on everything from automobiles and lawnmowers to loading down with Christmas gifts at Toys ‘R’ Us and Wal-Mart. All this indebtedness was obviously risky, but that could be taken care of by the wondrous financial innovations of securitisation that supposedly spread the risk around and even created the illusion that risk had disappeared. Fictitious financial capital took control and nobody wanted to stop it because everyone who mattered seemed to be making lots of money. In the US, political contributions from Wall Street soared. Remember Bill Clinton’s famous rhetorical question as he took office? ‘You mean to tell me that the success of the economic program and my re-election hinges on the Federal Reserve and a bunch of fucking bond traders?’ Clinton was nothing if not a quick learner.
But there was another way to solve the demand problem: the export of capital and the cultivation of new markets around the world. This solution, as old as capitalism itself, was pursued with added vigour from the 1970s onwards. The New York investment banks, then flush with surplus petrodollars from the Gulf States and desperate for new investment opportunities at a time when the potential for profitable investment within the United States was exhausted, took to lending massively to developing countries like Mexico, Brazil, Chile and even Poland. This happened because, as Walter Wriston, head of Citibank, put it, countries can’t disappear – you always know where to find them in the event of difficulties.

Difficulties soon did arise, with the developing country debt crisis of the 1980s. More than forty countries, mainly in Latin America and Africa, had trouble repaying their debts when interest rates suddenly rose after 1979. Mexico threatened bankruptcy in 1982. The United States promptly reinvigorated the International Monetary Fund (IMF) (which the Reagan administration had sought to de-fund in 1981 in accordance with strict neoliberal principle) as the global disciplinarian that would ensure that the banks would get their money back and that the people would be forced to pay up. IMF ‘structural adjustment programs’, which mandated austerity in order to pay back the banks, thereafter proliferated around the world. The result was a rising tide of ‘moral hazard’ in international bank lending practices. For a while, this practice was hugely successful. On the twentieth anniversary of the Mexican bail-out the chief economists from Morgan Stanley hailed it as ‘a factor that set the stage of increasing investor confidence worldwide and helped to ignite the growth market of the late 1990s, along with a strong US economic expansion’. Save the banks and screw the people worked wonders – for the bankers.

But for all of this to be truly effective, a globally interlinked system of financial markets needed to be constructed. Within the United States, the geographical constraints on banking were step by step removed from the late 1970s onwards. Hitherto, all banks, except for
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the investment banks – which were legally separated from deposit institutions – had been confined to operating within single states, while savings and loans companies financed mortgages which had been kept separate from deposit banks. But integrating global as well as national financial markets was also seen as vital and this led, in 1986, to the interlinking of global stock and financial trading markets. The ‘Big Bang’ as it was called at the time, linked London and New York and immediately thereafter all the world’s major (and ultimately local) financial markets into one trading system. Thereafter, banks could operate freely across borders (by 2000 most of Mexico’s banks were foreign-owned and HSBC was everywhere, fondly referring to itself as ‘the people’s local global bank’). This did not mean that there were no barriers to international capital flows, but technical and logistical barriers to global capital flow were certainly much diminished. Liquid money capital could more easily roam the world looking for locations where the rate of return was highest. The suspension in 1999 of the distinction between investment and deposit banking in the United States that had been in place since the Glass–Steagall Act of 1933 further integrated the banking system into one giant network of financial power.

But as the financial system went global, so competition between financial centres – chiefly London and New York – took its coercive toll. The branches of international banks such as Goldman Sachs, Deutscches Bank, UBS, RBS and HSBC internalised competition. If the regulatory regime in London was less strict than that of the US, then the branches in the City of London got the business rather than Wall Street. As lucrative business naturally flowed to wherever the regulatory regime was laxest, so the political pressure on the regulators to look the other way mounted. Michael Bloomberg, the mayor of New York City, commissioned a report in 2005 that concluded that excessive regulation in the US threatened his city’s future financial industry. Everyone on Wall Street along with the ‘Party of Wall Street’ in Congress trumpeted these conclusions.

