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"Causes of Current Economic Crisis in Light of Marx's Capitalism"

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Abstract:

The specter of economic collapse is haunting the world. Bankers, bosses, politicians and economists talk about it, but none of them know what to do? Marx has now been dead for more than 100 years yet his ideas and in particular his analysis of the capitalist crisis are alive, while those of our contemporary defenders of bourgeois rule have only a zombie-like existence. For some bourgeois spokesmen, defending their ideology is primarily a matter of public relations and confidence.

Key words:

Marx, Capitalism, Causes, Economic Crisis

Introduction:

Marx observed: "As long as the social character of labour appears as the money existence of the commodity and hence as a thing outside actual production, monetary crises, independent of real crises or as an intensification of them, are unavoidable. It is evident on the other hand that, as long as a bank's credit is not undermined, it can alleviate the panic in such cases by increasing its credit money, whereas it increases this panic by contracting credit" (Marx 1991: 649)[1].As we know, financial crises are sometimes the prelude to, and sometimes the result of, a crisis of over-accumulation of capital. Sometimes, again, the financial crisis manifests itself independently of the broader economic conjuncture, that is to say does not have any significant effect on the level of profitability and the level of employment of the "factors of production" in the other sectors of the economy above and beyond the financial sphere or some specific parts of it.

As we have seen that traditional Western capitalism also has crisis in a form of different from the classical business cycle. It too has become hidebound, weighed down by giant firms whose collapse would be catastrophic for even the strongest countries. The rulers of both East and West are faced with an overwhelming dilemma[2]: their economies need to undergo a full-scale crisis to wipe out capital and smash the working class, but the size of the collapse required and of the industriesaffected is so great that this cure cannot be risked.

Methodology:

In the present study mostly secondary data have been used. In addition to this, data have also been collected from various journals, articles, newspaper archives. The research is also based on the referred sources – published, unpublished and electronic.

Discussions:

The reasons for the current crisis can be traced to the contradictory requirements that the neoliberal model for regulating the capitalist economy and its expanded reproduction is called upon to serve. This amounts to saying that it is a systemic crisis in the sense that it has been produced by, and has afflicted, the core of the neoliberal model. We can ascertain this by making a critical survey of the other interpretations of the crisis. There are interpretations of the crisis that situate it at each of, or all of, the points in the chain of securitization described above. Before we examine this in detail let us point out that what predominates is a seeking out of causality as synonymous with responsibility: "It is their fault". But the attribution of responsibility to subjects or to extraneous factors is likely to hinder comprehension of the crisis as a crisis engendered by the model of economic regulation itself. However some of important causes responsible for current economic crisis are discussed as under the following headings:

Subprime loans:

The commonest approach focuses on the issuing of subprime loans. These are loans that are generally made available to borrowers who do not fulfil some formal requirements for taking out a conventional loan. These are loans made available to the poorer layers of society and to minorities, which therefore from the viewpoint of the credit system (which bears the greatest credit risk) they also require higher interest rates to counterbalance the risk. But they are also made to borrowers from other income strata who are deeply in debt, as well as those who use this form of borrowing for buying and selling houses. Finally, they represent an opportunity for borrowing for the purpose of rescheduling loans[3]. There are other categories of loans with similar characteristics. It seems tautological, given that the crisis began with securities on subprime loans, to consider that the issuing of this type of loan is responsible for the emergence of the crisis. Even if we assume that this line or reasoning is correct, it cannot explain why such a crisis did not emerge between 1998 and 2001, when once more there was an increase in delays in paying instalments and so similar problems with the securities issued on the basis of them. The reasoning isnevertheless fallacious. Not because it is not true, but because it obscures the factors that operated in such a way as to nurture the crisis and then trigger it. Why were subprime loans issued? And why were there borrowers who took them out? The latter question seems to be easier to answer. Firstly, home ownership and the availability of cheap loans to make it possible was a significant factor in the securing consent to the neoliberal programme not only in the USA but also in other developed countries. In the course of development of the conditions for crisis, in 2002 the US president announced the (neo-conservative-oriented) Homeownership Challenge, according to which the possession of one's own home was at the heart of the American dream. He then took steps to implement the programme, whose aim was to increase the proportion of homeowners, particularly among minorities (AfroAmericans and Hispanics – those categories of the population among whom four years later one could observe the highest levels of inability to pay off loans and the highest levels of home foreclosures), that is to say to groups mostly excluded from the traditional credit system. To carry out this programme, which "could be implemented only by the state", many organizations responded, offering new types of housing loan so as to increase the options available to borrowers (evidently including the various categories of subprime, which took off spectacularly after 2002). Secondly, through the availability of loans, tax breaks and credit facilities (made possible by the existence of the home as an asset), the significance of the house itself changes: It is converted (also) – even when seen as a "roof over one's head" – into a basis for bolstering one's income and as a entry ticket to the facilities provided by the credit system. Thus, in a context of stagnating real wages and withdrawal of the state from a whole range of social services formerly provided "free of charge", the potential for increasing one's disposable income offered by entry into the credit system (particularly if the mortgage each year increases in value with the increase in land prices) is an important element not only of individual strategies but also of relief from the pressures being exerted by the system. There are other points that could be cited (for example the fact that, depending on the location of the house, one might have access to "more reputable" schools than those in the area of one's current residence), what has been said is nevertheless enough to show that the development of the subprime market was set in motion by profounder elements in the neoliberal model and that today's crisis marks the limits of incorporation of social needs through the neo-liberal model. In other words themanagement of aggregate demand via borrowing and expansion of credit as a means of counteracting constraints on wages is not an effective management mechanism. As for the first part of the hypothesis, that the issuing of subprimes is simply part of the speculative activity of the bankers who issued them, it is worth stressing that to understand the deeper significance of financial crises it is not useful to make very general references to “speculation” in the sphere of finance. All business activity is “speculative”. Every investment of capital aims at securing the highest possible level of profit. The choice of one or the other sphere of economic activity is simply the means for achieving the goal. Capital is continually migrating from one sector of business activity to another. It increases or reduces its involvement in the financial sphere. It chooses between production of one commodity and another, its only criterion being to serve the objective of higher profit. References to speculation or profiteering thus offer little to aid comprehension of the specific mechanisms out of which each concrete financial crisis emerges. Speculation as the reason for the issuing of the subprimes is linked to another more highly elaborated explanation for the appearance of the crisis: the originate and distribute (O&D) model for the functioning of banks that has become predominant as banking practice, enabling banks to acquire sections of the market and profitability after the consolidation of the neoliberal model. This is another way of saying the securitization process.

The securitization process:

The issuing of subprime is a product of the capacity for securitization possessed by the banks that issued them. Given that they simply originated the loan and distributed the risk by selling the securities to others while retaining a commission for that service (O&D: an operational model for banks), they did not have sufficient incentive to examine the quality of the credit underlying the loan they had issued, as they would have had if they had kept the loan on their own balance sheet without being able to transfer it. Because their profitability depended on the volume of securities they issued, they indeed had every incentive to extend credit without too closely examining the risks. First of all, not all subprime loans are securitized. Securitization covered 28% in 1995 but this figure from 1998 onwards began to fall, only recovering from 2001 onward. In 2001 50% of the value of the subprime loans issued were securitized. This percentage gradually rose to 60% in 2003 and between 75% and 80% from 2004 to 2006. But this is not the important figure when attempting to assess the validity of the above argument. The relaxation of the regulations and conditions for the issuing of credit, with easy acceptance of guarantees in periods of rapid growth of credit in a context of cyclical economic upturn is a general phenomenon and not something innovatory. In the specific case we are examining, in a context of record low interest rates, low inflation and stable growth in the developed economies, it appears as a natural consequence of the conditions of functioning of credit in a capitalist economy. Note that the relaxing of requirements for issuing of credit, above and beyond questions of incentive, does not involve only the initial issuers of the loans, the banks that securitize the loans, but also involves security holders, as may be seen from the observed general squeeze on the differences between all types of return from interest rates on risk-free securities (a clampdown on credit spreads) to the pursuit of "normal" profitability of capital. One line of explanation for the credit crisis which considers securitization of loans the cause of the crisis, that is to say the transfer of risk outside the portfolio of the lender, because if provides him with incentives to downgrade the quality of loan issuing, has as its necessary supplement a second cause, which is faulty assessment of the credit risk by the credit rating agencies. Because otherwise one cannot explain why securities were bought which corresponded to low quality loans (unless one evoke the ignorance of "naïve" investors). Nevertheless, persisting in the logic of "mistakes", that is to say including the "second cause" one is not enabled to explain how many holders of capital (most of them banks with research departments and immediate access to a plethora of data) internationally made a "mistake" in their purchase of securities. It suffices to take into account the common knowledge that higher yields means higher risk insurance and the fact that a certain exchange of written communications between analysts in the international organizations and the central banks has been in public circulation since 2004 at the latest, which made it clear that the methods of price calculation and credit evaluation of CDO departments are "unsound", because they do not take into account a variety of factors. Here we have to do with the intermingling of practices that are always socially over-determined (and it is on such relations that the elaboration of the specific mechanisms is based) such as those of the rating agencies, the lending and securitization mechanisms, etc. No manager of capital can easily say: "I know that the CDOs are high-risk and not easily sold and for that reason I inform you that this year you will be content with 3% profit. Don't look at others who are earning 9% profit because your money is at risk". In 2001 he would have received the answer: "introduce suitable differentiation into your portfolio, take security measures or risk insurance and throw in some money and we'll see". In 2005 they would have told him he was a fool because others have earned a lot of money by retaining a larger proportion of their portfolio in CDOs. Faced with the demand for guaranteed securities and high profits, in the climate that prevailed after 2001, we can imagine the answer of the bank directors when they find out that they can make money from issuing securities and expanding borrowing, and by falling in with the responses of the remaining parties in the securitization chain. But the pursuit of (risk-free) profit on a global scale has never been the privilege of a few. It is the outcome of arrangements (abolition of restrictions) imposed by (and making possible the elaboration of) the neoliberal model and also comprising a prerequisite for it. One consequence of neoliberalism is that a borrower who has lost his house because of a sudden increase in installment payments owing to expiry of the period of grace and insufficiency of his income may simultaneously be a participant in the mutual fund that financed the mortgage-based securities and sought the issuance of the subprimes on account of the greater profitability, as well as being holder of a truncated portion of his pension on account of the fall in value of the securities in which his insurance fund was investing. His life is thus divided up in the same way as the portfolio whose fate is determined by the good and bad moments for the markets. Before moving on to the composition of the various factors that have nurtured, and then triggered, the crisis we propose to examine one final point, which is also projected as one of the underlying reasons for it.

