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### **World economy**

The world capitalist economy has been buoyed up by a tide of liquidity, a flood of cheap credit. This has fuelled the frenzied financial speculation of the last few years, a profits bonanza for the super-rich. Underlying this, however, are unsustainable imbalances and deepening contradictions in world economic relations. Lynn Walsh looks in depth at the processes taking place.

socialism today

## Forever blowing bubbles? What is happening to the world economy?

### **Financial bubbles and the overaccumulation of capital**

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At the end of February, world stock exchanges and other sectors of the financial markets (company bonds, debt securities, commodity futures, etc) suffered a sharp fall, opening a period of jitters throughout the global financial system. The dip was apparently triggered by a 9% fall (27-28 February) on China's two main stock exchanges, Shanghai and Shenzhen. The fall in China was precipitated by investors' fears that the Chinese government would increasingly curb the flow of credit for purchasing shares, undermining the recent surge in share prices (up 130% in 2006).

But the effect of the fall on China's stock exchanges was far in excess of their weight in world financial markets. China undoubtedly plays an increasingly important part in the world economy. But Chinese stock markets account for a tiny share of the total capitalisation of world stock markets. The total capitalisation of all China's stock exchanges is only about 5% of the valuation of US markets. Morgan Stanley Capital International (MSCI) estimates that Chinese shares that can be purchased by international investors (as opposed to those restricted to domestic investors) constitute about 11% of the total 'emerging markets' index, and a mere 0.9% of the MSCI all-world index. This means that China's stock exchange capitalisation is smaller than South Korea or Taiwan, and about the same level as Russia and Brazil. "China's sway over global stock markets", remarked one commentator, "is more psychological than fundamental. [China's stock market] resembles more of a casino than a legitimate investment venue". (Michael Sesit, China Not Yet in Driver's Seat, International Herald Tribune, 2 April)

Falls on China's stock exchanges, however, prompted a worldwide retreat by speculators from high-risk investments, reflecting widespread fears that shares and other financial assets are significantly overvalued and due for a 'correction'. Shares appear to have suffered most in this retreat, but junk bonds, commodities futures, debt securities, in fact the whole range of financial assets, were affected.

The result was a tremor rather than an earthquake. In the US, for instance, about \$580 billion was wiped off the value of US stocks in the 28 February fall. However, the Savings & Poor 500 Index, the broadest of Wall Street's share indices, was down 3.5%, whereas a correction is considered to be a 10% drop, and a slump over 20%. (Wall Street fell 21% in a day during the October 1987 crash.) But this was the biggest fall in the US since the puncturing of the dotcom bubble in 2000-01, a reminder to speculators that playing financial markets still involves risk.

The February jitters were not so much a question of contagion, a situation where events in one region have a knock-on effect, spreading to other parts of the world financial system. It was more a question of synchronisation, with the stock exchange fall in China reminding speculators that the same conditions exist throughout the world. The rapid, simultaneous fall of markets indicates the extent to which financial markets have become globalised – today, the whole global financial system functions virtually as a single market.

Investors in February, moreover, were affected by several other important factors. Most important were additional signs of a slowing down in the US economy. At the end of January, gross domestic product (GDP) growth for the fourth quarter 2006 was revised down to 2.2% (from the provisional 2.5%), in contrast to 5.6% growth in the first quarter of 2006. This slowdown was mainly because of the slump in the US housing market, which has been a key factor in sustaining consumer demand. The housing

slump, moreover, provoked a crisis in the 'sub prime' loan market, in which high-interest loans are extended to borrowers who cannot even afford home loans at regular interest rates. Some of the companies and banks involved in the sub-prime market announced huge losses, while others have been forced into bankruptcy. There are widespread fears among serious capitalist commentators that the sub-prime crisis will spread to other sectors of the financial system. The sub-prime loan crisis certainly has the potential to provoke a wider financial crisis.

