From Credit Crunch to Depression

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Abstract

This paper revisits and updates a paper I presented to the 2005 AHE conference. In this latter paper I argued that in the face of the declining rate of profit manifest during the more than 3 decades of the Long Stagnation the world economy had entered its initial stages of a new great depression akin to that of the 1930s. This I termed a downward curve of capitalist development. Contrary to the Long Cycle theorists most prominently Leontiev Kondratiev I argued that the trigger of this was exogenous, and sharply distinguished it from the business cycle or a combination thereof, as formalised by Joseph Schumpeter. Having said that I followed Wynne Godley in arguing that a consumer debt crisis, founded on the house-price balloon would trigger a major economic downturn. To this, however, I indicated that the massive leverage resulting from the explosive expansion of derivatives and other complex financial instruments threatened a substantive crisis marked by a kind of debt-deflation as the asset and stock markets bubbles deflate. At the time I admitted that we did not know the trigger: what we did know was that it was coming. Now the culprit has revealed itself in the deepening financial crisis. I now take the argument further. On the one hand, I insist that money creation (credit) is endogenous. Accordingly, the asset-price bubble is a response to the failure to invest in capacity-expanding plant and equipment. In this framework I suggest it quite mistaken to see the present crisis as essentially one of over-extended mortgage loans – or indeed simply a "credit crunch"; that the banking crisis is far from over and the threat of systemic collapse remains. Actions by the Federal Reserve followed by the central banks in the major financial centres - even if combined with serious fiscal injections - will at best only prepare a deeper crisis in the fashion we have witnessed over the past three decades. The present recession may well see inflationary episodes, but the underlying trend is one of price deflation which the present debt deflation will simply reinforce. Undoubtedly, world capitalism will recover from the present recession. Yet what we are witnessing is the end of the beginning of an extended depression. There is no endogenous mechanism that will reverse this.

This raises a cautionary note: Unless the working class and its allies seize the time, world capitalism will willy-nilly find a way out - albeit with all the horrors that will, thereby, be visited on us, as with the 1930s. Depression conditions will deepen the growing inter-imperialist political and trade rivalry, leading to wars for markets and political spheres of influence.

Key words: Depression, asset price bubble, downward curve, Kondratiev long cycles, fictitious capital, debt deflation, falling rate of profit.

Introduction

The world economy is now in it fifth recession since the opening of the Long Stagnation in the early 1970s. The present one will be as least as deep and long as that of the early 1980s and probably rival that of the early 1930s. It will be worldwide in scope. The much-touted "de-coupling" has gone the way of the proclaimed "New Economy" paradigm fashionable amongst bourgeois economists in the late 1990s. The latter ignominiously hit the buffers in the face of the 2001 recession and the prior bursting of the dot.com bubble. There is something more afoot this time around: an intertwining of this downturn with a profound crisis of the financial system. No region or country will escape. Even the International Monetary Fund has downgraded its ridiculously optimistic projection of the previous period suggesting a slowdown on a world-scale to something like 4% over the next year. This is likely still too optimistic. In any event, it is clear that China and India will be affected significantly, although China has important defences as it is not a capitalist economy. Yet it is still deeply integrated into the world economy and has its own financial bubble waiting to burst.

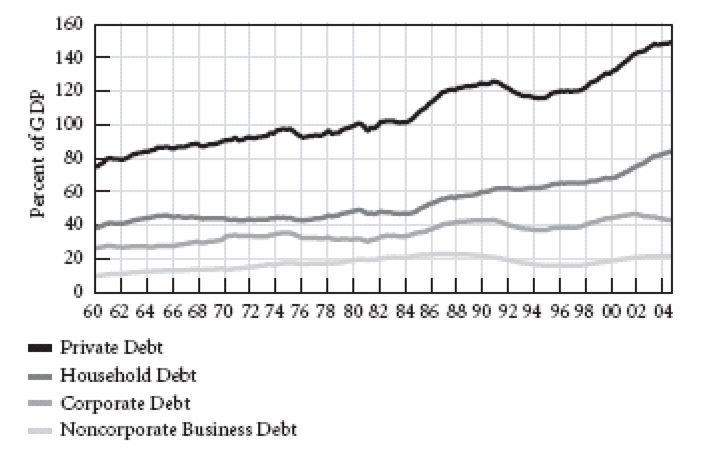
The imperialist economies are walking a tightrope between inflation and deflation. Nonetheless, whether the present downturn is short or long, it is to the 1930s that we should look for comparison, not the stagflation of the 1970s. The backdrop to the whole next period, as with the Great Depression, will be a deepening of the secular downward curve within which the business cycle will continue. For the first time since the Great Depression debt deflation is once again on the agenda. To be sure the present panic of the worlds central banks led by the Federal Reserve is preparing an inflationary spike. This may well get worse if further liquidity is injected into the system. It is a complete illusion to believe that crafty sterilisation measures will prevent inflation in such circumstances (*qua* Mulraine, 2008). Having said that, however, the underlying trend is one of deflation. The fall in the price of assets raises the real value of net debt discouraging consumption and investment. Deflationary price competition is inevitable, both domestically and through imports from low-wage economies. Once deflation has taken hold, it cannot be resolved by monetary means. Deflation is not the opposite of inflation, despite the campaigning of Krugman et al who saw exogenously produced inflation as a means to cure Japanese persistent deflation (c.f. Krugman, 2000 Ch 4ff). The evidence speaks for itself.

In what follows, I want to establish a framework for understanding this phase of imperialism. In the first section, via a dialogue with Long Cycle Theorists, I develop a series of propositions that have characterised the period of the Long Stagnation. In differentiating the classical Marxist view from that of Long Cycle Theorists, I draw the conclusion that it was exogenous factors which precipitated the Long stagnation, a downward curve of capitalist development. And that, by the same token there will be no endogenously engendered upturn to sustained growth, let alone a return to the Golden Age. I will then take a look at the factors threatening international financial instability. Applying a working hypothesis that a systemic crisis is the most likely outcome of the present global imbalances, I will look at the interlinked factors which will precipitate debt deflation. All these strands will then be drawn together to argue the deepening of a world depression.

Fits of giddiness

Bourgeois economists are having a hard time of it. Some are still in self denial: that if there is to be recession in the US it will be short and sweet. And in any event, such will have limited impact on the world economy as the core of emerging markets have “decoupled “from the imperialist economies. More serious observers like the IMF and OECD – and even latterly the Federal Reserve – are lowering their world-growth projections dramatically.[1] As to the financial crisis, many still refuse to bite the bullet. Trapped in either their neo-classical or Keynesian frameworks they are still debating whether the “credit crunch” will impact the “real economy”. Of course there is no such separation. The nearest Keynesians get is the impact of the “wealth effect” on consumer demand. Whilst that notion is not incorrect in its own terms their theoretical universe is still bounded by the Keynes-Hicks IS-LM paradigm. It is now obvious that the differential economic growth of the US relative to its major competitors lay in debt-induced consumer spending – accounting for some 70% of aggregate demand in late 2007. Already total private sector debt stood at almost 150% of GDP at the end of 2004, of which consumer debt contributed over 80%. Wynne Godley et al pointed out as early as 2005 that ‘… all it may take for net lending to fall is a slowdown in the growth rate of debt’ (Godley et al, 2005). The story is now familiar. As in other key imperialist countries, low interest rates fostered a house-price balloon. These inflated assets were then been used as collateral for higher loans, which can be used for current purchases (the ‘wealth effect’). It has been calculated that the contribution of borrowing to current spending had been some 15 per cent of disposable income, and that borrowing has mainly been through ‘revolving loans’ such as credit card debt (Dodley 2005a, and Shaikh et al 2005). The latter alone is twice the level of private sector debt registered in 1960 (see Fig 4). A collapse in the housing market is the result. Historical evidence shows such a collapse has a greater and more immediate impact on consumption than a stock market crash (IMF World Economic Outlook April 2002). At this point, the ‘wealth effect’ works in reverse, lowering aggregate demand and inducing a decline in real output (Bernanke and Carey, 1996; Bordo, Erceg, and Evans, 2000). Add the potential descent into negative equity and the resulting debt default and bankruptcy will make a major contribution to precipitating debt-deflation.