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The successful politics of wage repression after 1980 allowed the rich to get much richer. We are told that this is good because the rich will invest in new activity (after first satisfying their competitive urge to indulge in conspicuous consumption, of course). Well, yes, they do invest, but not necessarily directly in production. Most of them prefer to invest in asset values. For example, they put money in the stock market and stock values go up, so they put even more money in the stock market, irrespective of how well the companies they invest in are actually doing. (Remember those predictions in the late 1990s of the Dow at 35,000?) The stock market has a Ponzi-like character even without the Bernie Madoffs of this world explicitly organising it so. The rich bid up all manner of asset values, including stocks, property, resources, oil and other commodity futures, as well as the art market. They also invest in cultural capital through sponsorship of museums and all manner of cultural activities (thus making the so-called ‘cultural industries’ a favoured strategy for urban economic development). When Lehman Brothers tanked, the Museum of Modern Art in New York lost a third of its sponsorship income.

Strange new markets arose, pioneered within what became known as the ‘shadow banking’ system, permitting investment in credit swaps, currency derivatives, and the like. The futures market embraced everything from trading in pollution rights to betting on the weather. These markets grew from almost nothing in 1990 to circulating nearly $250 trillion by 2005 (total global output was then only $45 trillion) and maybe as much as $600 trillion by 2008. Investors could now invest in derivatives of asset values and ultimately even in derivatives of insurance contracts on derivatives of asset values. This was the environment in which hedge funds flourished, with enormous profits for those who invested in them. Those who managed them amassed vast fortunes (more than $1 billion in personal remuneration a year for several of them in 2007 and 2008, and as much as $3 billion for the top earners).
The trend towards investment in asset values became widespread. From the 1980s onwards reports have periodically surfaced suggesting that many large non-financial corporations were making more money out of their financial operations than they were out of making things. This was particularly true in the auto industry. These corporations were now run by accountants rather than by engineers and their financial divisions dealing in loans to consumers were highly profitable. General Motors Acceptance Corporation soon became one of the largest private holders of property mortgages, as well as a lucrative business financing car purchases. But even more importantly, the internal trading within a corporation producing auto parts all over the world allowed prices and profit statements to be manipulated across currencies in such a way as to both declare profits in those countries where the tax rates were lowest and to use currency fluctuations in themselves as a means to make monetary gains. But
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betting the whole value of the New Zealand kiwi (which sent the New Zealand government into a panic) — and came off making around $250 million in 1987, a financial crisis year in which the rest of Bankers Trust made losses. He had, it appeared, single-handedly kept Bankers Trust afloat. He had been promised a 5 per cent bonus, which at that time would have been enormous, so when he received a mere $3 million he resigned 'on principle'. Meanwhile, Bankers Trust, without checking his figures, put out reassuring statements on its profitability to prop up its share value. Krieger's figures turned out to be faulty by $80 million but, rather than admit its profitability had disappeared, the bank tried all manner of 'creative' accounting practices to cover over the discrepancy before finally having to admit that it had been wrong.

Notice the elements in this tale. First, unregulated over-the-counter trading permits all sorts of financial innovation and shady practices which nevertheless make a lot of money. Secondly, the bank supports such practices, even though they don't understand them (the mathematics in particular), because they are often so profitable relative to their core business and hence improve share value. Third, creative accounting enters the picture, and fourth, the valuation of assets for accounting practices is extremely uncertain in volatile markets. Lastly, it was driven by a young trader who had skills that seemed to put him in a league of his own. Frank Partnoy, in his account of all this, *Infectious Greed* (published, it should be noted, in 2003), writes:

In just a few years, regulators had lost what limited control they had over market intermediaries, market intermediaries had lost what limited control they had over corporate managers, and corporate managers had lost what limited control they had over employees. This loss-of-control daisy chain had led to exponential risk-taking at many companies, largely hidden from public view. Simply put, the appearance of control in financial markets was a fiction.
As asset values were bid up, so this carried over to the whole economy. Stocks were one thing but property was another. To buy or even live in Manhattan became all but impossible unless you went incredibly into debt. Everyone was caught up in this inflation of asset values, including the working classes whose incomes were not rising. If the super rich could do it, why not a working person who could buy into a house on easy credit terms and treat that house as a rising value ATM machine to cover healthcare emergencies, send the kids to college or take a Caribbean cruise?