The jitters were also intensified by reported comments of Alan Greenspan, formerly head of the Federal Reserve Bank, to a group of investors. The press reported that he warned that "the US appeared to be at the end of a long expansion and that such times usually brought with them the seeds of recession". Still regarded by many as an infallible guru, Greenspan cautioned that "investors are in danger of being too complacent and too confident that the benign mix of low inflation and steady economic growth would continue". (International Herald Tribune, 3 March 2007)

Recent company reports, moreover, were indicating that, after 19 quarters of 10%-plus increases in profits, growth in corporate profits for 2007 is estimated to slow to 4% or 5%. "The last time this kind of decline happened", commented Business Week, "was April 2000, a month after the start of the bear market and eleven months before the economy fell into recession". (Volatility is Back, Ominous Signs Loom, 12 March 2007)

The prices of financial assets have been hugely inflated by frenzied speculation on the basis of ever growing quantities of cheap credit. The record growth of the world economy is heavily dependent on a series of bubbles. The financial system appears to have become more and more divorced from the real economy, the production of goods and services. Nevertheless, the bursting of the bubbles – a financial crash – would have a devastating effect on world economic growth.

### **A speculation frenzy**

There has been an orgy of frenzied financial speculation during the last three or four years. A third of corporate profits in the US come from the finance sector. It has been on an even bigger scale than during the late 1990s, when the US and world economy appeared to be propelled by the so-called 'dotcom' boom, speculation in shares in information and communication technology companies that pushed share prices way beyond any realistic prospect of profitability. Currently, moreover, financial speculation has penetrated every corner, every nook and cranny of the global economy. Today, there is not just a bubble, but a series of bubbles: shares, property, foreign currency, emerging markets, commodities, junk bonds, utility companies, take-overs, and so on.

They have been blown up by the seemingly endless supply of cheap credit and the aggressive, competitive activity of the big speculators. This time round, many super-rich individual speculators (who have not forgotten their huge losses in 2000-01) have retreated from the more risky markets, taking refuge in government bonds or simply sitting on their huge piles of cash (in bank deposits). Financial-market activity has become increasingly dominated by the big players: hedge funds, finance houses (like Goldman Sachs, Morgan Stanley, Merrill Lynch, etc), and private equity companies. At the same time, traditionally more cautious finance institutions, like mutual funds, insurance companies and pension funds, have been following the example of the adventurous predators, searching for higher yields while interest rates are low. Exploiting small price differences between different types of financial asset and different regional markets, these institutions amplify their profits by using huge amounts of credit to finance trading in huge volumes (often up to two-thirds of their investment is actually credit or, in fact, debt). Fifty years ago, the debt of the US financial sector was zero. Today, it is the equivalent of 100% of the US GDP.

Every type of asset, whether company debt or commodities like oil and grain, have become 'securitised', that is, bundled into packages represented by a piece of paper, a security, that can be bought and sold on fast moving financial markets. These markets are highly liquid, and funds can move in and out at an incredible rate.

Derivatives, a special type of security that derive their value from underlying assets (various types of options, futures, swaps, etc, related to currencies, commodities, debts, shares, etc, etc) have become one of the main vehicles of speculative activity. They were developed to spread risk between a large number of financial market players, and they appear to do so under buoyant market conditions. They are, however, extremely complex financial instruments, and even experts admit they have no idea where the risk will end up. What happens when there is a major correction or a crash? "The tide of global liquidity", commented Tony Jackson (Financial Times, 6 February), "is deforming the credit markets", and no one "knows where the risk is sitting in the system".

Company shares (or equities) are the most favoured form of investment. In general, they provide a higher return than bonds and many other investments. With very few new share issues, however, there is a shortage of shares on the market, and so share

prices have been pushed up (although in real terms they have not yet regained the peak levels of the late 1990s boom).