Fig 1 Private sector debt and its components



Source: Godley et al, 2005 (in turn taken from BEA).

The last decade has seen the ever closer integration of the world financial institutions, the cross-border holdings of trillions of dollars of debt and derivative instruments, and the world-dominance of a relative handful of, now shaky, multinational commercial and investment banks. The deflating bubble in asset-backed securities poses a systemic threat. This latter is all the more dangerous given the re-emergence in the last decade of universal banks - as greed reversed the legal barriers instated in the aftermath of the Great Depression. Conceptually it is still possible to make a distinction between bank and non-bank financial institutions, but what the recent turmoil has revealed is the way that credit-creating banks, investment banks, mortgage lenders, hedge funds, equity funds, insurance/assurance companies, and other smaller fries, are mere departments of each other.

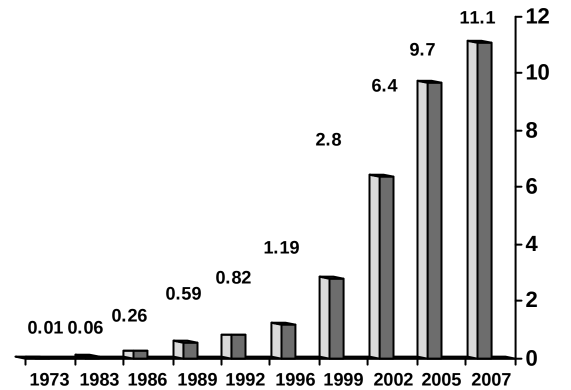
In an important sense to call the sub-prime mortgage debacle a “trigger” is a mistake. The present financial breakdown is not self contained. It is just the latest phase of a crisis which has been gathering speed since the end the Golden Age - which for the sake of simplicity we could date with the demise of Bretton Woods. The “Greenspan put” simply continued a 35 year course which relied primarily on monetary policy to blunt each shock as it struck. To be sure, the successive palliatives worked, but only at the expense of preparing a deeper crisis somewhere else in the system. The consequences of the death agony of Bretton Woods transmitted an inflationary impulse around the world. The recycling of the dollar overhang by the OPEC countries laid the basis for the Third World Debt Crisis of 1982. The Brady “solution” was a key element, amongst others, of the 1987 stock market crash, which laid bare the loss of confidence of the bourgeoisie. The coordinated panicky reaction of the main central banks merely prepared the bank failures of the late 1980s and early 90s. By then a key ingredient was the role of derivatives and other complex financial instruments whose explosive growth periodically rocked the system. The consequent massive extension of liquidity on top of that provided by the world’s central banks guaranteed the 1997 East Asian currency crisis as the “search for return” on bloated assets reversed itself and greed once more quickly turned to panic. The Russian sovereign debt default, the collapse of the dotcom(edy) of the late 1990s and the subsequent 2000 stock market crash were all of a piece. The identification of “toxic” mortgage-backed securities and other worthless bits of paper are just the latest, albeit more deadly, phase of this saga. The International Monetary Fund has suggested that these dud cheques amount to some $945tr. Others have put the figure as high as $3tr (IMF 2008; Roubini, 2008). The truth is no-one not even the big banks or the central banks know: they are still on a voyage of discovery. Despite a string of financial catastrophes involving derivatives, bourgeois economists were generally united in the belief that such developments spread risk and made the financial system more robust and more able to withstand shocks. Instead, as Bordio put it: ‘From being a vehicle for the distribution of risks and comfort in the system, securitisation now distributed fear’ (Bordio, 2008, p.11).

Despite all this liquidity the last years have witnessed a progressive decline in the proportion of investment in GDP in the major industrial economies, and, latterly even the hitherto Asian Tigers. In the heart of the beast, the mass of corporate profits has soared since the 2001 recession. These have been boosted by the increase in the dollar value of repatriated funds. The US productivity “miracle” consequential on wage- and benefit-cutting, speed-up and extension of the working day has pushed down the share of wages and salaries in national income, and pushed up the share of profits approaching its long term high. At the end of 2004, undistributed profits stood at $469bn, whilst y-o-y 2004 dividends per share increased by 12% compared with an average of 3% over the previous decade. Accordingly, non-residential fixed investment in real terms in 2004 was still below that of 2000, the height of the last boom. At the end of the second quarter of 2004 non-financial corporations held $1.3 trillion in liquid assets (Bernanke, B., 2004. See also, Federal Reserve, *Flow of Funds Account*s, 9 June 2005, Table F6; Bureau of Economic Affairs, *NIPA*, 29 June 2005 Tables 1-5; BIS (2) p. 112). (these figures need updating). This now intertwines with the global economic slowdown, the declining dollar and persistent global imbalances.

The stock market balloon was, and remains, a sign of sickness, not health. According to all historic indices, stock markets remain massively overvalued (Campbell & Shiller, R., 2001; Smithers, 2004; Morrison, C., 2004, Shiller 2008). Adding to this is that because there is less demand from industry for bond and bank finance, the latter sought income from elsewhere, notably in securitisation through the creation of ever-more exotic financial instruments. This is adding to the already mountainous stock of fictitious capital. The antics would be hilarious if its consequences weren’t so dire. Thus, for example, the securitisation of credit insurance (credit default swaps) has produced a situation whereby these instruments were sliced and diced and issued as Collateralised Debt Obligations. And what was the collateral backing these CDOs? Other CDOs! Talk about the snake eating its own tail.

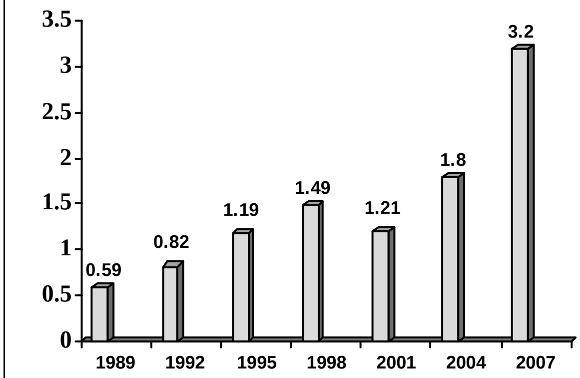
The story goes something like this: Ever since the 1987 stock market crash, the Federal Reserve (and other major central banks) have shown a marked propensity to lower interest rates to prop up declining asset prices. This has increased moral hazard and simultaneously lowered the risk premium demanded. Low interest rates and therefore the low cost of capital expands the number of profitable speculative investments, financed on credit, *ipso facto*, increasing the value of paper assets (discounted present value of projected future income streams). Hence asset prices are pushed up further, periodically engendering speculative bubbles. Fictitious capital has risen to unprecedented levels. Derivative contracts have risen virtually exponentially, in the face of the turbulent financial and commodity markets and gyrations of exchange rates. Such instruments were only marginal in 1973 and still limited in 1986, the year of the “Big Bang”. However, by the end of 2007, according to the Bank of International Settlement, over-the-counter derivative contracts had reached some $11 trillion with a nominal value of $629 trillion (see Figs 1 & 2). The majority of derivatives are in foreign exchange contracts having expanded explosively since the demise of Bretton Woods. By the end of 2007, the forex market traded to the tune of $3.2 trillion per day, the lions share grabbed by the City (of London). No-one knows, but it is estimated that somewhat in excess of 95% of currency trading is speculative in nature (Stecher, H. 1999).