But inflation in asset values cannot go on for ever. Now it is the turn of the United States to experience the pain of falling asset values, even as US policy makers do their level best to export their perverse version of capitalism to the rest of the world.

The relationship between representation and reality under capitalism has always been problematic. Debt relates to the future value of goods and services. This always involves a guess, which is then set by the interest rate, discounting into the future. The growth of debt since the 1970s relates to a key underlying problem which I call 'the capital surplus absorption problem'. Capitalists are always producing surpluses in the form of profit. They are then forced by competition to recapitalise and reinvest a part of that surplus in expansion. This requires that new profitable outlets be found.

The eminent British economist Angus Maddison has spent a lifetime trying to collate the data on the history of capital accumulation. In 1820, he calculates, the total output of goods and services in the capitalist world economy was worth $694 billion (in 1990 constant dollars). By 1913 it had risen to $2.7 trillion; by 1950, it was $5.3 trillion; in 1973 it stood at $16 trillion; and by 2003 nearly $41 trillion. The most recent World Bank Development Report of 2009 puts it (in current dollars) at $56.2 trillion, of which the US accounts for nearly $13.9 trillion. Throughout the history of capitalism, the actual compound rate of growth has been close to 2.25 per cent per annum (negative in the 1930s and much higher – nearly 5 per cent – in the period 1945–73). The current consensus among economists and within the financial press is that a ‘healthy’ capitalist economy, in which most capitalists make a reasonable profit, expands at 3 per cent per annum. Grow less than that and the economy is deemed sluggish. Get below 1 per cent and the language of recession and crisis erupts (many capitalists make no profit).

British Prime Minister Gordon Brown, in a fit of unwarranted optimism, argued in late autumn 2009 that we could look forward to a further doubling of the world economy over the next twenty years. Obama also hopes we will be back to 3 per cent ‘normal’ growth by 2011. If so, there will be over $100 trillion in the global economy by 2030. Profitable outlets would then have to be found for an extra $3 trillion investment. That is a very tall order.

Think of this way. When capitalism was made up of activity within a fifty-mile radius around Manchester and Birmingham in England
and a few other hotspots in 1750, then seemingly endless capital accumulation at a compound rate of 3 per cent posed no big problem. But right now think of endless compound growth in relation not only to everything that is going on in North America, Oceania and Europe, but also east and south-east Asia as well as much of India and the Middle East, Latin America and significant areas of Africa. The task of keeping capitalism going at this compound rate is nothing if not daunting. But why does 3 per cent growth presuppose 3 per cent reinvestment? That is a conundrum that needs to be addressed. (Stay tuned!)

There has been a serious underlying problem, particularly since the crisis of 1973–82, about how to absorb greater and greater amounts of capital surplus in the production of goods and services. During these past years, monetary authorities such as the International Monetary Fund have frequently commented that 'the world is awash with surplus liquidity', that is, there is an increasing mass of money looking for something profitable to engage in. Back in the crisis of the 1970s vast surpluses of dollars piled up in the Gulf States as a result of the hike in oil prices. These were then recycled into the global economy via the New York investment banks which lent big time to developing countries, setting the stage for the developing world debt crisis of the 1980s.

Less and less of the surplus capital has been absorbed in production (in spite of everything that has happened in China) because global profit margins began to fall after a brief revival in the 1980s. In a desperate attempt to find more places to put the surplus capital, a vast wave of privatisation swept around the world carried on the backs of the dogma that state-run enterprises are by definition inefficient and lax and that the only way to improve their performance is to pass them over to the private sector. The dogma does not stand up to any detailed scrutiny. Some state-run enterprises are indeed inefficient, but some are not. Travel the French train network and compare it to the pathetically privatised US and British systems. And nothing could possibly be more inefficient and profligate than the privately insured health care system in the United States (Medicare, the state-run segment, has far lower overhead costs). No matter. Industries run by the state, so the mantra went, had to be opened up to private capital which had nowhere else to go, and public utilities like water, electricity, telecommunications and transportation – to say nothing of public housing and public education and health care – all had to be opened up to the blessings of private enterprise and market economics. In some instances there may have been gains in efficiency, but in others not. What did become obvious, however, was that the entrepreneurs who took over these public assets, usually at a discounted rate, quickly became billionaires. Mexican Carlos Slim Helú, rated the third richest man in the world by Forbes magazine in 2009, got his big boost with the privatisation of Mexico’s telecommunications in the early 1990s. This wave of privatisation in a country riddled with poverty catapulted several Mexicans on to the Forbes wealthiest list in short order. Shock market therapy in Russia put seven oligarchs in control of nearly half the economy within a few years (Putin has been fighting with them ever since).