Share price has become a crucial indicator of a corporation's 'success', and so many companies have been buying back shares to keep up the value of the remaining shares. In recent years, 29 out of 30 companies listed on the Dow Jones Industrial Average repurchased some of their own shares. In 2006, Dow Jones Industrial Average buybacks amounted to \$370 billion, four times the 2003 total. It is estimated that in the first nine months of 2006 a record \$600 billion US shares were removed, overall, from US stock exchanges. In many cases, the companies concerned borrowed the cash required to buy back a proportion of their shares. This process makes a mockery of the idea that shares raise capital for new company investment. In reality, most investment comes from retained profits or borrowing.

Many shares have been removed from the market through takeovers (so-called mergers and acquisitions), especially through 'leveraged buy-outs' by private equity firms. In 2006 in the US there were \$420 billion-worth of leveraged buy-outs, 'leveraged' meaning debt-financed, with the debt being landed on the acquired company.

### **High risk investments**

Because of the shortage of shares and the relatively low return from government bonds (ten-year US treasury bonds have been averaging a 4-5% return) big speculators have turned to more risky markets in search of higher yields (profits). There has been a huge growth of investment in junk bonds, that is company bonds that are not rated 'investment grade' but considered to be high risk. "Since the start of the year, we have seen a notable surge of new investor positioning in emerging market corporates", mainly junk bonds. (Financial Times, 21 February) In the past, junk bonds returned 8-10% more than government bonds, reflecting the risks involved. But in the last few years, the risk premium has fallen to around 2%. Speculators have become increasingly complacent, acting as if risk was a thing of the past. "The amount of debt carrying the highest risk of default is rising as a proportion of the junk bond market, prompting fears the next cycle of corporate failures could be more severe than the last". (Financial Times, 15 January)

Martin Fritzen, writing in Leverage World, commented: "I don't think anyone seriously disputes that a lot of precariously financed deals have been sold into the market in recent years". The problem, he said, is that "liquidity is there when you don't need it, in the high-yield market". Moreover, the biggest growth of the junk bond market has been in so-called 'emerging markets', in many cases semi-developed economies where there is very little scrutiny of the companies issuing the bonds.

In the last few years there has been a big increase of investment in the housing market, particularly in the sub-prime sector where returns have been high. Housing debt has been packaged into so-called 'collateralised debt obligations' (CDOs), complex financial instruments which package together bonds of varying degrees of risk. Huge quantities of high-yield CDOs have been purchased by hedge funds and other big speculators on the basis of cheap credit, particularly from low interest lenders in Japan.

This sector of the debt market was supported by the housing bubble in the US and elsewhere. While prices were rising and mortgage credit rapidly expanding, huge profits could be made from trading in housing debt. But the US housing slump and the meltdown of the sub-prime mortgage sector threatens a much wider instability of financial markets. "Analysts worry that the sub-prime meltdown could be the catalyst that brings the era of easy access to cheap debt to a close". (Financial Times, 16 March)

Chen Hooi, of EON Capital, Kuala Lumpur, comments: "The US sub-prime concern has cast a great shadow over Asia. The worry is that it could spill over and cause the US economy to slow down, and this will cause a domino effect on the world economy". (New York Times, 14 March)

"Another [concern] is the rapid growth of derivatives. The problems in the sub-prime mortgage sector have focussed attention on the slicing and dicing of risk using sophisticated instruments such as collateralised debt obligations and credit default swaps. Banks have used these to shed credit risk, but it is not clear where all that risk now lies". (Market Turmoil, Rethinking Risk, The Economist, 28 February)

It was quite accurate for Tim Lee, a strategist at pi Economics, to describe the whole financial system as "the equivalent of a gigantic Ponzi scheme". Charles Ponzi was a US fraudster who operated an investment scam in 1920, offering investors exceptionally high returns that could only be paid out from payments from new punters. The whole scheme depended on continual growth, and inevitably collapsed when Ponzi could no longer pay the promised return – and then the fraud was exposed.