Fig 2 Gross market value OTC derivatives $tr



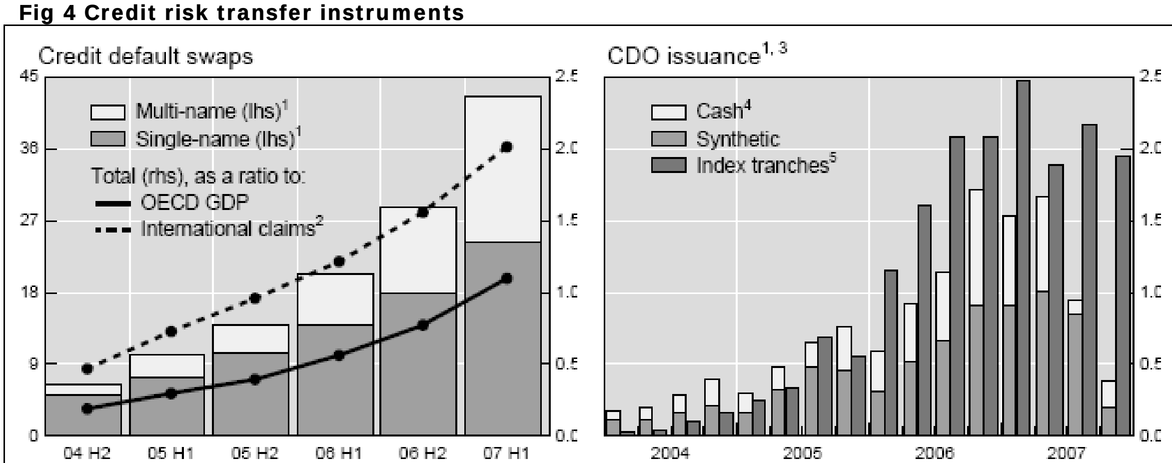
Source: BIS quarterly review up to march 2008

Fig 3 Currency market $tr per day



Source: BIS, *Triennial Central Bank Surveys*, especially March 2008

Fig 4 Credit risk transfer instruments



Source: Bordio 2008

Marx long ago identified the recurrence of such periods under capitalism when he pointed out that: '(t)he production process appears simply as an unavoidable middle term, a necessary evil for the purpose of money-making'. To which Engels added: 'This explains why all nations characterised by the capitalist mode of production are periodically seized by fits of giddiness in which they try to accomplish the money-making without the mediation of the production process' (Marx, K, 1978, p. 137, quoted Barnes, J. 2005, p. 144). Further Marx explained: 'All connection with the actual expansion process of capital is thus completely lost, right down to the last trace, confirming the notion that capital is automatically valorised by its own powers'. The result, Marx holds, is that 'interest-bearing capital generally is the mother of all crazy forms, so that, for instance, debts may appear in the eyes of the banker as commodities' in which 'even the accumulation of debts … can appear as an accumulation of capital … everything in this credit system appears in duplicate and triplicate, and is transformed into a mere phantom of the mind' (Marx, K., 1981 pp. 597 & 603). [2]

The Long Stagnation

In reality, the credit crunch, the imbalances in the world economy, and the challenge facing the dollar are just the latest form of a crisis that has been building for over a quarter century. The sharp upward lift in the rate of profit which spawned the Golden Age began to turn down in the late 1960s/early 1970s (Shaikh, A., 1987 and 1999. For the UK see Glyn, A. and Sutcliffe, B., 1972. From a different perspective see Brenner, R., 1998). With the 1974-75 synchronised international recessions, the world economy saw the opening of the period of the Long Stagnation. Or, to put it more scientifically, world capitalism entered a downward curve of development. Such downward curves do not follow the lawful periods of expansion and contraction which characterise the business cycle. There is no analogous endogenous way that the world economy will reverse its downward path. This is why the neo-liberal, supply-side policies of the 1980s turned out to be a historical *cul de sac*. Such policies did indeed prepare the seemingly impetuous growth of the US and a few other economies in the 1990s. But it is now clear that this period of expansion was deformed. It turned out that there was no 'new economic paradigm' where the business cycle no longer existed. The 2000 stock market crash and the 2001 recession simply served to show that the purported "Goldilocks" economy was indeed a fairy tale. Rather, instead of a return to the Golden Age, the world economy has entered the first stage of a new Great Depression (Barnes, J., 1999 & 2005. See also Peterson, W., 1991). From the mid-1970s on, the world economy has seen a secular decline of rates of profit, output, capital stock and productivity. This picture is laid out in Fig 2.

Several theories have been advanced to explain this unexpected development. One alternative is that propounded by the regulationist school - a theory, fashionable in the 1980s and embraced with such enthusiasm that its buzzwords have entered into general parlance. This presented the problem in the dysfunctioning of the world economy resulting from the breakdown of a "Fordist" model of capital accumulation and regulation, and the inevitable delay in re-adjusting the economy to the changes in consumer demand which had purportedly precipitated the crisis (Aglietta, M., 1980; Lipietz, 1986; Hall, S. & Jacques, M., 1989; Jessop, B. 1995). Keynesian demand management, it was alleged 'had prevented crises of over-production through the continual adjustment of mass consumption. … As a result, the life-style of workers … was even integrated into capitalist accumulation itself' (Lipietz, p. 35, emphasis in original). The problem, therefore, was an ongoing disequilibrium resulting from "de-industrialisation", the growth of a service (as opposed to an industrial) economy, and changing consumer demand. Whatever the merits of the extrapolation of 1980 trends of "de-industrialisation", the basic problem with this paradigm is that the putative shift to "post-Fordism" has failed to establish a new equilibrium at high growth rate and corresponding productivity and investment levels to that of the Golden Age. It is now quite clear that the world economy could not revert to its growth path automatically – let alone on the purported basis of bringing production into line with (new) demand. This proposition has been answered by history.

There are two, rather more serious, hypotheses.[3] The first of these argues that, looked at from a long historical perspective, growth since the mid-70s is simply a reversion to trend. What is to be explained, it claims, is the remarkable growth of the Golden Age, not the stagnation since then (Webber, M.J. & Rigby, D.L., 1996; Hobsbawm, E.J., 1994). However, the whole notion of a "historical trend" is a very dubious one. Historical averages depend on the base year (1870? 1930? 1975?). There is an implicit assumption that similar factors explain the character of growth between, say, 1870 and 1913, as between the inter-war years, or, likewise, the period of the long stagnation. Why, indeed, identify such a specific historical segment as the Golden Age? Why not follow neo-classical economists and average out the past 50 years? In my view, the reasons for the performance of the world economy are different in each of these periods. They all need specific explanations. This applies with equal force to the Long Stagnation. The "historical trends" hypothesis simply conjures away the different segments. This view is in fact little more than a radical re-iteration of the neo-classical Solow "steady state growth" model, which Anwar Shaikh in his devastating critique has been shown to be so much humbug (Shaikh, A, 2000). Thus, when looked at in secular terms (that is, ironing out the ups-and-downs of the business cycle) growth figures have exhibited a continuing downward trend since the ending of the Golden Age.

Finally, the culprit identified by the majority of academic economists was the quadrupling of oil prices in 1974. The only real evidence for such a shallow view was the coincidence of the oil price hike with the beginning of the economic slowdown. Oil, whilst entering nearly all goods production is actually - and was - a relatively small fraction of a typical firm's costs. In any event, if oil prices could play such a role, then the subsequent collapse in oil prices ought to have led to a growth and productivity spurt. This clearly didn't happen.[4] And this was because the oil prices rises of the 1970s were "validated" through an expansion of liquidity. Otherwise, these oil price rises would simply have led to a change in relative prices, not inflation, which is an upward shift in overall prices. To be sure, this change in relative prices, other things being equal, may have increased the cost to individual firms. Insofar as these increased costs were fed through into prices, this would simply lead to a decline in consumption of such commodities. Of course, passing on increased costs is not the only option. Firms could absorb such increased costs in a variety of ways, notably by taking a hit in profit margins. This course is indeed the case in the face of current rocketing oil price in today's deflationary world. So-called "cost-push" inflation was then further theorised in the "expectations augmented Phillips curve", now erected into a law, although initially based on a mere statistical observation of the movement of prices and growth (unemployment). This theorisation as been conjoined with neo-liberalism, and supply-side economics – a theorisation of the street-fighting politics of Thatcherism (and Reaganism - if the US union tops hadn't turned and fled).

