Imperial Finance

The historical development of the global financial order under US hegemony

George Stapleton

2009

Contents

World Wars, Economic Ruin and the Turn to Autarky . . . 3
The Bretton Woods System . . . 4
The Bretton Woods System Begins to Unravel . . . 5
  1. The Cold War and Vietnam . . . 5
  2. The Post-War Settlement and Workers' Militancy . . . 6
  3. Control of Financial Markets and the Eurodollar Market . . . 6
Collapse of Bretton Woods . . . 7
Collapse of Keynesianism . . . 8
Smashing the Unions, the 'Volcker Shock' and the Emergence of Neo-liberalism 9
The 'End of History': The defeat of the Left . . . 10
The Clinton Boom . . . 11
The Stock Market Boom and Bubble . . . 11
Post 9–11 Jobless Recovery, Property Bubble, Debt . . . 12
US Debt and its Dependence on China . . . 13

This article tells the story of the historical development of the regime of global financial order under US hegemony. It begins by examining how the centre of capital accumulation shifted from Europe to the US in the first half of the twentieth century, and how following World War II the global financial order became centred around the US through the Bretton Woods system. It then looks at how the Bretton Woods System was undermined, concentrating as much on the role of workers militancy as on the role of the Eurodollars market. After considering the response to the crisis of Bretton Woods, it concludes by looking at the Clinton boom, bringing us up to the current situation of the US's current heavy dependence on foreign borrowing

---

During the course of the twentieth century, capitalism, a European invention, shifted its centre across the Atlantic to the US. In order to get an understanding of how this happened, it's worth going back to the period of European hegemony at the end of the nineteenth century.

The late nineteenth century was the period when the modern economic system, capitalism, emerged as a world system. Although capitalism had established itself in Britain at the start of the nineteenth century, it was not until the end of the century that it emerged as a global system. This period saw the industrialisation of Germany, the Benelux, France and America; the era of the scramble for Africa; the opening of the Suez canal; the switch from sailboats to steamboats; the opening of rail links all across the world; the telegraph etc. Added to this were the mass migrations from the old world to the new and from the country to the cities. All in all, it was an era of unprecedented economic change as the capitalist system expanded outwards from Britain to define the lives of millions across the globe.

This newly global form of capitalism rested on a system of international trade and finance based on the gold standard. The gold standard operated whereby banks held gold and gave their customers notes entitling them to a certain amount of gold. So if you had a £10 note you could go to the Bank of England and ask for £10 worth of gold and they would give it to you. As such, the value of a currency fluctuated only with the value of gold (or on the odd occasion when a currency was revalued). This made international trade and international finance very safe; it removed a lot of risk. So for example, if you wanted to buy a French product worth 100F, and 100F were worth £10, the French seller would know that he could go to the bank and get out 100F worth of gold with your £10. It didn't matter what the paper said; as long as a currency was convertible into gold it was safe and almost entirely risk free.

The rapid expansion of the world economy would never have been possible without the removal of risk ensured by the gold standard.

World Wars, Economic Ruin and the Turn to Autarky

However, this era of capitalism came to an end with World War 1. By November 1918, the world system that tied global capitalism together was in ruins. World War 1 had marked a major crisis for Europe. Of the Allied Powers, Russia had had a revolution in 1917, while Britain and France, the two major European economies of the Allies had borrowed heavily from America to fund their war effort. This placed Britain and France, previously two of the world's strongest economies, into a position where they were in massive debt.

The Central powers were both economically and politically destroyed. Both the Austro- Hungarian and Ottoman Empires were dissolved, while a Revolution toppled the Imperial German State. Germany was also burdened with massive war reparations as punishment for ‘starting’ the war.

These reparations saw large quantities of money flow from the German economy to the Allies. This money in turn flowed from the debt- ridden European powers to their American financiers. Gold flowed from Germany to Britain and France and then to America and thus greatly empowered the US on a global scale. In 1913 America had 26.6% of the world’s gold reserves, by 1924 it had 45.7%. The result was monetary chaos in Europe. European banks simply did not have enough gold reserves to continue operating on the gold standard.

