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Economic crisis

The free fall is over, but... The crisis continues

- Features - Economic and debt crisis -

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A new phase of the long-term systemic crisis of international capitalism is unfolding. The recession that began in December 2007 is the longest, deepest, most far-reaching global crisis since the 1930s. Its worst phase followed Henry Paulson, Ben Bernanke, and Tim GeithnerâEuros''s September 2008 decision to allow Lehman Brothers to go bankrupt. World capitalism went into a six month tailspin. The shadow banking system collapsed and commercial banks lost hundreds of billions of dollars. The financial system was effectively bankrupt and the capital markets shut downâEuros''a situation requiring large-scale intervention from governments around the world.

World GDP fell between 4 and 6 percent, industrial production in developed economies dropped between 15 and 25 percent, exports collapsed, and world trade contracted by more than 20 percent. These are numbers not seen since the Great Depression. In April, the free fall ended. The decline continues, but at a much reduced pace. Some economic indicatorsâEuros"so-called green shootsâEuros" are pointing to the end of the economic slide, but not of the crisis. All downturns eventually hit a bottom at which the economy stabilizes at a new low level, or from which a recovery takes off. But this is not a normal recession, and the recovery, when it comes, will not be a normal recovery.

The stock market rally of the past several months is based on projections that growth will soon be restored. But the recovery expected is abnormally weakâEuros"growth of .5 to 1 percent in the last six months and 1 to 2 percent next year are predicted. A severe downturn is usually followed by strong growth (coming off the very steep drop of 1929âEuros"32 growth from 1933âEuros"36 was 8.5 percent a year, and even that could not signal an end to the crisis). The end of the free fall is not due to free market self-correction, but to the most massive state fiscal and monetary stimulus that the world economy has ever experienced. The centerpiece of Barack ObamaâEuros"s economic program was the rescue of finance capital. The government ponied up bank subsidies, loans, credits, and guarantees totaling $13 trillion. This intervention to save bank bondholders will be paid for by years of lower living standards for American workers.

The banking crisis is not over, but the fear that the banks will collapse is over. Moreover, the Obama administration has been able to push back the call for nationalization of the banks, a call that even Alan Greenspan joined. The recent âEurosoestress test,âEuros the last piece of the governmentâEuros"s economic rescue plan, was designed to restore confidence by guaranteeing that none of the nineteen largest banks will be permitted to fail. The flood of government funds into the banks unlocked the money markets and ended the credit gridlock. Interbank lending, which had come to a standstill, resumed.

Risk premiums tightened and the capital market for corporate bons restarted. The credit sustem is now functional, though many individuals and compÃ¢nies are still finding it difficult to get credit.

The second basis for recovery is the U.S. and Chinese monetary stimulus programs. U.S. stimulus has been financed by $1.84 trillion of deficit spending this year or 13 percent of GDP, a figure only exceeded during the world wars, enough to provide some life to an otherwise comatose economy. Small tax relief, lower mortgage rates, and lower gas prices provided a prop to falling consumer spending. The infrastructure spending slated to begin in the next few months replaces private capital investment as the engine for the modest growth expected at the end of the year. ChinaâEuros"s infrastructure construction program of $585 billion is credited with reflating the commodity boom for industrial raw materials and oil, which has spilled over into grains, providing support for commodity producers.

Yet a weak recovery, and the inability to stabilize key sectors of the economy, raises the potential of prolonged

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stagnation, or of an abbreviated business cycle without a period of strong economic growth. Housing is still in crisis. Prices have dropped by 32 percent, and twenty-seven million peopleâEuros"up from sixteen million a few months agoâEuros"have a mortgage greater than what their house is worth. This is 29 percent of all homeowners, many of whom may be forced to abandon their homes. There is also a new wave of foreclosures by those who have lost their jobs and can no longer make house payments.

More than five million people havenâEuros"t paid their mortgage for over three months, or are in the process of foreclosure. Most are excluded from the Obama mortgage modification program, which excludes homes that have mortgages greater than 105 percent of the homeâEuros"s value. This program was sugar coating to sell the bank bailout; it was advertised as saving four million people from foreclosure. It is a pathetic failure, with only 10,000 to 50,000 homes so far qualifying. The insane logic of capitalist bust continues: More people lose their jobs and go into foreclosure; prices are driven down again, wiping out everyoneâEuros"s savings, making fewer eligible for relief, and choking the projected recovery. Despite the cost of the Bush-Obama banking program, the financial crisis will continue, with bank losses growing in the next two years. Two million houses will foreclose the next year, at an average bank loss of $50,000âEuros"a $100 billion bank hit.

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The commercial real estate market is now entering a crisis similar to the one that struck housing. Commercial real estate prices have dropped by 30 to 40 percent. Rising vacancies and declining rents are producing a wave of commercial real estate bankruptcies. Writes the Wall Street Journal, âEurosoeOver the past decade, Wall Street unleashed a wave of âEurosÜsecuritizedâEuros" commercial-real-estate debt, just as it did in residential mortgages. Some $700 billion worth of commercial-real-estate mortgages were sliced up, packaged into securities and sold to a wide range of investorsâEuros"meaning that this time, the pain will be felt by many more players beyond banks and thriftsâEuros .