All this was then thrown into the pot with the theory of globalisation. Their answer to the Long Stagnation was encapsulated in the "Washington consensus": open your borders to imperial predation and privatise your national patrimony, and sustainable development will ensue. For liberals, globalisation is a political option, rather than the form that capitalism must take, in today's imperialist stage. The problem of world poverty, economic catastrophe, and other horrors, they insist is not globalization, but the supposed obstacles in its path, whether trades unions, state protectionism, or even political and cultural factors (Wolf, M. 2004 passim). There is just one little problem with this theory: it hasn't done the job at either the international, nor national level. Internationally, trends of inequality have gone in the opposite direction. According to Angus Maddison the inter-regional spread of per capita GDP in 1820 was 3:1; in 1870, was 5:1, in 1913, 9:1; in 1950 15:1; in 1973, 13:1, and in 1998, 19:1 (Maddison, Table 3-1b, p.126). At the theoretical level neo-liberalism finds justification for the present world order in the hoary old Ricardian theory of comparative advantage: that even if you have no absolute advantage in anything, there is still a basis for trade in which all participants gain. It rests on numerous indefensible assumptions: that it is nations that trade, not capitalist concerns; that full employment always pertains; that labour is homogenous; that there are no constraints on trade; that there are no capital flows in the model, that it fails to take account of tastes - we could go on (consult any textbook on the subject). As with its sibling theory, the Hekscher-Ohlin Model, the inability of 'factor endowment' actually to explain the pattern of trade is dismissed as a "paradox". The fact is that all of today's financially powerful states achieved take-off behind protectionist barriers (Wade 2003, p. xv).

The call for the removal of all protectionist barriers – aimed especially at the semi-colonial by the likes of Martin Wolf - even if politically acceptable is completely utopian. Free trade has never existed. World trade has always been combined with protectionism. Karl Marx pointed this out long ago. Nothing has changed in the age of imperialism (*aka* globalisation) (Agosin and Tussie, 1993, p. 25; Rodrik 2001, p. 11; Chang 2002; Stiglitz 2002). The fact is that absolute advantage governs international markets just as much as it drives national markets (Shaikh, A, 1980,1996, 2000). This why semi-colonial and transition economies have right to take measures to protect themselves against the predatory policies of the imperialist countries and their marauding multinationals. Moreover, growth in semi-colonial countries yokes together both capitalist and non-capitalist modes of production, putting tight limits on the development of the domestic market and what can be achieved economically. And the more free the trade, the more unequal the exchange, again erecting insurmountable hurdles. If these theorists had pursued Ricardo's real lasting contribution - the labour theory of value - they would have found an answer to the persistence of unequal exchange, even where – and especially – barriers are removed. To be sure, access to the capital markets in the financially powerful states and foreign direct investment are indispensable for any rapid or sustained growth in the Third World (or even the transitional economies of the ex Soviet bloc, and China, Cuba and N. Korea). But such investments in the age of imperialism is a necessary evil, which in the long-run simply benefit the big bondholders, share holders and banks in the imperialist centres. Without lowering barriers to finance capital, capital flows to the semi-colonial countries is turned off. Moreover in a study commissioned by Christian Aid it has been forcefully argued that in two decades of trade liberalisation, sub-Saharan Africa is some $272bn worse off than it otherwise would have been (www.christianaid.org, accessed 26 November 2005). Unfortunately, such "anti-globalisation" critics accept the basic theoretical and political framework of its liberal defenders – but they simply want to chop off those parts with which they don't agree. The fact is that in the age of imperialism, this is how imperialism must work. The answer to the Catch-22 in which the semi-colonial world finds itself cannot be found in pleas for more developmental aid from imperialist governments or their clubs – the IMF and World Bank. The only answer is the overturn of the system which inevitably reproduces this contradiction. The present food crisis is testimony if any were needed of the lack of development of semi-colonial countries.

Downward curve of capitalist development

In economic history, the underlying secular trends which frame the business cycle have been characterised as "Long Cycles". My conception profoundly differs from this in a crucial sense. There is nothing endogenous about the downward curve. Exogenous shocks precipitate them and they will only emerge from them through similar shocks. The last time around it was World War. The Long Cycle theory (LCT) was initially proposed by the Russian economist N.D. Kondratiev in the early 1920s.[5] He postulated regular long-term cycles in prices, interest rates and other economic variables within which there continued to operate the shorter business cycle. Joseph Schumpeter took up these ideas in the 1930s, notably in his classic work *Business Cycles* when he identified Jugular waves and a shorter one within the latter, later to be dubbed a "Kuznets cycle" (Schumpeter, J 1929). Subsequently, in the 1980s,the LCT was revisited and reformulated by Ernest Mandel 1980s (Mandel, E., 1995).

In the original Kondratiev formulation, within the postulated 50 years span, we are invited to see a period of impetuous growth followed by a period of slow-down, deflation and depression, each lasting about 25 years. The fluctuations are endogenous, each period of upturn provoked by the application of qualitative technological innovations. This precipitates a more general re-organisation of capitalism at the level of distribution, organisation and exchange. However, as these technological advances are diffused throughout the world economy profits decline, price competition increases, demand contracts, and a downturn ensues. During this period of slow or nil growth, there would be new incentives to discover cost-cutting innovations. These, however would only be applied when capitalism has found a new equilibrium whereby (new) markets are found, demand expands and new profitable investment opportunities emerge sufficient to justify the costs involved in introducing the large scale application of the new technology. The types of technological leaps that Kondratiev had in mind were such things as the shift from manufacture to machinofacture at the time of the industrial revolution; and the application of steam power, and inauguration of new communications systems, like canals, railways, telegraph and so on.

Within these cycles, periods of upturn and downturn can be identified:

- Upward swing, 1780-1815; downward 1816-48
- Upward swing, 1848-73; downward, 1873-93
- Upward swing, 1893-1913; downward, 1914-1940
- Upward swing, 1940/47-73; downward 1974/5 onwards. [6]

There is a general consensus that there are distinct over-arching historical periods within capitalism. But two issues: is there a cyclical patter as suggested and can they be explained in similar endogenous fashion? The fact is that each period (whatever the dates) cover completely different epochs of capitalism; and it is clear to see that non-economic factors play a key role. They are not endogenously determined in an analogous way to the business cycle. The debate therefore concerns the mechanism generating the long-term phases. It is here that substantial flaws can be identified with the LCT. The LCT has a number of different formulations. The more vulgar proponents are simply technological determinists, an approach exemplified by Freeman and Perez. They explain: '…a new techno-economic paradigm develops initially within the old, showing its decisive advantages during the 'downswing' phase of the previous Kondratiev cycle. However, it becomes established as a dominant technological regime only after a crisis of structural adjustment, involving deep social and institutional changes, as well as the replacement of the motive branches of the economy' (Freeman, C. & Perez, C. 1988, quoted Dicken, P., p. 149. Dicken himself generally endorses this approach). The failings of such a mono-causal, technologically determinist explanand can readily be appreciated from the fact that the inception of (convergent) information technology in the 1980s and 1990s is projected as the beginning of the upward swing of a fifth Kondratiev cycle. Indeed, if the Long Cycle theory were correct, then the present period ought to be exhibiting a new impetuous upturn. Indeed, this latter is the view of Long cycle theorists of the Freeman Perez ilk, which seemed to find justification in the supposed advent of the New Economy.[7] From the vantage point of the new millennium, it is very difficult to sustain a view that suggests that the latter half of the 1990s triggered a new international secular economic upturn.

It was already clear at the time these ideas were being formulated that the communications revolution and the wider application of computerisation in no way play a role as fundamental as the shift from manufacture to machinofacture which lay at the heart of the first industrial revolution, or those technological advances at the beginning of the twentieth century, nor of the immediate post-war period. As Robert Gordon put it: 'I classify these earlier inventions into four clusters, starting with electricity (including electric motors, electric light, consumer appliances), internal combustion engine (motor transport, air transport, superhighways, supermarkets, suburbs), "rearranging molecules" (petrochemicals, plastics, pharmaceuticals), and communications/entertainment (telephone, movies, television). The "big four" were much more profound creators of productivity growth than anything that has happened recently. Much of what we see now is second order ... Enthusiasts of the internet might consider that the computer has not created the paperless society but rather a duplication of electronic activities, all of which generate paper ... ' (Gordon, J., 1999a, p. 8). In any event, a new industrial revolution or not, there has been no return to the Golden Age.