In any market, if supply contracts then, with fixed demand, prices rise. What this means in the money market is that if you reduce the supply of money then interest rates increase. If banks have less money to lend they will charge the people they lend money to more. i.e. the price of money increases. If interest rates increase then it becomes more expensive to borrow, so investors don’t invest as much. This causes the economy to slow down, jobs to be lost etc. This is precisely what happened in Europe in the interwar period. The contraction in the money supply caused by the flow of money towards America was followed by mass unemployment and a general economic slow down.

This economic chaos created immense social tension in Europe as the working class grew more and more militant and organised. In response to this continent-wide tension, large sections of the bourgeoisie, backed by landed interests, abandoned the free market and turned to fascism. Meanwhile, in America, the Smoot-Hawley Tariff Act of 1930 marked the end of free trade. Quickly the internationally integrated capitalist system of the prewar period became little more than a memory as country after country shifted to beggar-thy-neighbour style economic policies. This turn to autarky (economic self-reliance) was one of the driving forces behind World War 2. From 1939–1945 Europe again fell into a war of pointless self- destruction.

The Bretton Woods System

When it became evident that the Allies were going to win the Second World War, 730 delegates from all 44 Allied nations met in Bretton Woods, New Hampshire, USA to work out how the international capitalist system would work post-war. What was agreed at Bretton Woods ultimately brought about the creation of the IMF (International Monetary Fund), the World Bank and the World Trade Organisation. The World Bank was originally called the International Bank for Reconstruction and Development, the WTO was originally called the International Trade Organisation, the US Congress vetoed the setting up of this organisation so instead of it being an organisation it was, until 1994, merely an ‘agreement’, the General Agreement on Trades and Tariffs.

The reasoning behind this conference was the Allies’ ruling class’s fear of a repetition of the chaos of the interwar period. They wanted a return to the pre-1914 situation of an internationally integrated and rapidly growing world economy. However, it was clear that after the war Europe would not have enough gold to operate under the gold standard. This turned out to be the case. By 1947, America once again had the bulk of the world’s gold reserve: 47%. In place of the gold standard a system was developed, known as the Bretton Woods system, whereby the American

dollar would be convertible into gold and every currency would have an exchange rate fixed to the US dollar. Thereby every currency would be convertible into dollars, which, in turn, were convertible into gold. The dollar was as good as gold, and every other currency as good as the dollar.

This gave the rest of the world the economic stability it desired. But, significantly, it also gave America unprecedented economic power as the centre of global capitalism. The Bretton Woods system was managed through the IMF whose headquarters were in Washington DC. The headquarters of the International Bank for Reconstruction and Development (i.e. the World Bank), which oversaw post-war international loans for 'reconstruction and development' was also in Washington DC. The GATT, which facilitated the reduction in trade tariffs and the increase in international trade, was also based in Washington DC.

The Bretton Woods system, was not a free market system i.e. it was not a system where things were determined exclusively by the price mechanism, it was a system that saw intense and constant state involvement in the international economy. Under Bretton Woods, world trade, economic integration and globalisation were in the hands of governments, whereas the central premise of the pre-1914 global system was the absence of such intervention.

The Bretton Woods System Begins to Unravel

The overtly political nature of the Bretton Woods agreement threw up its own problems. By the 1960s, these problems had generated a crisis that threw its continued existence into doubt. The major problems were:

1. The Cold War and Vietnam

Firstly, the Vietnam War threw the legitimacy of US hegemony into question within the US itself. An interesting aspect of the Bretton Woods agreement was the difficulty with which it was sold to the American ruling class. Although Bretton Woods did see America become the world hegemon, America had historically been uninterested in world hegemony, preferring isolationist policy and unilateral action. The infamous Smoot-Hawley Act of 1930, which effectively quadrupled import tariffs, drew a large degree of the blame for the total collapse of international trade in the 1930s. As noted above, even with the Bretton Woods agreement, Congress vetoed the creation of an International Trade Organisation. It must therefore be asked why the US agreed to take the position of world hegemon despite such recent history of strongly isolationist stances. The answer was given clearly by the contemporary Republican leader in the House of Representatives, who identified it as a question of *"whether thereshall be a coalition between the British sphere and the American sphere or whether there shall be a coalition between the British sphere and the Soviet sphere."* This question did not even need to be asked in countries such as France and Italy, which would surely have gone Communist without American intervention. The legitimacy of the Bretton Woods system in America was therefore tacked to the Cold War and the threat that American Capital believed the USSR posed. In the 60s, the Vietnam War threw the legitimacy of the Cold War and the extent of the Soviet threat into question.

