Capitalism in crisis, again!

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October 6, 2008

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With the crisis in the finance markets rumbling on, it is hard to make any comments on it as it is sure to become redundant. Its roots lie in the nature of financial capital, in its tendency to generate bubbles as resources are poured into specific markets in an attempt to make money. Before the housing bubble, it was dot.com. Before dot.com, it was the Savings & Loans fiasco…

The creation of such bubbles is just as regular as the denials that a bubble exists. Seeking profits, banks create credit and financial institutions speculate. The margins for error decrease as capital accumulates while rising inequality makes aggregate demand teeter on the edge. Rising debt cannot cover the repayments, new buyers cannot enter the market and the whole think collapses. Irrational exuberance gives way to fear and panic, easy credit turns into expensive, hard-to-find credit. Financial capital impacts on the real economy as industry cannot find funding and consumers cut-back on spending. Investments no longer pay off, firms go under ("Credit Crunch: The return of depression?").

Then the calls for wage cutting and bailouts begin as those who did not cause the crisis are made to pay for it. As usual.

Seeing the Tories grind their teeth and promise to re-regulate finance markets while complaining about excessive CEO pay is amusing. While trying to make political capital out of New Labour's problems they face the almost insurmountable problem that Brown followed the Tory blueprint in terms of the City – leave well alone and let the wonder of the market do its magic. As Bush's Republican regime is facing the same problems, they have decided the best course to win votes is to present a quasi-socialist critique of finance capital! Which is to be expected, as Bush's regime has implemented a quasi-socialist bailout (that is, "socialist" in the usual capitalist sense of *"state aid for the rich, market discipline for the working class"*).

In America, the Republican politicians are hamstrung by their own rhetoric and are resisting a bailout. Their perchance for less obvious forms of state intervention for capital has become a handicap now that the government needs to act. The Democrats are trying their best to make the package less obviously pro-capital, with some support for "Main Street" rather than Wall Street. Still, they are working within an administration whose rhetoric in favour of "free markets", lackadaisical concern for regulation and debt to big business means that any bailout will be tailored to the few, not the many.

A model doomed to failure

The current crisis has deep roots. Some are in the inherent dynamics of capitalism, others in the particular form current capitalism has taken (neo-liberalism). Some flow from the ideological justifications for neo-liberalism which allowed the notion of unregulated finance markets to gain such influence. These are to be found in the neoclassical analysis of the finance market.

According to the **Efficient Market Hypothesis**, information is disseminated equally among all market participants, they all hold similar interpretations of that information and all can get access to all the credit they need at any time at the same rate. In other words, everyone is considered to be identical in terms of what they know, what they can get and what they do with that knowledge and cash. This results in a theory which argues that stock markets accurately price stocks on the basis of their unknown future earnings, i.e. that these identical expectations by identical investors are correct. In other words, investors are able to correctly predict the future and act in the same way to the same information. Yet if everyone held identical opinions then

there would be no trading of shares as trading obviously implies **different** opinions on how a stock will perform. Similarly, in reality investors are credit rationed, the rate of borrowing tends to rise as the amount borrowed increases and the borrowing rate normally exceeds the leading rate. The developer of the theory was honest enough to state that the *"consequence of accommodating such aspects of reality are likely to be disastrous in terms of the usefulness of the resulting theory … The theory is in a shambles."* (W.F Sharpe, quoted by Keen, **Debunking Economics**, p. 233)

Thus the world was turned into a single person simply to provide a theory which showed that stock markets were "efficient" (i.e. accurately reflect unknown future earnings). In spite of these slight problems, the theory was accepted in the mainstream as an accurate reflection of finance markets. Why? Well, the implications of this theory are deeply political as it suggests that finance markets will never experience bubbles and deep slumps. That this contradicts the well-known history of the stock market was considered unimportant. Unsurprisingly, *"as time went on, more and more data turned up which was not consistent with"* the theory. This is because the model's world *"is clearly not our world."* The theory *"cannot apply in a world in which investors differ in their expectations, in which the future is uncertain, and in which borrowing is rationed."* It *"should never have been given any credibility — yet instead it became an article of faith for academics in finance, and a common belief in the commercial world of finance."* (Keen, **Op. Cit.**, p. 246 and p. 234)

This theory is at the root of the argument that finance markets should be deregulated and as many funds as possible invested in them. While the theory may benefit the minority of share holders who own the bulk of shares and help them pressurise government policy, it is hard to see how it benefits the rest of society. Alternative, more realistic theories, argue that finance markets show endogenous instability, result in bad investment as well as reducing the overall level of investment as investors will not fund investments which are not predicted to have a sufficiently high rate of return. All of which has a large and negative impact on the real economy. Instead, the economic profession embraced a highly unreal economic theory which has encouraged the world to indulge in stock market speculation as it argues that they do not have bubbles, booms or bursts (that the 1990s stock market bubble finally burst like many previous ones is unlikely to stop this). Perhaps this has to do the implications for economic theory for this farcical analysis of the stock market? As two mainstream economists put it:

> *"To reject the Efficient Market Hypothesis for the whole stock market … implies broadly that production decisions based on stock prices will lead to inefficient capital allocations. More generally, if the application of rational expectations theory to the virtually 'idea' conditions provided by the stock market fails, then what confidence can economists have in its application to other areas of economics … ?"* (Marsh and Merton, quoted by Doug Henwood, **Wall Street**, p. 161)

Unfortunately for ideology, reality has this bad habit of disproving it. This can be seen today, with the unregulated "efficient" finance markets proving that the neo-classical dogmas which have justified and rationalised the acts and desires of finance capital are as unrealistic and misleading as the critics argued. Unsurprisingly, given this flawed theoretical model the so-called "experts" (including those in government) none of them saw the crisis coming even though the signs of a housing bubble have existed for many, many years. And now the "experts" who failed

to see the problem are now urging us to bailout Wall Street! But, then , that is their job – to bolster the elite.

This is not to say that bad economic theory caused this crisis. No, but such ideological positions helped ensure that deregulation desired by finance capital appeared both objective and economically sensible. Such is the magic of the market, with the demand for economic theory to justify the desires for finance being meet with an appropriate supply.

Privatising profits, socialising cost and risk

With the financial markets in a panic, the calls for bailouts have increased. The shock of crisis is being used to push through a bailout for the people who caused the problems in the first place, with the state ensuring that no billionaire or banker is left behind. Yet this comes into one of the key defences of capitalism, inequality and profits for the few, namely that these are the result of "risk taking." Rather than labour being exploited, non-labour income is justified because its owners took a risk in providing money and deserve a reward for so doing.

First, it must be noted that in the mainstream neo-classical model, risk and uncertainty plays no role in generating profits. According to general equilibrium theory, there is no uncertainty (the present and future are known) and so there is no role for risk. As such, the concept of profits being related to risk is more realistic than the standard model. However, this is unrealistic in many other ways, particularly in relation to modern-day corporate capitalism.

According to capitalist myth, those who take the risks should pay the price. Yet, when push comes to shove, the socialisation of risk is always there. This is because, it is claimed, the impact of letting the banks fail would harm everyone. Strangely, though, during the good times the impact of inequality was ignored. If the few benefit the many can go hang; if the few are threatened, then the many must pay. This *"socialisation of risk"* is something capitalism is built on, not some kind of unusual event applicable in bad times. Most kinds of "risks" within capitalism do **not** contribute to production and, thanks to state aid, not that risky.

So appeals to "risk" to justify capitalism are somewhat ironic, given the dominant organisational form within capitalism – the corporation. These firms are based on *"limited liability"* which was designed explicitly to reduce the risk faced by investors. As Joel Bakan notes, before this *"no matter how much, or how little, a person had invested in a company, he or she was **personally** liable, without limit, for the company's debts. Investors' homes, savings, and other personal assess would be exposed to claims by creditors if a company failed, meaning that a person risked finance ruin simply by owning shares in a company. Stockholding could not becomes a truly attractive option … until that risk was removed, which it soon was. By the middle of the nineteenth century, business leaders and politicians broadly advocated changing the law to limit the liability of shareholders to the amounts they had invested in a company. If a person bought $100 worth of shares, they reasoned, he or she should be immune to liability for anything beyond that, regardless of what happened to the company."* Limited liability's *"sole purpose … is to shield them from legal responsibility for corporations' actions"* as well as reducing the risks of investing (unlike for small businesses). (**The Corporation**, p. 11 and p. 79)

This means that stock holders (investors) in a corporation hold no liability for the corporation's debts and obligations. As a result of this state granted privilege, potential losses cannot exceed the amount which they paid for their shares. The rationale used to justify this is the argument that

without limited liability, a creditor would not likely allow any share to be sold to a buyer of at least equivalent creditworthiness as the seller. This means that limited liability allows corporations to raise funds for riskier enterprises by reducing risks and costs from the owners and shifting them onto other members of society (i.e. an externality). It is, in effect, a state granted privilege to trade with a limited chance of loss but with an unlimited chance of gain.

This is an interesting double-standard. It suggests that corporations are not, in fact, owned by shareholders at all since they take on none of the responsibility of ownership, especially the responsibility to pay back debts. Why should they have the privilege of getting profit during good times when they take none of the responsibility during bad times? Corporations are creatures of government, created with the social privileges of limited financial liability of shareholders. Since their debts are ultimately public, why should their profits be private?