The bubble in housing prices and low interest rates:

In the United States a sharp rise in house prices is to be observed between 2000 and 2006, with some areas showing a greater rise than others. For example in Los Angeles and Miami a price rise of more than 160% is to be noted in a period of six years, while in Detroit the corresponding figure is 10%. On the basis of this increase in prices, construction activity starts to grow after 2002, leading to a record high level of supply of apartments in 2006 and probably playing an important role in the falling off in the increase in price rises in 2006, which in turn had an effect on the servicing of debt. Because above and beyond the fact that this period saw the expiry of the period of grace on a great proportion of loan contracts or low-repayment-rate subprimes that had been taken out previously, we have at the same time a hike in interest rates withconcomitant difficulties in servicing debts, and simultaneous incapacitation of the chain of loans for buying a house, which you could later reschedule on more favourable terms because its value would have risen. Nevertheless the average increase is considerably smaller, in fact many times smaller, than what was observed in other countries. The reasons for the increase in prices are not traceable only to expansion of credit. They should also be sought out in what was said earlier about the importance of owning one’s own home and also in the fact that following the dot.com meltdown the purchase of a house seemed like the next risk-free refuge for investments. Another important factor was of

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course the record-low interest rates after 2001 and the squeeze on various high-risk premiums. There is nevertheless a big difference between recognizing the importance of the factor of low interest rates and regarding it as the reason for the increase in house prices. Much moreso when it takes the form of a proposal that the FED should increase interest rates so as to bring a halt to the bubble in the housing market. For a start, after 2004 when the FED increased interest rates, a doubling in the proportion of subprime loans can be observed (from 335 billion in 2003 to 540 billion in 2004 and 60 billion in 2006). In general after 2004 and the gradual increase in interest rates, the categories of loans being made available included non-conventional variable-interest rate loans, that is to say the loans through the medium of which the crisis made its appearance. Even worse, the monetarist-leaning proposal claiming for an increase in interest rates large enough to be capable of curbing the rise in house prices (that is to say quite a significant rise), it amounted indeed to a proposal that the economy should be led into a recession in 2001 so as to avoid the recession of 2008.

References:

1. In Volume I of Capital, it is written: "The monetary crisis defined in the text as a particular phase of every general industrial and commercial crisis, must be clearly distinguished from the special sort of crisis, also called a monetary crisis, which may appear independently of the rest and only affects industry and commerce by its backwash. The pivot of these crises is to be found in money capital, and their immediate sphere of impact is therefore banking, the stock exchange and finance" (Marx 1990: 236).
2. Socialist Voice No. 19 (Summer) 1983 p-37
3. One example of such disqualifiers is a bad credit rating, that is to say delays of more than 90 days in paying instalments. Other examples include having an income insufficient to justify the taking out of a loan of such high value, or being employed in a job which does not guarantee a regular flow of payments, or lacking suitable documents that could justify the size of the loan in relation to the client's declared income, etc.