The Buttonwood column of The Economist (17 March) commented on this: "The American housing market seems to be suffering from the unravelling of a Ponzi-type

system. Sub-prime loans were offered on generous terms that, implicitly or explicitly, depended on rising house prices. The banks that made these loans bundled them up and sold them in the credit markets to investors, eager for high yields. This was supposed to make the financial system more secure by dispersing risk more widely.

"But look what is happening now. The buyers of these loans are asking the original mortgage-writers to buy them back. But these home lenders do not have the money to do so. The confidence that sustained the balance sheets has evaporated, leaving many in dire trouble".

### **Over-accumulation**

The immediate sources of the tide of liquidity are the loose monetary policies of the central banks and the recycling of the huge surpluses of exporting economies (China, Japan, South Korea, etc) and, more recently, the oil producing countries. The liquidity tide, however, is not merely a monetary phenomenon. If the central banks were merely printing money, there would be a massive inflation of major currencies, in spite of the reduction in the prices of manufactured goods from low cost countries.

Behind the liquidity tide there is a deeper source, the over-accumulation of capital. Capitalists only invest their money if they can find profitable fields of investment. Since the last phase of the post-war upswing (1945-73), capitalists have found it increasingly difficult to find profitable fields of investment in production. Despite the growth of new products and new sectors of the economy, in many sectors there is an over-capacity in relation to money-backed demand. Billions of people lack basic necessities, let alone luxury products. But they also lack the income, and therefore the purchasing power, to buy the goods and services available within the framework of the capitalist economy.

Nevertheless, since the 1980s the capitalist class has intensified the exploitation of the working class, in particular by increasing the share of profits in national income at the expense of wages. As profits have soared, the 'excess' of capital has become even more conspicuous – and the capitalists have increasingly turned towards financial speculation, the buying and selling of existing paper assets rather than investment in new productive capacity. It is the excess of capital arising from over-accumulation (showing the fundamental limits of the capitalist system) that underlies the tide of liquidity. Gambling in the casinos of world financial markets is primarily a struggle for the re-division of profits between the hyper-rich players involved in the speculative activity. The driving down of wages, however, further undermines the market for capitalist goods and services, aggravating the problem of over-accumulation and preparing the ground for inevitable crises in the system.

### **The tide of liquidity**

Most commentators attribute the tide of bubble-producing liquidity to the loose monetary policy of the central banks, beginning with the US Federal Reserve, formerly under the stewardship of Greenspan. Undoubtedly, this has been an important immediate source of liquidity. In response to a series of crises, the central banks repeatedly lowered interest rates and expanded the money supply, pumping huge amounts of cash into the world financial system in an effort to prevent a breakdown. This was done after the 1997 Asian crisis, again in response to the bankruptcy of Long Term Capital Management hedge fund in 1998, again (on a massive scale) after the collapse of the dotcom boom at the end of 2000, and once again by the Federal Reserve to prevent an economic shock following the 9/11 attacks on the Twin Towers and the Pentagon.

The injection of additional liquidity undoubtedly cushioned the effects of financial instability and economic slowdown. The loose monetary policy of the central banks was buttressed by a number of important factors. China, Japan and other Southeast Asian exporters have had recurring trade surpluses with the United States and other advanced capitalist countries. They have recycled their surpluses, using their foreign exchange reserves to invest in US government bonds on a vast scale in order to sustain the US economy as the world's 'market of last resort'. Clearly, this is done in order to protect their own economic interests. At the same time, it provides a source of relatively cheap credit to the US government, US corporations and US consumers. Without the recycling of these huge surpluses, the US would not have been able to sustain its trade deficit, currently running at over \$800 billion a year (reflecting the fact that the US actually consumes more than it produces, on the basis of credit).

Another source of the global liquidity is the so-called 'carry trade', linked especially to Japan. As a result of a decade or more of economic stagnation and deflation (with falling consumer prices), the Japanese government adopted a policy of zero or near zero interest rates. International speculators have been able to borrow yen at a very low cost, change them into dollars or other currencies, and invest in higher yielding financial assets throughout the world. The carry trade has been a major source of credit for speculative activity. (The carry trade also had the additional advantage for Japan of

preventing the yen from increasing its value, which would make Japanese exports more expensive on world markets.)