Kondratiev himself was much more nuanced. His approach focused on the role of technology in precipitating both equilibrium and disequilibrium in the capitalist system. Nonetheless, seeing the shifts endogenously generated, he found himself in the same trap when he predicted a new phase of capitalist upswing coming out of the First World War. Ernest Mandel stakes out an intermediate position. For him, the downturn segment is endogenously determined – crucially, as a result of the falling rate of profit. For him, it is only upturns that are triggered by exogenous shocks. It is not possible to square the circle by these means. He offers the same reasons for both the down-turn in the business cycle *and* the long cycle. So why the exit from the long cycle would be exogenous whilst the upturn of the business cycle is endogenous is unclear. Crucially, however, if the exit from downturn is indeed exogenous, in what way - in terms of the theory – is it possible to insist on an approximate 50-year long cycles (Mandel, E, 1995)? Historically, what we see is that there are ascending and descending curves of varying historical time-spans. The upward or downward shifts actually correlate with significant historical events, which are not immediate reflections of economic shifts. By the same token, they may or may not coincide with technological developments – and there is little evidence that the latter is a root cause. Financial and economic shocks clearly play a key role. But whether such shocks precipitate downward shifts depends on the fragility or otherwise of the world capitalist system. This latter is as much a political as an economic question, relating to the confidence of the bourgeoisie in robustness of the world order (Trotsky, L., 1941). 'There are distinct phases of economic performance, each with its own momentum', explains Angus Maddison in summing up his discussion of the various theories and his evaluation of the statistical evidence. 'The move from one phase to another has been caused by system shocks. These may well be due to predictable breakdown of some basic characteristic of a previous phase, but the timing of the change is usually governed by exogenous or accidental events which are not predictable.' (Maddison, A. 1991 p.123). The most likely culprit this time is a systemic financial crash.

Debt-Deflation

Hitherto, talk of depression and deflation were only considered appropriate in relation to Japan's economic and financial malaise. The present credit crunch has changes all that. Analogies with the 1930s now abound. To be fair, in the late 1990s, noted liberal economist Paul Krugman in his aptly titled book 'The Return of Depression Economics' highlighted '(t)he alarming string of financial crises that plagued the world in 1990s, especially the Asian contagion', and concluded that they 'bear an eerie resemblance to the Great Depression. Instead of the New World Order promised by the triumph of capitalism over socialism, the world economy has turned out to be a much more dangerous place than we imagined' (Krugman, P., 2000). His solution was conceived in terms of Keynesian monetary policy. He saw the economic depression in Japan as a "liquidity trap" the answer to which was aggressive monetary expansion by the Bank of Japan.

Japan, it has turned out was a harbinger of the present crisis. Historically, secular downward curves have been associated with deflation, following an extended period of expansion of fictitious capital. Since the onset of the Long Stagnation in the mid-1970s led by the US, they have been feeding the world economy with liquidity through monetary and/or fiscal means aimed at reviving flagging growth – whether under the banner of Monetarism or Keynesianism. This situation was magnified by the decision of Washington - together with its junior partner in London - to use the dollar and their large, deep and liquid financial markets as an international battering ram against its major competitors. In the process, it discovered that the IMF and World Bank was an ideal means to economically restructure the semi-colonial countries in the interests of the big banks and bond holders. This set-up has been aptly dubbed by Peter Gowan as the imposition of the "Dollar-Wall Street Regime" (Gowan, P., 1999, Chs. 3&4). The Bank of International Settlement is more prosaic but attests to the same reality as it avers that: '… a combination of deregulation and technological progress has had profound effects on financial systems. They are increasingly market- rather than bank-based, global in scope, and populated by ever larger and more complex forms whose activities span many sectors' (BIS, 2005, p. 151). The sum total of all of this is the present credit squeeze and financial turmoil.

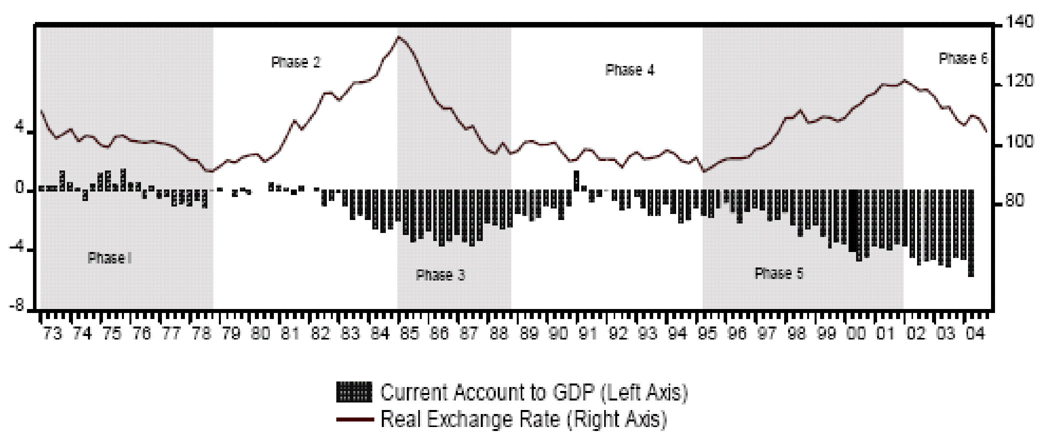
There have been a series of explanations of the Great Depression. The most notable, other than the Marxist, have been the notion of debt deflation and the Keynesian view of the lack of effective demand leading to a liquidity trap. The two most notable theorists of debt-deflation being Irving Fisher and Hyman Minsky. It is not accidental that Ben Bernanke, chair of the Federal Reserve is an advocate of the debt-deflation hypothesis. According to Fisher, over-indebtedness and deflation are the dominant forces that account for "great" depressions. But he saw this as a consequence of prior price deflation, albeit the two mutually reinforcing. Hyman Minsky developed this further by incorporating the asset markets. Minsky, argued that financial innovations have resulted from attempts on the part of the central bank to tighten up on the system and that such innovations, once instituted, have become permanent such as securitization (Minsky, 1987 p.2). Thus, given nominally-denominated debt contracts, a protracted fall in prices and nominal incomes and profits substantially increases real debt burdens, leading to personal and business bankruptcy, and, through the 'wealth effect' lowering aggregate demand. This reinforces a continuing decline in the price level and thus further increases in the real burden of debt. The process works something like the following. Falling goods prices erode profit margins leading to rising debt burdens threatening or actually occasioning bankruptcy. Insolvency is exacerbated through rising real interest rates resulting from price deflation (despite official (nominal) rates being reduced to 0% - a floor below which they cannot fall). In such an environment, businesses are reluctant to borrow for investment, as are consumers for those goods generally requiring credit finance. For their part, banks are unwilling to lend, having to cope with already existing bad loans, and unclear as to the credit-worthiness of borrowers. Concomitant declining asset prices reduces the value of collateral for bank loans. Healthy banks purchase more secure government bonds with their excess reserves. Worse yet weakened banks are forced to engage in a sale of their loans and securities, leading to further asset price deflation. The negative impact on asset markets and banks' balance sheets becomes self-reinforcing. This engenders a collapse of broad money even in the face of massive increase in liquidity by central banks. A house-price collapse would add to the agony. A vicious cycle ensues (Fisher, 1933, Parker R.E., & Fackler, J.S., 2004).