As more surplus capital went into production during the 1980s, particularly in China, heightened competition between producers started to put downward pressure on prices (as seen in the Wal-Mart phenomenon of ever-lower prices for US consumers). Profits began to fall after 1990 or so in spite of an abundance of low-wage labour. Low wages and low profits are a peculiar combination. As a result, more and more money went into speculation on asset values because that was where the profits were to be had. Why invest in low-profit production when you can borrow in Japan at a zero rate of interest and invest in London at 7 per cent while hedging your bets on a possible deleterious shift in the yen-sterling exchange rate? And in any case, it was right around this time that the debt explosion and the new derivatives markets took off, which, along with the infamous dot.com internet bubble, sucked up vast amounts of surplus capital. Who needed to bother with investing in production when all this was going on? This was the moment when the financialisation of capitalism’s crisis tendencies truly began.
The Enigma of Capital

Three per cent growth for ever is running into serious constraints. There are environmental constraints, market constraints, profitability constraints, spatial constraints (only substantial zones of Africa, though thoroughly ravaged by exploitation of their natural resources, along with remote usually interior regions of Asia and Latin America, have yet to be fully colonised by capital accumulation).

The turn to financialisation since 1973 was one born of necessity. It offered a way of dealing with the surplus absorption problem. But where was the surplus cash, the surplus liquidity, to come from? By the 1990s the answer was clear: increased leverage. Banks typically lend, say, three times the value of their deposits on the theory that depositors will never all cash out at the same time. When a bank run does occur the bank will almost certainly have to close its doors because it will never have enough cash in hand to cover its obligations. From the 1990s on, the banks upped this debt–deposit ratio, often lending to each other. Banking became more indebted than any other sector of the economy. By 2005 the leveraging ratio went as high as 30 to 1. No wonder the world appeared to be awash with surplus liquidity. Surplus fictitious capital created within the banking system was absorbing the surplus! It was almost as if the banking community had retired into the penthouse of capitalism where they manufactured oodles of money by trading and leveraging among themselves without any mind whatsoever for what the working people living in the basement were doing.

But when a couple of banks got into trouble, trust between banks eroded and fictitious leveraged liquidity disappeared. De-leveraging began, sparking the massive losses and devaluations of bank capital. It then became clear to those in the basement what the inhabitants of the penthouse had been up to over the preceding twenty years.

Government policies have exacerbated rather than assuaged the problem. The term ‘national bail-out’ is inaccurate. Taxpayers are simply bailing out the banks, the capitalist class, forgiving them their debts, their transgressions, and only theirs. The money goes to the banks but so far in the US not to the homeowners who have been foreclosed upon or to the population at large. And the banks are using the money, not to lend to anybody but to reduce their leveraging and to buy other banks. They are busy consolidating their power. This unequal treatment has prompted a surge of populist political anger from those living in the basement against the financial institutions, even as the right wing and many in the media castigate irresponsible and feckless homeowners who bit off more than they could chew. Tepid measures to help the people, far too late, are then proposed to fend off what could be a serious legitimation crisis for the future of capitalist-class ruling power. Can we return to the credit-fuelled economy once the banks start lending again? If not, why not?

The last thirty years have seen a dramatic reconfiguration of the geography of production and the location of politico-economic power. At the end of the Second World War it was well understood that inter-capitalist competition and state protectionism had played an important role in the rivalries that had led to war. If peace and prosperity were to be achieved and maintained, then a more open and secure framework for international political negotiation and trade, a framework from which all could in principle benefit, had to be created. The leading capitalist power of the time, the United States, used its dominant position to help create, along with its main allies, a new framework for the global order. It sought decolonisation and the dismantling of former empires (British, French, Dutch, etc.) and brokered the birth of the United Nations and the Bretton Woods Agreement of 1944 which defined rules of international trade. When the Cold War broke out, the US used its military might to offer (‘sell’) protection to all those who chose to align themselves with the non-communist world.