The banks have kept these loans on their books at face value, even as the Federal Deposit Insurance Corporation (FDIC) has been selling them off at 59 cents on the dollar. The commercial real estate bust is expected to cost the balnks over $200 billion. Four or five hundred banks, mostly regional, are expectd to go bankrupt.

Corporate loan quality is also declining. During the bubble years, corporations took big loans at cheap credit rates. As profits nosedived, difficulties arose in meeting interest payments. In the last three months, Standard & PoorâEuros"s has downgraded the credit of more than 500 corporations. They will not be able to roll over their loans at low rates, and 14 percent of corporate bonds are expected to default in the next year. The stress test of the nineteen largest banks concluded that these banks will lose $599 billion in the next two years, with $424 billion of the loss concentrated in the four biggest banksâEuros"Chase, Bank of America, Citicorp, and Wells Fargo.

European banking is in even worse shape, with expected losses of $1 trillion, and more if the East European bank crisis spirals out of control. What impact that will have on the American banking system is clouded in bank secrecy. The International Monetary Fund estimates that the international banking system will lose $4 trillion; $2.2 trillion in the United States, $1 trillion in Europe, and $800 billion for the rest of the world. Nouriel RoubiniâEuros"s estimate is that U.S. bank losses alone will reach $3.6 trillion. Since conservative bank leverage is ten times capital, $40 trillion or more will disappear from the credit system, in a deleveraging that has not really begun yet. This is a key to why this crisis will be so prolonged, and the recovery so anemic.

Crisis of overproduction

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The crisis underscores the enormous levels of overproduction throughout the world, and the unsustainable world trading system that revolved around the $700âEuros"$800 billion annual balance of payments deficit of the United States. There can be no return to this pre-crisis regime. The United States can no longer run huge balance of payments deficits paid by foreign borrowing. As a result, the whole global trading system has to be restructured. The Chinese model of superexploitation, in which only 35 percent of whatâEuros"s produced goes for domestic consumption, and the rest for export and reinvestment, will come up against a world system unwilling to tolerate ChinaâEuros"s export-led growth strategy.

The depth of the overproduction crisis is the source of the collapse of industrial productionâEuros" 15 percent in the U.S., 20 percent in the Eurozone, and 34 percent in Japan. As a result, U.S. capital investment dropped at a rate of 40 percent in the first quarter of this year. Since industry is functioning at 69 percent of capacity, its lowest point since the 1930s, there is no basis, outside of restructuring, for business investment in new plants for years to come. The downsizing of General Motors and Chrysler is one aspect of a world auto overcapacity that is estimated to be between twenty and thirty million cars.

Large numbers of jobs are going to disappear in this restructuring, probably at least a third of the remaining jobs in the existing auto companies. The ripple effect will produce layoffs, cutbacks, restructuring, and bankruptcies throughout the supply chains dependent on the auto industryâEuros"in auto parts, dealerships, transport, marketing, municipal taxes and services, and so on. Auto is a template for the future. Other industries that are candidates for restructuring due to overcapacity include airlines, newspapers, shopping malls, and restaurants. Yearslong restructuring with layoffs and wage and benefit cuts will continue even in the recovery. One new study indicates that 16 percent of corporations have cut pay, and 20 percent have cut hours, and hours worked in the first quarter were down by 9 percent. A strong consumer-led recovery is therefore a fantasy.

The debt bubble at the heart of the crisis continues. With the failure of the free market, of private capital, the state became the only institution capable of shoring up liquidity, credit, and consumer demand. The state transferred debt from the banks and the corporations to its balance sheet, raising the fear of it monetarizing this debt and producing sharp inflation in the future. The depth of the crisis has raised deficit spending to a whole new level. The government deficit this year is $1.84 trillion, $1.26 trillion next year, and a trillion or so the year after. This new level of deficits and accumulated state debt threatens the credit status of the United StatesâEuros"the position of the dollar as the world reserve currencyâEuros"and the U.S. FedâEuros"s status as the central banker to the world. In the last few months the governments of Ireland and Spain have lost their Triple-A credit ratings. Recently, Standard & PoorâEuros"s put British government debt on a credit watch to potentially downgrade its Triple-A rating because its national debt is rising so fast.

Britain has not defaulted on its debt since 1693, an unbeatable credit history. This has led to a huge sell-off in the U.S. bond market because the U.S. government is following the same road at a slightly slower pace. This has raised all long-term interest rates including mortgage and corporate bond rates, further constricting potential recovery growth.

The deficit calls into question the position of the U.S. as capitalâEuros"s safe haven in times of crisis. The Congressional Budget Office estimates that interest on the national debt will grow from $172 billion this year to more than $800 billion annually within the decade. Interest payments alone would be greater than any deficit before this year. This will create a debt trap where the government has to borrow just to pay interest, further increasing the national debt.

Meanwhile, the Chinese and other governments are starting to shift out of long-term U.S. bonds to shortterm U.S. treasury bills and other alternatives for fear of a sharp dollar decline as a result of the debt build up, which in turn could cause a sharp rise in interest rates to protect the dollar and national debt, setting off another deep economic

downturn.