In the last few years, moreover, the major oil producing states have accumulated vast foreign currency surpluses as a result of the soaring price of oil and gas. Oil rose from an average price of \$25 a barrel in 2002 to \$66 in 2006 and remains on about the same level this year. The combined current account surplus of the oil exporters shot up from only 0.1% of global GDP in 1999 to 1.4% last year. Over the last five years, there was an income transfer from oil consuming countries to oil producing economies of \$1.8 trillion, about 4% global GDP. A large proportion of these surpluses, mainly but not exclusively held in dollars, have been recycled into world financial markets as governments and corporations in the oil producing economies have been investing in the advanced capitalist countries, not only buying government bonds but increasingly speculating in financial markets. (Serhan Cevik, Tracking Petrodollars, Morgan Stanley Global Economic Forum, 14 February 2007)

The petrodollars have become an increasingly important source of cheap credit in the global economy.

### **Capital versus labour**

Internationally, the capitalist class has generally restored its profitability to the peak levels of the post-war upswing. The share of wages in national income has been brutally squeezed, especially for the least skilled sections of workers but also increasingly for technical workers as some services are outsourced to countries like India. In the 'G7-plus' group of advanced capitalist countries (US, Japan, Euro-12, Britain, and Canada) real compensation (wages plus benefits) as a share of gross domestic income (GDI) fell from 56% in 2001 to a record low of 53.7% in 2006. The Bank of International Settlements (BIS) comments: "The secular [long-term] decline in inflation has gone hand in hand with great restraint in nominal wage growth... and wage shares in the total economy have fallen by 5% over the past three decades or so". (BIS Annual Report 2006, p18)

The surge in profits at the expense of wages is very clear in the US. One commentator writes: "...wages and salaries now make up the lowest share of gross domestic product since 1947, when the government began measuring such things. Corporate profits, by contrast, have risen to their highest share of GDP since the mid-60s – again that has come chiefly at the expense of American workers". (Harold Meyerson, Devaluing Labor, Washington Post, 30 August 2006)

Referring to the recovery in the US economy since the collapse of the dotcom boom in 2001, the Economic Policy Institute comments: "The rise in corporate profits' share is, by far, the largest that has occurred 19 quarters after a business cycle peak since world war two, and it is almost eight times as large as the average shift that has characterised previous recoveries. If these shares had remained constant, labour incomes as an aggregate would be \$346 billion higher today". (EPI Snapshot, 30 March 2006)

Unlike the situation during the post-war economic upswing, accelerated productivity growth has not resulted in any improvement in labour's share of the wealth produced. In the US, productivity grew at an average rate of 2.8% a year, double the weak 1.4% gain during 1974-95. Stephen Roach, of Morgan Stanley, comments: "Fully ten years into a spectacular productivity revival, real wages remain nearly stagnant and the labour share of national income continues to move lower". (Labor Versus Capital, Global Economic Forum, 23 October 2006)

This shift in favour of profits at the expense of wages is the fundamental reason for the sharp growth of inequality both in the advanced capitalist countries and many developing countries such as China. Under capitalism, wealth is produced by the exploitation of workers' labour power in the production process. Workers are only paid part of the wealth, or new value, that they create. The remainder, 'surplus value' in Marxist terms, is expropriated by the capitalist class, the private owners of the means of production. The sharing out of the surplus between wages and profit is determined by the class struggle. In the post-war period, because of the balance of forces at that time, workers were able to improve their share, and relatively high productivity growth allowed for a simultaneous growth of profits and real wages.

Since the end of the post-war upswing, however, the balance of forces has swung against the working class. This is a result of a combination of economic and political factors.

The decline of heavy manufacturing industries, especially in the advanced capitalist countries, undermined the basis of the 'heavy battalions' of the organised working class. Newer sectors of industry and especially services have relied on casual, part-time workers. Under neo-liberal policies there has been a general attack on trade union rights resulting in a weakening of trade union organisation.