Whilst this story has some plausibility, it leaves unanswered why over-indebtedness develops in the first place, a feature we have already commented on. In any event, this theory sees money as exogenous. Adept initiatives by the central bank can deal with deflation and declining assets if handled correctly. It is quite clear that Bernanke and the Federal Reserve have followed the debt-deflation thesis of the causes of the great depression to a 'T'. But money is not exogenous. It is endogenous. As Karl Marx pointed out, the Equation of Exchange has the opposite direction of causation to that postulated by the Quantity Theorists. Industry will be provided by the banks with the credit it needs if it considers adequate royalties will be earned – whatever the central bank does. And the opposite: whatever the central bank does, if it considers the counterparty – either firms or other financial institutions – not credit-worthy it will create a credit famine, again, whatever the central bank does. This is the process we are now seeing with the problems encountered by the Federal Reserve and others to open up the credit markets.

Euro versus the dollar

Our story would be incomplete without a look at the dollar. One way out of the crisis is for the US to use the dollar as a means of making the rest of the world pay for the crisis. There is only one little problem: As the dollar has declined in relation to the major currencies, its viability a store of value is coming to be questioned. Yet there is no alternative. The distorted economic development of the last years has bequeathed grotesque international imbalances, most readily seen in the persistent unprecedented US current account deficit. Whilst this has been reduced by the substantive fall in the dollar against major currencies, the present 5% current account deficit is still unsustainable. Accordingly, as the authors of the IMF's World Economic Outlook pointed out some time ago, the question is not *whether* the current account will be reduced to a more sustainable 3% - but at what pace this will occur (IMFb 2005, p. 73). However, as Roubini and Setser have argued a collapsing dollar would lead to '… a rapid increase in US long-term interest rates and a sharp fall in the price of a range of risky assets including equities and housing. The asset price adjustment would lead to a severe slowdown in the US, and the fall in US imports associated with the US slowdown and the dollar's fall would lead to a global severe economic slowdown, if not an outright recession' (Roubini, N. and Setser, B. 2005 p. 5).

Fig 5 US dollar v current account



Source: Economic Report to the President 2005

As can be seen from Fig 5, ever since the dollar was set loose from its gold anchor with the demise of Bretton Woods, its exchange rate has gyrated wildly. Towards the end of the Golden Age, the US – and more dramatically, the UK - was losing the productivity battle internationally. The US was facing growing price competition in key sectors from a reviving Western Europe and Japan - and even some semi-colonial countries. The first response under the Nixon and Carter administrations was a deliberate depreciation of the dollar. Nixon summarily ended Bretton Woods and, on the pain of facing a 10% import surcharge, forced all the major currencies to revalue. The 18% depreciation of the dollar between 1973 to 1978 magnified the inflationary impulses set in train in the dying days of Bretton Woods. Instead of a devalued dollar reviving US manufacturing, a period of stagflation ensued. As the UK had found out much earlier, only temporary gains could be made through devaluations. The key was to be found in upping productivity. Worse in many ways than the failure to revive productivity was that the inflationary spiral actually threatened to undermine the dollar as the international store of value and reserve currency. In the face of this, the Reagan administration (in cahoots with British Prime Minister Thatcher) decided on three inter-linked measures. First, to brutally squeeze inflation out of the system in order to restore the dollar as a repository of value. Its chosen method was a draconian contraction of the money supply (so-called "monetarism"). This inevitably drove up interest rates. Secondly, it decided to tackle its anaemic productivity by launching a major assault on the trades unions and targeting the social wage. The third prong of the offensive consisted in unleashing the combined and inter-linked financial power of Wall St and the City. The massive spike in the interest rates with the Reagan presidency saw the dollar's Real Exchange Rate (RER) appreciate by an astonishing 50% between 1979 and 1985. This - amongst other things - precipitated the Third World debt crisis of 1982. In the face of the declining rate of profit and world overproduction investing in capacity expanding plant and equipment domestically was not a real option. Instead, "downsizing" became the order of the day. This required a determined assault on the working class. Headed up by a cowardly bureaucracy, the unions were routed. This allowed a re-tooling of US industry. However, it is worth noting for our subsequent argument that the technological upgrading was aimed at producing less more competitively.

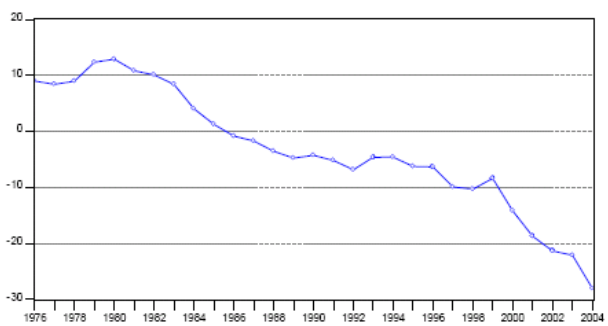
It was during this phase that the current account went into deficit, reaching some 3% of GDP by the end of 1984. Alongside the upping of productivity, a depreciation of the dollar would now aid in the process of restoring US competivity. Thus between 1985 and the end of 1988 the dollar experienced a rapidly depreciating trend. The near 30% decline in its effective exchange rate in the period after 1985 was, however, a major contributory factor in the stock market crash of 1987. The response to this relied on a dramatic pumping of liquidity into the world markets – aided especially by the UK. This spiked inflation once again, and led to a further dollar decline - 10% up to 1995. However, by the middle 1990s, sustained growth of the US economy was clear-cut. This contrasted sharply with the fortunes of its main rivals, the eurozone and Japan. A massive flow of overseas capital headed towards the US. The upshot was a major appreciation of the dollar, causing a trough-to-peak real exchange rate appreciation of 33.4%. From the other side - and more importantly - the asset price bubble of the 1990s was amplified. The stock market crash beginning in 2000 precipitated a new depreciation of the dollar, which by the end of 2004 amounted to some 14% on a trade-weighted basis. In contrast to previous periods of depreciation, however, the current account deficit continued to widen, breeching 6% of GDP (these figures have been taken from Edwards, S., 2005).

An immense body of literature now exists debating the implications of all this for the dollar, and what the effect of all this might be for the future of the US and world economy. No consensus exists. Ever since the dollar was set loose from its gold anchor with the demise of Bretton Woods, exchange rates have gyrated wildly. Between 1971 and 1980, the dollar depreciated by over 25% against the yen and deutschemark. Then again, between 1985 and 1988, the effective dollar exchange rate fell by 32%, and a further 4% up to 1995 (OECD, 2004, Ch V, p.9). To be sure, whilst the dollar has fallen some 30% against the euro since early 2002, its effective exchange rate has only fallen by some 14%. Yet one of the key reasons for this contrast is the fact that the Asian economies, especially, are pegging their currencies to the dollar. This cannot last. Meanwhile, there is a dance of death between the US and the Asian central banks. On the one hand, there is pressure from both Europe and the US for Asian central banks to revalue their currencies, especially the renminbi. This would not only undercut their export-led growth, but massively devalue their dollar assets, with potentially serious further negative economic consequences. On the other, if this were to happen, the US would lose the major funding for its fiscal deficit profligacy. Between 2002 and 2007 Asian central banks and governments have purchased dollar Treasuries to the tune of $240 billion. At the end of 2004, Asian central bank dollar holdings amounted to some $2.4 trillions with those of China standing at $600 billion and Japan's more than $650 billion (BIS (2), 2005, graph VI.6, p. 103).

Chatter about the emergence of what has been prosaically dubbed a Revised Bretton Woods system is a nonsense (Dooley, M., D. Folkerts-Landau and P. Garber 2003, 2004a, 2004b; see also, Aizenman and Marion, 2002; cf. Eichengreen, B. 2004). The durability of Bretton Woods was not only its character as a gold exchange regime, but also the fact that there was a dollar shortage. Now there is a surplus of dollars. If there is any analogy at all, it is with the dying days of Bretton Woods when the export-dependent economies of Japan and the deutschemark zone desperately bought dollars to prevent a revaluation of their currencies. Nonetheless, the purchase of US dollar assets by the Asian central banks means that the US is able to enjoy a free lunch. Take the case of China. There are two crucial determinant of the upward pressure on the Renminbi. One is dollar purchases of Chinese exports and the other is US FDI.[8] For the Chinese, exports to the US are a big deal. So to counter pressure for an appreciating currency, the Chinese central bank purchases US Treasury bonds and other low default-risk paper. This maintains the competivity of Chinese exports. The other side of the coin is that US investment flows are effectively funded by the Chinese government itself. There is somewhat of a similar story in relation to the rest of emerging Asia.[9] In 2003, US FDI amounted to $107bn to the region (WIR, 2004).