Needless to say, this reducing of risk is not limited to within a state, it is applied internationally as well. Big banks and corporations lend money to developing nations but *"the people who borrowed the money [i.e. the local elite] aren't held responsible for it. It's the people … who have to pay [the debts] off … The lenders are protected from risk. That's one of the main functions of the IMF, to provide risk free insurance to people who lend and invest in risky loans. They earn high yields because there's a lot of risk, but they don't have to take the risk, because it's socialised. It's transferred in various ways to Northern taxpayers through the IMP and other devices … The whole system is one in which the borrowers are released from the responsibility. That's transferred to the impoverished mass of the population in their own countries. And the lenders are protected from risk."* (Noam Chomsky, **Propaganda and the Public Mind**, p. 125)

Capitalism, ironically enough, has developed precisely by externalising risk and placing the burden onto other parties — suppliers, creditors, workers and, ultimately, society as a whole. *"Costs and risks are socialised,"* in other words, *"and the profit is privatised."* (Noam Chomsky, **Op. Cit.**, p. 185) To then turn round and justify corporate profits in terms of risk seems to be hypocritical in the extreme, particularly by appealing to examples of small business people whom usually face the burdens caused by corporate externalising of risk! Doug Henwood states the obvious when he writes shareholder *"liabilities are limited by definition to what they paid for the shares"* and *"they can always sell their shares in a troubled firm, and if they have diversified portfolios, they can handle an occasional wipe-out with hardly a stumble. Employees, and often customers and suppliers, are rarely so well-insulated."* Given that the *"signals emitted by the stock market are either irrelevant or harmful to real economic activity, and that the stock market itself counts for little or nothing as a source of finance"* and the argument for risk as a defence of profits is extremely weak. (**Wall Street**, p. 293 and p. 292)

So looking at the typical "risk" associated with capitalism, namely putting money into the stock market and buying shares, the idea that "risk" contributes to production is seriously flawed. As David Schweickart points out, *"[i]n the vast majority of cases, when you buy stock, you give your money not to the company but to another private individual. You buy your share of stock from someone who is cashing in his share. Not a nickel of your money goes to the company itself. The company's profits would have been exactly the same, with or without your stock purchase."* (**After Capitalism**, p. 37) In fact between 1952 and 1997, about 92% of investment was paid for by firms' own internal funds and so *"the stock market contributes virtually nothing to the financing of outside investment."* Even new stock offerings only accounted for 4% of non-financial corporations capital expenditures. (Henwood, **Op. Cit.**, p. 72) *"In spite of the stock market's large symbolic value, it is notorious that it has relatively little to do with the production of goods and services,"* notes David

Ellerman. *"The overwhelming bulk of stock transactions are in second-hand shares so the capital paid for shares usually goes to other stock traders, not to productive enterprises issuing new shares."* (**The Democratic worker-owned firm**, p. 199)

In other words, most investment is simply the "risk" associated with buying a potential income stream in an uncertain world. The buyer's action has not contributed to producing that income stream in any way whatsoever yet it results in a claim on the labour of others. At best, it could be said that a previous owner of the shares at some time in the past has *"contributed"* to production by providing money but this does not justify non-labour income. Investing in shares may rearrange existing wealth (often to the great advantage of the rearrangers) but it does produce anything. New wealth flows from production, the use of labour on existing wealth to create new wealth.

Ironically, the stock market (and the risk it is based on) harms this process. The notion that dividends represent the return for "risk" may be faulted by looking at how the markets operate in reality, rather than in theory. Stock markets react to recent movements in the price of stock markets, causing price movements to build upon price movements. According to academic finance economist Bob Haugen, this results in finance markets having endogenous instability, with such price-driven volatility accounting for over three-quarters of all volatility in finance markets. This leads to the market directing investments very badly as some investment is wasted in over-valued companies and under-valued firms cannot get finance to produce useful goods. The market's endogenous volatility reduces the overall level of investment as investors will only fund projects which return a sufficiently high level of return. This results in a serious drag on economic growth. As such, "risk" has a large and negative impact on the real economy and it seems ironic to reward such behaviour. Particularly as the high rate of return is meant to compensate for the risk of investing in the stock market, but in fact most of this risk results from the endogenous stability of the market itself. (Steve Keen, **Debunking Economics**, pp. 249–50)

Rather than individual evaluations determining "risk", these evaluations will be dependent on the class position of the individuals involved. As Schweickart notes, *"large numbers of people simply do not have any discretionary funds to invest. They can't play at all … among those who can play, some are better situated than others. Wealth gives access to information, expert advice, and opportunities for diversification that the small investor often lacks."* (**After Capitalism**, p. 34) As such, profits do not reflect the real cost of risk but rather the scarcity of people with anything to risk (i.e. inequality of wealth).