The United States, in short, assumed the position of a hegemonic power within the non-communist world. It led a global alliance to keep as much of the world as possible open for capital surplus
absorption. It pursued its own agenda while seeming to act for the universal good. The support the US offered to stimulate the capitalist recovery in Europe and Japan immediately after the Second World War was an example of such a strategy. It ruled by a mix of coercion and consent.

At the Bretton Woods conference of 1944, the British negotiator, the renowned economist John Maynard Keynes, had sought a global currency unit outside of any one nation's control. The US rejected this idea, insisting that the US dollar play that role, backed by a fixed exchange rate of the dollar against gold. All other currencies would then fix their exchange rate against the dollar to facilitate global trade. Obviously there was no need for any currency futures market because the exchange rate in six months' time was known, barring, of course, the occasional catastrophic devaluation. Financial crises – as opposed to crises of overproduction of the sort that produced severe downturns in 1958 and 1966 – were rare under this system. The powers of finance capital, though important, were circumscribed and reasonably transparent.

This system worked well, as long as the US refrained from using its power to print dollars in a self-serving way. However, the war in Vietnam and the 'Great Society' anti-poverty programmes of the 1960s (a strategy of 'guns and butter', as it was said at the time) led to a crisis of the dollar after 1968 or so. It was around this time also that US corporations began to take their surplus capital abroad. Surplus dollars, outside of US control, were accumulating within the European banking system. Belief in the fixed exchange rate of the dollar against gold began to erode. But what was to replace it?

Keynes' idea of a neutral global currency in the form of 'special drawing rights', based on the value of five major currencies and managed by the IMF, was revived in 1969. But this threatened US hegemony. A more acceptable solution to the US, worked out in a series of complicated international accords between 1968 and 1973, was for the fixed exchange rate with gold to be abandoned. All the major currencies of the world would then float against the dollar.

While this introduced both flexibility and volatility into the international trading system, the global reserve currency remained under US control.

The effect was to displace one challenge to US hegemony by another. If the dollar was to remain strong, the US productive economy had to perform as well as, if not better than, its rivals. By the 1980s it was clear that the economies of Japan and West Germany were way ahead of the US in terms of productivity and efficiency and that there were other competitive threats lurking in the wings. The US could not revert to protectionism. If anything, it had to take the lead in pushing for ever freer international trade as a means for capital surplus absorption. The US simply had to compete. Capitalism, which had developed earlier along monopolistic lines within nation state frameworks, became far more internationally competitive (witness the sudden invasion of the US auto market by Japanese and German car makers). Finance capital, both internally within the US and internationally, had to move to the fore to allocate surplus capital to wherever the profit rate was highest.

In many industries that turned out not to be in the United States, and especially not in the traditional centres of production in the north-east and the mid-west, but in the west and the south. The result was the wrenching and relentless reorganisation and relocation of production throughout the world. Deindustrialisation of older production centres occurred everywhere from Pittsburgh's, Sheffield's and Essen's steel industry to Mumbai's textile industry. This was paralleled by an astonishing spurt in the industrialisation of entirely new spaces in the global economy, particularly those with specific resource or organisational advantages – Taiwan, South Korea, Bangladesh and the special production zones such as Mexico's maquiladoras (tax-free assembly plants) or the export platforms created in China's Pearl River delta. Global shifts in production capacity accompanied by highly competitive technological innovations, many of which were labour-saving, contributed further to the disciplining of global labour.
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The United States still retained immense financial power, even as it lost its earlier dominance (though not significance) in the realm of production. Increasingly, the US relied upon the extraction of rents, either on the basis of its advantages in technological and financial innovation or from intellectual property rights. But this meant that finance should not be burdened by excessive regulation.