The gyrations of the dollar over the past 30 years may well have helped reverse the competitive threat from its major rivals. However, the Fed's various decisions have had dramatic unintended consequences. The 25% depreciation of the dollar in the 1970s magnified the inflationary impulses set in train in the dying days of Bretton Woods which in turn threatened to undermine the dollar as the international store of value and reserve currency. The decision by the Reagan administration to reverse this process sent US and therefore world interest rates rocketing which, amongst other things, precipitated the Third World debt crisis of 1982. The massive decline in its effective exchange rate in the period after 1985 was a major contributory factor in the stock market crash of 1987. The dramatic pumping of liquidity into the world markets in response to the latter – aided especially by the UK - spiked inflation once again, but more importantly began to inflate the asset price bubble of the 1990s. It is this which is responsible for the much talked-about 'global imbalances'. The financial markets are even shakier today than in the 1990s. Any substantial shock could trigger a crisis.

Fig 6 US Net investment Position (% GDP)



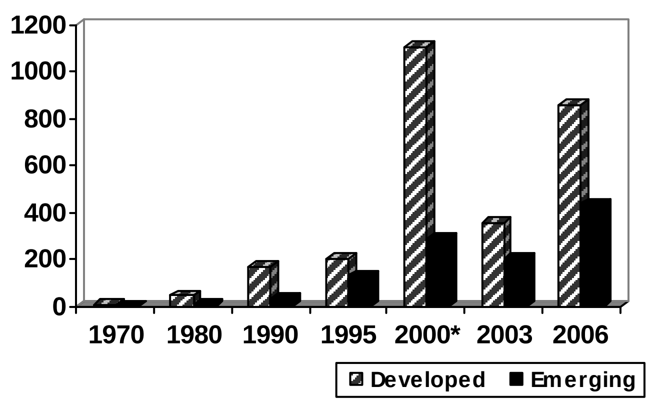
Source: BEA, International Investment Position

The dollar remains the top currency and as such, neither inward capital flows, nor demand for dollar denominated assets from central banks will dry up. No alternative is in sight, certainly not the euro. Indeed, a question mark has now been raised as to the very viability of the euro in the intermediate term. An index of their relative strengths is to be seen in the holdings of the world's central banks: Foreign Exchange Reserve Holdings (COFER) of the main central banks> Total: $6,390,611m of which dollars 4,064,806; euro: 1,075,517; yen 118,65 sterling: 190,780 (http://www.imf.org/external/np/sta/cofer/eng/cofer.pdf). This by no means rules out portfolio adjustments in favour of the euro. To the contrary, such is already happening as the dollar depreciates, and dollar holdings lose their value. But there is a finite limit to the fall of the dollar against the euro. At some point, the elevated euro exchange rate will decimate exports form the eurozone (Germany is the biggest exporter in the world, China included). At that point measures will be implemented to reverse the situation – with all the unforeseen consequences that might ensue.

Moreover, it is important to analyse US debt. As with all other economic categories debt is a social relation. US debt is not at all the same thing as debts of "emerging" markets. Interest payments are dollar denominated. The US has its hands on the printing press. The almost $2 billion per day of world savings required to cover its current account deficit is more akin to tribute from the rest of the world. One element of this is that capital inflows continue despite the fact that the return on foreign capital invested in the US is less than the return on US capital invested abroad. More important in this regard are the vagaries of capital flows into and out of the US. Ever since the US gained world hegemony after 1945, Foreign Direct Investment has always been more important for the US than trade flows pure and simple. Today U.S. sales from American subsidiaries producing and selling overseas are five times larger than total U.S. export sales. This, of course, is more and more a two-way process. During the period 1997-2001 FDI flows contributed in an increasingly important way to deficit financing: everyone wanted to part of the action of a booming US economy. Perhaps even more striking, net equity flows during that period were positive. After the stock market collapse starting in 2000, and the US recession of 2001, cross-border capital flows were cut back. Net FDI and portfolio flows from the eurozone fell away. As a result, the dollar saw a marked depreciation against the euro and other major currencies, with the marginal exception of the yen. To a large degree, the FDI and equity shortfall in the financial account was replaced by fixed income investment mainly from Asian central banks in pursuit of their dollar peg. However, by 2004, the relatively more robust growth of the US economy amongst the major economies ensured that FDI flows expanded once more. The US again overtook China as the top destination for inward flows (Christiansen, H. and Bertrand, A., 2005). This has stalled but not reversed the dollar's fall.

Whereas up to the beginning of the 1990s, Foreign Direct Investment (FDI) was essentially market-seeking and therefore primarily between the imperialist economies, since that time we have seen a secular shift towards semi-colonial and transitional economies ("emerging markets") in search of higher rates of profit, based on sucking in masses of cheap labour and therefore generating a greater mass of surplus value. The character of the FDI going into these countries, whilst undoubtedly having a trickle-down effect, makes them little more than processing zones. Plant and equipment in these countries is vertically integrated into the home multinational company (MNC).

Fig 7 FDI Developed v emerging markets 1970-2006

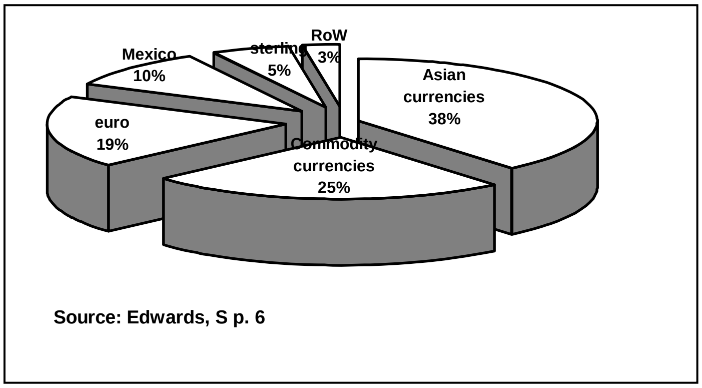


*This was a blip due to the extraordinary leap in M&A activity
Source: UNCTAD data base

This has implications for the US current account. For example, the shift in the renminbi peg and its appreciation against the dollar will only marginally affect US Chinese imports since most of them are part of the production chain of US MNCs. Not only that. As a result of such vertical integration, the shift in the effective exchange rate of the dollar will behave differently than in the past.

In the period between 1995 and 2005, the weight of the renminbi in the US dollar-basket has increase from 5.67% to 11.35%, and that of the Asian countries as a whole to some 38.8%, dwarfing the weight of the euro at 18.8%, a proportion which, reading back synthetically prior to 1999, has hardly changed since 1995. Meanwhile, sterling now accounts for a little over 5%. If the bulk of US imports come from these processing zones, and if over 50% of these imports are within MNCs, then whatever the currency movements, it is going to have less of an impact on the current account deficit than seen in previous periods.

Fig 8 Composition of US weighted Real Exchange Rate



Nonetheless, 'benign neglect' has led the US into substantial difficulties before. We have already noted the problems the dollar faced in the 1970s. However, in the late 1980s its movements became so volatility prompted the Plaza accord. In today's world of fiat money, a currency, including the dollar, is only as strong as the government that issues it. The world economy is today more fragile than at any time in history, because it is more awash with paper values than ever before. Accordingly, the international financial system is more dominated by speculation, especially in relation to currencies. Given the massive international overhang of dollars, some shock might lead international speculators to dump the dollar causing a dramatic fall. If panic takes hold, a disorderly collapse of the dollar could ensue, causing financial and economic mayhem around the world.

What about the BRICs?