Making workers pay

Recovery or not, the misery of the American working class is going to deepen. Unemployment is going to continue to grow even in a weak recovery. Job creation, moreover, is years away. Cuts in wages, benefits, pensions, and health care will accelerate.

With real wages stagnant for the last forty years, and the decline in family income in the last decade, working-class consumption was financed by the growth of mortgage and other debt. That option has ended. There is not going to be credit for American workers whose income is falling, whose home values are declining, and whose savings have been decimated. Before the crisis, consumer spending accounted for 70 percent of GDP. Capitalist consensus is that consumption has to be cut in order to rebuild the U.S. economy on a healthier basis, that is, based on savings rather than debt and foreign capital. The capitalist class and their intellectual flunkies tell us that workers, not bosses, were living beyond their meansâEuros"in spite of the fact that wages have largely stagnated or declined in the past three decades. So long as debt stimulus was directed toward saving American capitalism, and in particular the banking system, it was championed by capital, particularly since it was being paid for by the working class and not by taxes on the rich. Now that debt spending is a threat to American capitalismâEuros"s creditworthiness, capital will mount political opposition to any new stimulus through deficit spending. To reduce government debt, the ruling class will propose cuts in government spending, particularly in âEurosoeentitlementsâEuros such as Social Security and Medicare. Without raising taxes on the rich, states are going to attempt to solve their expanding budget crisesâEuros" California, for example, has a budget shortfall of more than $20 billionâEuros"by expanding taxes on consumption, which fall chiefly on the working class. These taxes will be coupled with enormous cuts in social benefits that the working class depends onâEuros"education, school lunches, Medicaid, and other social programs.

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Bush and Obama found $170 billion to pay off AIGâEuros"s credit default swaps to bank and hedge fund speculators. Every dollar that went to the banks will be a dollar coming out of workersâEuros" standard of living. And the crisis will be the excuse for other attacks. ObamaâEuros"s education secretary, Arne Duncan, is using the crisis in California as a further opening to move toward charter schools and merit pay. The Republicans and the right want to destroy teachersâEuros" unions, while the Democrats will use the crisis to cut back the gains of teacher unionism.

Solutions

We are still very far from a solution to this crisis. In the last year the United States has experienced the beginning of an ideological crisis of neoliberalism, of the failure of the free market, its inability to self-correct without the prospect of a total collapse. State intervention prevented a 1930s style banking collapse. But it has not solved the crisis. Both economically and ideologically, the

U.S. may come up against the limits of what the capitalist state is willing to contemplateâEuros"that is, the limits of Keynesian economics. Keynesianism proposes as solutions to recession cheap money and credit through low interest rates, deficit spending to make up for capitalâEuros"s lack of investment, and the creation of effective demand for consumers. The government has lowered short-term interest rates to almost zero, and its deficit spending is beyond what occurred in the 1930s. Yet effective demand creation has been paltry due to the cost of the

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bailout of the banks, and the rise of the debt means demand is not likely to be raised in any meaningful way. Neither variant of capitalist economic policy, free-market neoliberalism or stateâEuros"capitalist Keynesianism, can solve the crisis.

Indeed, âEurosoegreen shootsâEuros may not be leading us out of crisis at all. A weak recovery could be derailed and become a double dip recession or the opening to a stagnant lost decade. The economy is no longer collapsing, but that by no means indicates that the crisis is over.

Large numbers of people have lost faith in the free market. A growing number of people no longer have any trust in the competence, intelligence, honesty, integrity, and fairness of the capitalist system. The idea that the rich deserve the money they make, and that inequality is a necessary price to produce a functional, prosperous society, has been dealt a body blow. Instead, there is remendous support for the state trying totackle the crisis and, in particular, to begin implementing policies that benefit Â« Main Street Â» rather than Â« Wall Street Â».

The support for, and illusions in, Obama will continue if the administration stabilizes the economy. But if things do not improve dramatically, if they continue to decline for working-class people, there will be a further radicalization. The radicalization will then go beyond disgust with the free market, the bankers, and the auto executives, and move toward people questioning whose government this is and why it looks out for the wealthy who got us into this mess and not the rest of us. This can fuel both a growth in radicalization to the left; but it can also fuel a growth in the far right ready to play on racist populism. Hence, the role of socialists and other radicals in beginning the process of rebuilding a fighting labor movement will be crucial.

The working-class movement has been crushed and marginalized by the triumph of neoliberalism over the past decades. The revival of class politics, class organization, and class struggle will therefore be a long, protracted process with many ups and downs. Like the crisis and the recovery, it will go through many stages. Illusions in state liberalism as the alternative to neoliberalism will come undone for growing numbers of workers whose lives will continue to worsen. The ideological opening created by the crisis will, over time, create conditions for the rebirth of the practical struggles of ordinary working people in response to the crisis.

Obama was elected because millions wanted a change from the reactionary Bush years. It will take hard experience for workers to learn that change doesnâEuros"t come from above, from the capitalist state; but that it comes from below, against the capitalists and their state.

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