The crash of the US financial sector in 2008—9 has jeopardised US hegemony. The ability of the US to launch a go-it-alone debt-financed recovery plan is limited politically by staunch conservative opposition at home as well as by the huge debt-overhang accumulated from the 1990s on. The US has been borrowing at the rate of around $2 billion a day for several years now and while the lenders—such as Chinese and other East Asian Central banks along with those of the Gulf States—have so far kept lending because the US economy is far too big to fail, the increasing power of the lenders over US policy is palpable. Meanwhile, the position of the dollar as the global reserve currency is threatened. The Chinese have resurrected Keynes’ original suggestion and urged the creation of a global currency of special drawing rights to be managed by a presumably democratised IMF (in which the Chinese would have an important voice). This threatens US financial hegemony.

The end of the Cold War has also rendered military protection against the communist menace irrelevant, even as the ex-Soviet Bloc countries, along with China and Vietnam by very different paths, have become integrated into the global capitalist economic system. While this creates new opportunities for surplus absorption, it also poses the problem of accelerating surplus creation. Attempts to mobilise the rest of the world under the US military umbrella for protection against another enemy—the so-called War on Terror—have not succeeded.

It is in this context that we have to read the delphic estimates of the US National Intelligence Council, published shortly after Obama’s election, on what the world will be like in 2025. Perhaps for the first time, an official US body has predicted that by then the United States, while still a powerful player in world affairs, will no longer be the dominant player. The world will be multi-polar and less centred, while the significance of non-state actors (from terrorist organisations to NGOs) will increase. Above all, ‘the unprecedented shift in relative wealth and economic power roughly from west to east now under way will continue’.

This ‘unprecedented shift’ has reversed the long-standing drain of wealth from east, south-east and south Asia to Europe and North America that has been occurring since the eighteenth century—a drain that Adam Smith noted with regret in The Wealth of Nations. The rise of Japan in the 1960s, followed by South Korea, Taiwan, Singapore and Hong Kong in the 1970s, and then the rapid growth of China after 1980, later accompanied by industrialisation spurs in Indonesia, India, Vietnam, Thailand and Malaysia during the 1990s, has altered the centre of gravity of capitalist development, although it has not done so smoothly. The east and south-east Asian financial crisis of 1997—8 saw wealth flow briefly but strongly back towards Wall Street and the European and Japanese banks.

If crises are moments of radical reconfigurations in capitalist development, then the fact that the United States is having to deficit-finance its way out of its financial difficulties on such a huge scale and that the deficits are largely being covered by those countries with saved surpluses—Japan, China, South Korea, Taiwan and the Gulf States—suggests this may be the occasion for such a shift. It is even possible to interpret the current difficulties in the US and UK as payback for what Wall Street and the City of London did to east and south-east Asia in 1997—8.

Tectonic shifts of this sort have occurred before, as described at length in Giovanni Arrighi’s 1994 book The Long Twentieth Century. There is, he notes, a clear pattern in which periods of financialisation precede a shift in hegemony. To accommodate endless accumulation, hegemony moves from smaller (e.g. Venice) to larger (e.g. the Netherlands, Britain and then the United States) political entities over time. Hegemony typically lies with that political entity within which
much of the surplus is produced (or to which much of the surplus flows in the form of tribute or imperialist extractions). With total global output standing at $56.2 trillion in 2008, the US share of $3.9 trillion still made it the controlling shareholder in global capitalism, able to call the shots with respect to global policies (as it does in its role as the chief shareholder in international institutions such as the World Bank and the IMF).

But the map of the world's productive activity and wealth accumulation looks radically different today from the way it was in 1970. Asia has caught up fast. Small Chinese villages like Shenzhen and Dongguan, close to Hong Kong, have become multimillion cities and production powerhouses overnight. Much of the global surplus has been absorbed in the production of these new spaces of capitalist activity as well as in the infrastructures required to facilitate their increasing volume of international trade (e.g. airports and container ports). The specific spaces into which activity has moved were not given in advance, but determined by a whole host of contingent and local factors, depending in part on so-called 'natural' as well as human resources and locational advantages (such as northern Mexico's proximity to the US market). The specifics of state policies (such as investment in infrastructures, subsidies for investment, policies towards labour or the setting up of the 'maquila' zone legislation in Mexico and the 'special economic zones' designated after 1980 in China) have also played an important role.