The weakening of the working class is also bound up with the political retreats,

particularly the set back in consciousness following the collapse of the Stalinist states after 1989. The confusion, disorientation and weakening of the traditional workers' organisations undoubtedly created favourable conditions for the capitalists' neo-liberal offensive against the working class.

At the same time, globalisation has also weakened the working class internationally. There has been an approximate doubling of the labour force integrated into the world capitalist economy during the last decade, with China, India and Russia contributing around 1.5 billion additional workers to the global workforce. Potentially, this means an enormous increase in the size and social weight of the working class internationally. Under current conditions, however, with neo-liberal conditions and a weakening of working-class organisation and consciousness, the rapid expansion of the labour force in cheap-labour countries has tipped the balance in favour of the capitalists. When workers in China, for instance, are paid only around 3% of the wage levels of workers in the advanced capitalist countries, outsourcing – or the threat of outsourcing – to low wage countries can be used to undermine the bargaining power of workers. At the same time, the increased flow of immigrant workers in countries like the US or Britain, another aspect of neo-liberal globalisation, has undoubtedly slowed wage growth.

### **Weak capital investment**

Despite rising profitability and the prevalence of business-friendly neo-liberal policies, however, the rate of capital accumulation in the advanced capitalist countries (including Japan, South Korea, Taiwan, etc) has continuously declined since the late 1960s. The annual growth of fixed capital stock (which takes account of the depreciation or obsolescence of worn out capital) in the United States fell from 4% in the 1960s to 3% in the 1990s and only 2% between 2000-04. In Europe, the growth rate fell from 4.6% in the 1960s to 2.6% in 2000-04. Even more dramatically, the growth rate of fixed capital in Japan, seen as a 'super-accumulator' during the post-war upswing, fell from 12.5% in the 1960s to 4% in the 1990s and 2.1% in 2000-04. (China, of course, is an exception to this trend, with growth accelerating from 1.9% in the 1960s to 10.9% in the 1990s.) (See Andrew Glyn, *Capitalism Unleashed*, p86)

There has been a decline in capital investment ('capex' – short for capital expenditure – in financial jargon) despite the fact that (1) the global labour force has been approximately doubled in the last decade with the accelerated development of China and India, etc, which has significantly lowered the capital-labour ratio (the amount of capital employed per worker); and (2) the accelerated depreciation of capital stock because high-tech equipment becomes obsolescent faster than previous equipment, thus requiring a higher level of capital investment even to maintain the net capital stock.

Until very recently, there has been little discussion of this phenomenon in the financial press, but a number of Morgan Stanley financial analysts have recently highlighted "the (curiously) low capex/capital stock in the world".

"There has been a curious reluctance on the part of the corporate sector in the world to invest in physical assets, ie, capex has been surprisingly low, despite the fact that the global capital-to-labour ratio is artificially depressed". (Stephen Jens, *Global Economic Forum*, 23 February 2007) He also notes that, outside China, investment rates in Asia (Japan, Taiwan, South Korea, etc) "have collapsed, even including the massive investment that has taken place in China in recent years".

Jens and other capitalist analysts point to a number of explanations. There is, they comment, intense uncertainty about the prospects for the global economy, and fears that US economic growth, dependent on inflated asset prices, may collapse. Multi-national corporations, moreover, appear to be extremely cautious about expanding capacity in 'emerging markets' (Brazil, Russia, Vietnam, etc), due to uncertainties about political and economic stability.

Another factor, however, is linked to the dominance of finance capital. Low levels of capital expenditure, referred to approvingly as 'capital discipline', help keep corporate profits high, boosting companies' valuation on the stock exchange.