2. The Post-War Settlement and Workers' Militancy

Secondly, and more importantly, the international post-war peace between labour and Capital was thrown into crisis. The Bretton Woods international system was not, as noted above, a pure free market system. This shift from the free market was mirrored on a national level in almost every Bretton Woods country with the emergence of Social Democracy. The

threat of the Soviet Union on an international level was matched in most Western countries by a domestic revolutionary movement. Thus, a major task in post war reconstruction was the need to bring about the defusing of the revolutionary labour movements. This was achieved by the 'Post War Settlement', which, simply put, meant that capital agreed to low profit rates, if labour agreed not to have a revolution and, more immediately, agreed to wage restraint. This post-war period was one of unprecedented economic growth, negligible unemployment, massive investment in social housing, education and health care, largely brought about through this post-war settlement. However, this settlement did not see the disempowerment of the working class.

Throughout the period, improvements in living conditions were matched by the increased power of the working class. This period saw the increasing size of the working class, its increased unionisation, large increases in unemployment benefit etc. Then, in the mid- to late-sixties, workers started demanding more than the settlement had granted them.

For instance, some 150 million strike days were taken in France in the revolutionary period of May-June 1968. These strikes resulted in a 10% wage increase, an increase in the minimum wage and extensions of union rights. In Italy, in 1969, some 60 million strike days were taken in a movement led from the shop floor. These also resulted in a 10% wage increase, reduced working hours, parity of treatment when sick for blue and white collar workers and increased union rights. In the UK in 1970–71, 25 million days were taken by striking workers. Such increased working class militancy was also seen in the US, which topped the OECD league table in days on strike per worker in 1967 and again in 1970. These struggles saw a significant increase in wages for workers across the world, increases in unemployment benefit for unemployed workers across the world, increased social investment and so on. Perhaps most significantly, it saw a significant decrease in the rate of profit and an even more significant decrease in the share of national income going to capital. The Post War Settlement was over: the working class wanted more.

These problems were compounded by a further problem for the Bretton Woods system; the emergence of the Eurodollar market.

3. Control of Financial Markets and the Eurodollar Market

The Eurodollar market began in 1957 when, following its 1956 invasion of Hungary, the Soviet Union grew increasingly worried that the US government would freeze (i.e. prevent the withdrawal of) its dollar deposits held in US banks. For this reason, it started transferring its dollar holdings into London based banks. Thus the London based banks were holding dollar deposits outside of the country in which they were legal tender — the US. As these deposits

were outside of the US they were no longer under the jurisdiction of the Federal Reserve (i.e. the US central bank). A Eurodollar is therefore a dollar held outside of the US. You can of course do this with other currencies creating what are known as Eurocurrencies. A Eurocurrency is any currency held outside of the country in which it is legal tender. For example you can have

Euro-Yuan, Euro-Yen, Euro-Sterling or even Euro-Euro. It's important to note, however, that Eurocurrencies have nothing to do with the Euro.

Eurodollars became significant in the 1960s as US Multi-National Corporations (MNCs) started investing more and more outside of the US. This Foreign Direct Investment (FDI) by US MNCs was directed primarily into Europe, and, to a lesser degree, South-East Asia. As US MNCs started investing heavily outside of the US they kept many of their deposits in dollars. This migration of capital from the US to Europe lead to many US banks entering the Eurodollars market. By 1961 US banks controlled 50% of the market.

These developments created in the Eurodollar market a financial system outside the control of the world's central banks, and therefore largely outside the control of the Bretton Woods arrangement.

With the growth of this unregulated liberal money market, and with the growth of US FDI, total US liabilities to 'foreigners' soon far exceeded the US's gold reserve (see graph above). To deal with this, President Kennedy tried to restrict US foreign lending and investment in 1963. However this attempt backfired. As Eugene Birnbaum of Chase Manhattan Bank explained, *"[f]oreign dollar loans that had previously come under the regulatory guidelines of the US government simply moved out of the jurisdictional reach. The result has been the amassing of an immense volume of liquid funds and markets — the world of Eurodollar finance — outside the regulatory authority of any country or agency".*

In brief, a situation had been created whereby US finance had simply migrated from the US into Europe, or more specifically, the City of London. As Andrew Walter put it, *"London regained its position as the centre for international financial business, but this business was centred on the dollar and the major players were American banks and their clients".*

Collapse of Bretton Woods

Combined with the problem of increased liabilities was a decrease in the US's gold reserves. This arose due to inflationary pressure as the increase in government spending pushed down the value of the dollar, causing foreign dollar holders to convert their dollars into gold.