The geography of this development and of the subsequent crisis has been uneven. Those countries that had been most profligate in promoting the housing bubble – the United States, Britain, Ireland and Spain – were the initial epicentres of the crisis but there were plenty of pockets elsewhere. The financial epicentres were New York and London, which had shared the lead in slicing, dicing and securitising housing mortgages and other forms of debt, and in constructing the financial instruments (chiefly collateralised debt obligations and special investment vehicles) for marketing and trading this debt along with the secondary mechanisms for insuring, hedging and swapping it. And the financial architecture that arose after the 'Big Bang' unification of global financial markets in 1986 meant that failures in London and New York were immediately felt everywhere else. This was, after all, the financial system that had allowed a back office trader in Singapore, Nicholas Leeson, to trade on the Tokyo market in such a way as to bankrupt the venerable London-based Barings Bank in 1995. This was why the shock delivered to the global financial system by the Lehman bankruptcy was so instantaneous and so deep.

The collapse of credit markets had, however, a differential impact according to the degree to which economic activity depended on them. Iceland, which had assumed the role of a speculative credit and banking entrepreneur, lost almost all of its asset wealth in a matter of weeks, leaving investors (many in Britain) with immense losses and its government in disarray. Many countries in eastern Europe that had recently joined the European Union and borrowed heavily could not roll over their debts and faced bankruptcy (the Latvian government collapsed).

On the other hand, those countries that had not fully integrated their financial system into the global network, like China and India, were better protected. And, as consumers drew back, those countries like the US and UK with huge household debt relative to income, were differentially hit, as were those countries, like the US again, that had the least generous social protections against rising unemployment. (European countries generally were much better off in this regard and therefore did not need to respond with extra stimulus packages). Those countries which relied heavily upon the US as a primary export market, particularly in east and south-east Asia, were ultimately pulled down, as were their stock markets, while raw material and commodity producers, which were riding high in early 2008 and considered themselves immune to the crisis, suddenly found themselves in serious difficulties as commodity and raw material prices plunged in the second half of 2008. Oil prices, which had risen to near $150 a barrel in the summer of 2008 (prompting a
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lot of chatter about 'peak oil'), were back down to $40 within a few months, causing all manner of problems for Russia, Venezuela and the Gulf States. The collapse of the oil-revenue based building boom in the Gulf saw thousands of migrant workers from India, Palestine and south-east Asia sent home.

Mexico, Ecuador, Haiti and Kerala in India, which depended heavily on remittances from those employed elsewhere, suddenly found household incomes drying up as overseas jobs in construction were lost and female domestic workers were cast off. Malnutrition and deaths from starvation surged in many of these poorer countries, giving the lie to the idea that marginalised populations are somehow unaffected by a financial crash in the advanced capitalist world.

The crisis cascaded from one sphere to another and from one geographical location to another, with all manner of knock-on and feedback effects that seemed almost impossible to bring under control, let alone halt and turn back. While populations appeared initially stunned by the turn of events, popular protests against the ways of international capital, which had surfaced and escalated after the Seattle protests of 1999 but diminished after 9/11, suddenly resurfaced, though this time with a sharpened target and again with a lot of geographical unevenness. Strikes erupted in France, along with protests in China, rural uprisings in India and student unrest in Greece. In the United States, a movement of the displaced to occupy foreclosed and abandoned housing began to take shape.

What was certain was that the Anglo-American model of world economic development that dominated in the post-Cold War period of free market triumphalism in the 1990s was discredited.

So why does capitalism periodically generate such crises? To answer this we need a far better understanding of how capitalism works than we currently possess. The problem is that the economic theories and orthodoxies which manifestly failed to predict the crisis continue to inform our debates, dominate our thinking and underpin political action. Without challenging these dominant mental conceptions there can be no alternative (as Margaret Thatcher liked to say) other than a botched return to the sort of capitalism that got us into this mess in the first place. How, then, can we best understand the crisis-prone character of capitalism and by what means might we identify an alternative? These are the questions that animate the analysis that follows.