Several Morgan Stanley analysts warn that 'capex anorexia', unless reversed, will increasingly slow down the growth of the world economy. Capital accumulation is key to productivity and output growth. Gerard Minack notes that "investment spending has been strangely muted through this cycle despite record-high profit margins and returns on equity, as well as relatively low interest rates". (*The Global Capex Debate*, Morgan Stanley *Global Economic Forum*, 16 February 2007)

This capex anorexia is in spite of the so-called global savings glut, the huge gap between funds saved from profits or other forms of income and capital investment in developing the means of production.

In the Morgan Stanley 'capex debate', Stephen Roach notes the increased flow of corporate cash from advanced capitalist countries to "offshore investments in green-field capacity in low cost developing economies". This would imply, he comments, that "the

domestic portion [of corporate investment] would then go to share buy-backs or replacement of worn out or obsolete capacity. Perhaps the best one can hope for in the maturer countries is enough 'replacement' spending simply to maintain the capital stock – hardly the grist for a powerful capex pickup that the bulls see as all but inevitable".

Because of the rapid development of new technology, especially computers and software, equipment currently becomes obsolete very quickly. It requires growth in equipment spending of between 6-7% in real terms in the US, just to maintain the capital-output ratio at its current level. Richard Berner comments: "The capital stock of equipment and software [in the US] has actually been declining in relation to GDP over the past four years. Real non-farm business output rose by an average annual rate of 3.9% over that period, while the real stock of equipment and software rose by an average annual rate of 3.5%. Nonetheless, to achieve that, the gross investment in equipment and software rose at an average 6.2% rate".

Berner further comments: "There is no mistaking the distinct cyclical downshift in capex growth – especially in equipment and software – over the past three quarters. Such spending crawled at a miserable 1.4% annual pace over the last nine months of 2006, compared with a 9.5% annual rate over the previous two years". (Global Economic Forum, 16 February 2007)

In his own comment on the 'capex conundrum' (Global Economic Forum, 9 March 2007), Berner comments: "Corporate America seems increasingly unwilling to boost capital expenditure despite moderately positive fundamentals..." Berner also considers that it requires roughly 6% of growth in real equipment spending in the US just to keep the capital-output ratio constant. This is because of "the large scale of existing capital stock and the heavy depreciation for today's quickly-obsolete equipment".

The capital stock of equipment and software has actually been falling in relation to GDP over the last four years. Andrew Glyn comments that "the investment boom of the later 1990s halted the seemingly inexorable trend in the growth rate of the capital stock which had begun in the late 1960s. Moreover, when the boom came to an end in 2000 capital stock growth plummeted more steeply than ever before". (Capitalism Unleashed, p134)

The capitalists face a dilemma. If capital investment continues at a rate barely sufficient to maintain the existing capital stock, future growth rates and productivity will inevitably be undermined. On the other hand, a significant increase in the rate of capital expenditure would reduce the current 'savings glut', pushing global interest rates higher. This would undermine the basis of the bubble economy, the series of bubbles on which the world economy has floated during recent years.

At the moment, however, there is little sign that the big corporations are interested in boosting the rate of capital accumulation. Public (stock-exchange quoted) companies are spending vast sums of money to buy back their own shares in order to increase their value and the flow of profits to shareholders. For instance, during the fourth quarter of 2006, US (non-financial) corporations bought back a record \$701 billion (at an annual rate) of their equity (shares net of new shares issued), while incurring a record of \$605 billion in debt to do so. (See Berner, Global Economic Forum, 9 March 2007)

Corporate executives and super-rich speculators are far more interested in gambling with existing financial assets, paper securities, than in real capital investment to develop new productive forces.

### **Where will it all end?**

Since the recession that followed the collapse of the dotcom bubble in 2000-01, the world economy has bounced back, growing at around 5% a year. Corporate profits have soared. 'The market', the big financial firms that play the global casinos, are mostly full of optimism. Everything is for the best in the best of all capitalist worlds. This is in spite of serious international imbalances, in reality deep contractions, in world economic relations. There is the unprecedented disparity between the deficit of US capitalism and the foreign currency reserves of the major exporters, China, Japan, and the oil producers, who use their reserves (in the main) not to develop their own domestic economies, but to invest in the US and other advanced capitalist countries, in order to underwrite the consumer markets on which they depend.