Similarly, given that the capitalists (or their hired managers) have a monopoly of decision making power within a firm, any risks made by a company reflects that hierarchy. As such, risk and the ability to take risks are monopolised in a few hands. If profit **is** the product of risk then, ultimately, it is the product of a hierarchical company structure and, consequently, capitalists are simply rewarding themselves because they have power within the workplace. In other words, because managers monopolise decision making ("risk") they also monopolise the surplus value produced by workers. However, the former in no way justifies this appropriation nor does it create it.

As production is inherently collective under capitalism, so must be the risk. As Proudhon put it, it may be argued that the capitalist *"alone runs the risk of the enterprise"* but this ignores the fact that capitalist cannot *"alone work a mine or run a railroad"* nor *"alone carry on a factory, sail a ship, play a tragedy, build the Pantheon."* He asked: *"Can anybody do such things as these, even if he has all the capital necessary?"* And so *"association"* becomes *"absolutely necessary and right"*

as the *"work to be accomplished"* is *"the common and undivided property of all those who take part therein."* If not, shareholders would *"plunder the bodies and souls of the wage-workers"* and it would be *"an outrage upon human dignity and personality."* (**The General Idea of the Revolution**, p. 219) As production is collective, so is the risk faced and, consequently, risk cannot be used to justify excluding people from controlling their own working lives or the fruit of their labour.

Needless to say, the most serious consequences of "risk" are usually suffered by working people who can lose their jobs, health and even lives all depending on how the risks of the wealthy turn out in an uncertain world. As such, it is one thing to gamble your own income on a risky decision but quite another when that decision can ruin the lives of others. With the panics in the finance markets, now is an ideal time for anarchists to argue that running an economy based on allowing the few to control, gamble and profit from the labour of the many is not only immoral, it does not work.

We need a society which is not based on bribing the rich to ensure investment and economic development. We need, as anarchists have long argued, an economy in which those who do the work control both it and its product. Unless we get the message out that capitalism needs to be ended, not propped-up, then any solution to the current panics will be paid for by the working class and the elite will, as always, benefit from the sacrifices of the many.

What now?

Of course, the faithful few will be complaining that the financial woes are do to there being too much, rather than too little, state interference. However, the awkward fact that over 30 years of financial deregulation has produced this crisis will ensure that they will remain on the fringes – particularly as the capitalist class need state action now, not pious proclamations on the need for liquidation to create a wonderful "pure" system on the ruins.

On the left, we can expect the dusting off of calls for nationalisation. For the reformist left, the Swedish financial rescue of the early 1990s is the preferred option rather than a Republican-style Savings and Loan style approach. For the "revolutionary" left, the aim will be full-blown state capitalism with, as Lenin promised, the "socialist" state nationalising the banks and so creating nine-tenths of the socialism in one fell swoop.

While social Keynesianism may be preferable to neo-liberalism or Leninist "socialism", anarchists should be stressing that this is not our only alternatives. We need to raise the point that this is a crazy way to run an economy, that we do not need to live this way bribing the rich to invest. Particularly as they do not do a good job of it ("Stop panic in the City — abolish capitalism!"). We need to raise the necessity for anarchism as replacing capitalists with state bureaucrats is no real change.

The great unknown in these times is working class people. If we remain quiet then any bailout will reflect the interests of big business, no strings attached. If we remain quiet then the costs of recovery will be inflicted on us in the shape of rising unemployment, lower wages, higher taxes. If we remain quiet, then neo-liberalism will shrug off this crisis like the previous ones and continue privatising the gains while socialising the losses and costs.

Our task as anarchists is to raise our voices and encourage direct action. Attempts to cut wages must be resisted as we did not create this crisis and because it will make it worse ("Would cutting wages reduce unemployment?"). Attempts to close workplaces must be meet by occupations.

Attempts to evict families from their homes must be stopped. We need to socialise the means of life, not have them run by a few capitalists or state bureaucrats. To do that, we need to organise community and workplace assemblies and build an alternative to a system in crisis, one based on solidarity and freedom.

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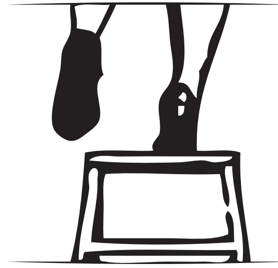

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Some comments on the continuing crisis in the stock markets, discussing how economic ideology contributed to it and how capitalism has always been based on socialising costs and risk while privatising profits.

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