With the continued growth in the power of the working class, government investment in social services increased. In 1964 the US saw the start of Lyndon Johnson's Great Society program. As the 60s wore on, this program increased in scope, with the increased demands of African-Americans and other sections of the working class for improved living conditions. Adding to this growth in spending was the war in Vietnam, which cost $518bn (9.4 per cent of GDP). To fund these spending increases the US government resorted to deficit spending and this borrowing drove inflation, so that the dollar was able to buy less; it was worth less.

However, as the dollar was set as being worth a certain amount of gold, it remained at the same value on the international market despite domestic inflation; the dollar was artificially strong. Increasingly holders of dollars became aware of the fact that the value of the dollar was artificially inflated and started converting their dollar holdings into gold, running down the US's gold holding, as shown in the graph above.

The US government was faced with a choice; it could rein in its economy; cut spending, thereby deflating the currency and maintaining the gold value of the dollar. Or it could simply refuse to

convert dollars into gold. In August 1971, Nixon did the latter and by 1973, the Bretton Woods system had completely collapsed.Stagflation, Workers Militancy and the

Collapse of Keynesianism

The collapse of Bretton Woods, matched with the explosion of the Eurodollar market, enabled countries to pursue extremely loose monetary policies. Countries cut interest rates to stimulate the economy. These cuts increased the money supply greatly driving inflation. There was too much money chasing too few goods, so the price of those goods increased. If prices increase then the real value of wages decrease as they can no longer buy as much. Therefore, as prices increased, workers demanded higher wages to compensate for the higher cost of living. This caused capitalists to charge even higher prices to maintain profit levels. This system of self-reinforcing inflation was referred to as stagflation because it saw inflation without increased economic growth or decreased unemployment.

A theory that many economic planners at the time were relying on was one element of Keynesian economics known as the Phillips curve. Essentially the Phillips curve is a graphical exposition of the idea that if you have high levels of inflation you will have low levels of unemployment and vice versa. The rationale behind this theory was that if you decrease interest rates you will stimulate the economy by making it easier to borrow, thereby stimulating investment. As investment increases, the demand for labour increases; unemployment falls and the economy grows.

However, in the 70s, this failed. The West experienced high levels of unemployment despite the fact that by the end of the 1970s interest rates around the world had fallen to below zero (i.e. borrowers were being paid to borrow).

The first reason worth looking at was the aforementioned working class militancy. Workers knew that capital was using inflation to cut real wages and the working class was strong enough to respond to this attack on living conditions. Workers demanded wage increases that at the very least matched inflation. Labour mobilised itself to protect its standard of living. British coal miners slowed work and then went out on strike in early 1974, forcing the country onto a three-day week. Between 1974 and 1979 an average of 12 million days a year were lost to strike action in the UK compared with an average of below 4 million for the 50s and 60s. In Italy intense class struggle saw the development of an "escalator", which tied wages to inflation. In Portugal, workers took over factories during the Carnation Revolution. In Spain, there was an explosion of class struggle as Franco's rule came to an end. In Germany, the Social Democratic government tried to assuage class struggle with its project of co- determination, which offered workers a voice in the management of the companies they worked for, while in Sweden the government developed the much more radical Meidner plan which was intended to see the gradual transfer of ownership of all enterprises in Sweden to Labour Unions.

The second reason was the 1973 oil crisis where OPEC massively increased the price of oil creating sudden and unexpected price increases across the world for almost every commodity. This increase in oil prices raised costs and cut into profits, thereby discouraging investment. It also drove inflation above the targeted level, creating uncertainty in the economy, further discouraging investment.