Perhaps it is not viable for the eurozone or Japan to take up the baton. But certainly in the intermediate term, it is argued, a market the size of China could do the job. Every decade sees a new country or region that is going to reach the top table – something that has not happened since the consolidation of imperialism at the end of the nineteenth century. In the 1970s it was the Latin American economies – notably, Mexico, Brazil and Argentina. In the 1980s, it was the Asian Tigers. This optimism carried over to the 1990s to be joined by the transition economies of the ex Soviet bloc. Now it is China (and in some readings also India). The suggestion that China can become the motor-force of the world economy is a nonsense. The fact is that China is little more than an export processing zones tied into US (and other) MNCs attracted by cheap labour. The latter is generally low-skilled to boot. To that degree, Chinese employment in US MNCs is an integral part of US production. Thus whilst there are some spill-over effects for the Chinese economy, Chinese growth is a different thing than Chinese development (Breslin, S. 2003). Dooley et al (op. cit.) are correct to emphasise that a major motivation in the Chinese governments' dollar peg is concern to find employment in their export industries for the estimated 100 million unemployed and underemployed - on pain of widespread social unrest. There is no social wage in China. Access to unemployment compensation, social welfare, education and health are enterprise based - either factories or rural communes. Once forced off the land, labourers have no choice but to migrate to the urban centres – often illegally. If they remain unemployed, they lose everything. These workers are not suffering such conditions lying down. Protests and mass mobilisations – some of them bloody – are multiplying. These are being joined by those in work, feeling their strength as a result of employment. As with previously much-touted miracle economies, supposedly about to take over the world, as with talk about S Korea two decades ago, workers are showing their propensity to organise and protest - pushing up wage rates and winning other concessions (on this, see Krugman, J., 1994). This poses objective limits to the transformation of China into a market driven economy (aka capitalist).

The fact is that the Chinese economy is not capitalist. It is impermissible to equate the inroads of the market in general with the specifically capitalist market. This was the fundamental error in projections related to the prospects for the ex Soviet bloc countries. These are still in transition, 15 years after the event. The nature of the "privatisations" in Russia is now more broadly appreciated. It has been calculated that 22 oligarchs dominate the Russian economy, accounting for 42% of employment, 39% of sales, and, it is estimated, a higher percentage of value added. They predominate in cars and natural resources (Guriev, S. and Rachinsky, A., 2004). China is somewhat different in that it was not an industrialised country before the major openings to market forces starting in 1978. However, even to this day, most industry is still state or quasi state owned. The financial system does not function as in a capitalist economy. The Shanghai and Shenzhen stock exchanges are little more than gambling dens. Whilst there are some 1,377 listed companies on the two exchanges, some two thirds of the equity is non-tradeable. Accordingly, the take-off of the Chinese stock exchanges relies on small investors out to make speculative gains. The Shanghai composite index *doubled* between March and October 2007 – and has fallen back 21% since the beginning of the year. This is preparing a heart-rending catastrophe as small scale players pledge their homes and personal possessions to raise money for speculation. When the crash comes, it will be these "small folk" that will be most hurt ensuring a collapse into dire poverty as their homes, meagre savings and even household items are seized by the money-lenders.

Domestic funding for industry and other lending comes primarily from the (state-owned) banks. But lending is generally politically determined. Capitalist criteria of risk and return don't apply. Thus we see a phenomenon of over-investment and speculative investments generating an asset price bubble. The unsustainability of many of the State owned enterprises (SOEs) saddles the banks with large-scale bad loans. As a result, Chinese banks are technically insolvent. For the time being, the state uses its dollar assets to re-capitalise these banks – on an ongoing basis. Such a state of affairs cannot continue. If there is a substantive reason for the pressure to re-value the renminbi, it is in order to prise open the financial market to the major US banks and bond holding financial institutions. This explains all the pressure on China to revalue the renminbi, given that such a move will have little effect on the US trade deficit with China. The US is not particular concerned with the trade deficit with China, except from certain sectional interests. Over half the $162bn deficit in 2004 was accounted for by trade within US MNCs (Chandler, M., 2004), bringing it down to about the same as the $75bn deficit with Japan. Intra-MNC trade would not be affected by a renminbi revaluation. Moreover as the Japanese deficit shows - which jumped over $10bn between 2003 and 2004 - and more especially the $46bn 2004 deficit with Germany, exporters can live with an appreciating currency. Again, Chinese imports account for a mere 4.8% of US consumption excluding services which when we subtract the contribution of those imports from US MNCs, it amounts to little over 2%. It is concerned than with the exchange rate to the extent that China's fixed regime is part of the barrier to the movement of US financial capital into the Chinese financial system – its main goal.

Table 6 GDP and Demand in China
Average Annual Percentage Change and Percent of GDP, respectively

	Percentage change 1982–2004	Percent of GDP in 1982	Percent of GDP in 2004
GDP	16	100	100
Investment	19	28	45
Household consumption	15	54	43
Exports	25	8	35
Imports	25	7	33

Source: National Bureau of Statistics, China.

China has extremely high investment and relatively limited consumption in proportion to GDP. With investment rapidly growing, its share of GDP rose from 28 percent in 1982 to 45 percent in 2004 (see Table 6). During this same period, consumption decreased as a share of GDP from 54 to 43 percent. Net exports of goods and services, which were negative for most of the 1980's, have been positive since 1990, except in 1993. Net exports in proportion to GDP were 2.6 percent in 2004, somewhat above the average of 2.2 percent since the outset of the 1990s. A re-balancing of this towards consumer spending is off the agenda, particularly in the face of a stock market crash and a reverse wealth effect.

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[1] It is with a great deal of mirth that we witness the *mea culpa* of self-righteous warriors for imperialism like Martin Wolf of the *Financial Times*.

[2] The perspicacity of Marx hers is revealed even in the details when the financial system is spoken of as an "industry" and new forms of paper assets and debts are spoken of as "products".

[3] One other school locates the cause in the alleged deterioration of experience and skill in the labour force. The entry into the labour force of baby-boomers and large numbers of women (sic) in the early 1970s, it is suggested, led to such a skill-deterioration. A variant of this is the alleged lowering of the mean educational level, devaluing "human capital". It is, of course, true that education under capitalism is focused, not on raising cultural levels, but on training for work. As demand for skills decline, so does educational levels, but there is nothing new about this (on these various views, see 'Symposium: The Slowdown in Productivity Growth,' Journal of Economic Perspectives 2, Autumn, 1988

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[4] It is now fairly well established that the quadrupling of oil prices in 1974 was deliberately fostered by the US, taking advantage of the response of the main oil producers in the Arab East to the Israeli pre-emptive Yom Kippur war of aggression against them (Kapstein, E.B., 1994, Ch. 3; Gowan, P., 1999, *passim*). In the short-term, this latter had no immediate consequences for the US as oil transactions - as with most other commodities (raw materials) - are conducted through the dollar. Things were quite different for the US's two main competitors, Japan and Germany, with no domestic oil resources. In other words, the US saw oil pricing as a weapon in its economic war against its main rivals. The former suffered a deterioration in their trade balance from two directions: the increase in oil prices and the consequent fillip this gave to inflation, thereby increasing their exports prices. The US was also facing inflationary pressures, but this was offset by the depreciation of its exchange rate: the effective dollar exchange rate fell almost 25% between 1975 and 1980.

[5] Kondratiev, N. There are succinct summaries In Maddison. A. 1991; Mandel, E. 1975; Day, R.B., 1976; and Lewis, W.A., 1978.

[6] I have followed the periodisation presented by Ernest Mandel, 1995, p. 82.

[7] The fact that US conditions have not been generalised, itself dispels the assertions of a new secular upturn and the attendant 'industrial revolution, which boils down to the communications revolution and attendant investment in computer technology - and the catch-all "globalisation". But such innovation have been available to and, indeed, utilised by other economies, not just that of the United States.

[8] Additionally, there is evidence of an inflow of speculative funds betting on an appreciation of the Renminbi (UNCTAD, 2004)

[9] To prevent the erosion of their own export competivity in relation to the US, Asian economies are forced to keep their currencies in line with the renminbi.