The US external deficit and the reliance of US consumers on debt, are unsustainable in the long run. The massive accumulation of reserves by China, Japan and other Asian exporters is also unsustainable. At a certain point, the continued and possibly accelerated fall of the dollar will trigger a flight from dollar assets, provoking turmoil (at the very least) in the world financial system.

The US economy is slowing down, and may possibly well fall into recession. Optimists believe that the slack will be taken up by the growth of domestic growth in Europe and Japan, and by the takeoff of domestic growth in China. This misses the point that these countries have, directly or indirectly, become decisively dependent on the US market. A

structural relationship has developed between US debt-driven consumption and the Asian exporters, who underwrite the US deficit. A smooth rebalancing, with a reduction of the US deficit (involving a contraction of US growth and consumption) and a diversion of Asian and oil-producers' surpluses into their home economies would require a very painful adjustment, one that could provoke a convulsion in the world economy.

Underlying the deficit-surplus relationship, moreover, are even deeper economic and social contradictions. There is a deepening chasm, globally and within rich and poor countries alike, between the super-rich capitalists and the mass of the population, the workers, labourers and small farmers who toil to produce the wealth. This extreme class polarisation poses the threat of social and political upheavals, a threat recently recognised by the more far-sighted capitalist strategists. At the same time, the falling share of wages in national income and the erosion of mass living standards is further restricting the market for capitalism. There is not a simple, unvarying relationship between wage levels and the market for capitalist goods. Nevertheless, in the last analysis, the capitalists have to sell the goods and services they produce in order to realise surplus value in the form of profit.

Despite the favourable conditions for capitalism since the collapse of the Stalinist states, the system has not overcome the problems of over-accumulation. In fact, it has become even more acute. The rapid growth China's economy, moreover, has not reversed this tendency. Over-accumulation is not just a short-term, conjunctural problem. It expresses an organic crisis of the system. Capital, as Marx predicted, has reached an impasse within the framework of private ownership of the means of production and the nation state, despite the increased integration of the global market. Only planning, under the democratic control of the working class, will make it possible to develop production to a higher stage, satisfying social needs rather than the greed for profit and to organise production on a global basis. The orgy of speculation, a symptom of over-accumulation, ultimately reflects the historic limits of capitalism.

But, it may be asked, if there are such acute balances and deep contractions in the system, how is it that the world economy continues to grow (at least in terms of GDP growth if not broad economic well-being)? How do the capitalists apparently surf through squalls of financial volatility and sail through episodes of economic turbulence?

One of the main factors in this situation is the flood of liquidity. Between 2002-06, global liquidity increased by an estimated \$3.9 trillion, over half of it from Asia, around 40% from oil producers. The cheap credit arising from this flood has blown up the bubbles that have kept the world economy afloat. The 'wealth effect' from the US housing bubble, the debt-financed transfer of higher property values into consumer spending, sustained the growth of the US economy. There has been a similar effect in Britain, Australia, and many other countries.

The global wealth effect from parallel bubbles (commodities, junk bonds, emerging markets, etc), funnelling wealth into the pockets of the super-rich and boosting the incomes of some middle-class strata, has been a key factor in sustaining growth in many countries. These bubbles – together with the weakness of working class forces – have, for the time being, allowed the capitalists internationally to surmount the deeper problems they face.

The bubble phenomenon, however, can only postpone crises, not eliminate them. Crises will unavoidably erupt when the underlying contradictions of the system assert themselves decisively. The longer they are postponed, the deeper they are likely to be. Regrettably, it is not possible to predict the timing of crises or the particular processes and pathways through which they will unfold. But the idea that speculative investment is now virtually risk free, that the capitalist business cycle is dead, are the delusions of people intoxicated by the fizzy profits of the recent period.

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