Added to these domestic problems was the further growth of financial markets. The Eurodollar markets received further stimulation from the surplus funds accruing to OPEC countries due

to the 1973 oil price hike. As the industrial world experienced stagflation, international banks invested Eurodollar capital in less developed countries, particularly in Latin America. Combined with innovations in financial techniques and instruments, the deregulation of the financial market and the possibilities opened up by modern communications technology, this caused the financial markets to grow rapidly, causing what some have called 'the financial revolution'. By the end of the 70s, international financial flows (i.e. movement of money between countries) dwarfed trade flows (i.e. movement of goods between countries) by a ratio of about 25 to 1. This expansion created a truly global form of capital, capable of moving from one country to another at the click of a button. This ability to move money enabled capital to escape government regulation or manipulation of the financial markets, and empowered capital to put pressure on government with the threat of disinvestment. By the late 70s, Western capitalism was in crisis. It didn't know how to respond. When a second round of OPEC oil shocks occurred in 1979, it was clear that something drastic had to be done.

Smashing the Unions, the 'Volcker Shock' and the Emergence of Neo-liberalism

On August 6th, 1979, President Jimmy Carter appointed Paul Volcker as head of the Federal Reserve. Immediately Volcker made clear his intentions. As head of the Fed, he would do whatever it took to bring inflation under control and stabilise the currency. This commitment became associated in the popular mind with the monetarism of Milton Friedman, although this is slightly inaccurate. Volcker pushed the short term interest rate up 5% to 15%, eventually bringing it above 20%. Persistent in his drive to bring down inflation, he kept interest rates at these astoundingly high levels until 1982. For capital these interest rate increases, known as the 'Volcker Shock' were like putting brakes on the economy as it began to spin out of control. In order to regain control, the Fed deliberately drove the economy into two successive recessions over this three year period. This raised unemployment to nearly 11%, drove down manufacturing output by 10% and drove down the median family income by an equal 10%.

This attack on working class living standards was secured in 1981 with Ronald Reagan's electoral victory. In this election the Professional Air Traffic Controllers Organisation (PATCO), along with the Teamsters and the Air Line Pilots Association, had departed from tradition and backed Reagan, a Republican, and not Carter, the incumbent Democratic candidate. On August 3rd, 1981, PATCO went out on strike for higher pay, better working conditions and a 32 hour week. This strike was technically illegal as government unions are not allowed to strike in the US. However, a number of government unions had gone on strike before without repercussions. This time it was different. Reagan ordered the PATCO workers back to work, threatening dismissal if they continued the strike. Few complied with these orders and on August 5th, President Reagan fired the 11,345 striking PATCO workers.

The PATCO strike and the 'Volcker Shock' marked the defeat of the working class in the long cycle of struggles that began in the mid 60s, turning the economy definitively in the interests of capital. High interest rates massively increased the return on capital. Financial investors who previously could barely earn rates of return equal to the rate of inflation could now earn the highest profit rates in memory. With the end of inflation and the inspiration of the PATCO strike, employers took a hard line when it came to wage increases. Workers, they held, could

no longer demand wage rises in line with inflation so no more increases would be forthcoming. Between 1978 and 1983 real wages in America decreased by over 10%. This decline in real wages was continuous until 1993, by which time real wages were 15% below 1978 levels.

This transformation had international ramifications. Due to the creation of the global financial market through the growth of the Eurodollars market, other countries were forced to follow suit in raising interest rates. Otherwise, they risked the migration of capital to the higher interest rates of the US. Investors would not buy German government bonds at 7% interest if US government bonds had a rate of 15%. The transformation was also matched by political shifts in Europe. Just prior to Volcker taking charge of the Fed, Thatcher had been elected Prime Minster of the UK. In Germany, for the first time since the mid-sixties, the Social Democrats lost the election in 1982 and the Christian Democrats came to power. In France, Mitterand's Socialist Party had come to power in 1981 amidst much fanfare, but had to abandon their program for government within two years as Mitterand launched the 'Franc Fort' policy following the 1983 French macroeconomic crisis. As Jeffrey Sachs and Charles Wyplosz noted in 1986, *"the government of the left has in the end introduced a tougher, more market oriented programme than anything considered by the previous centre-right administration."*

It would be cavalier not to mention here the impact that these interest rate increases had on the developing world, Latin America in particular. As mentioned above, billions of petrodollars were lent to Latin American states in the 70s through the newly global financial markets. When interest rates increased, Latin American countries had difficulty meeting their debt obligations and, one after another, defaulted causing the 1982 Latin American Debt Crisis. Latin America has yet to recover fully from this crisis, as in the years following, investors were no longer willing to invest in the region. This prolonged recession is referred to as 'the lost decade'. It was this debt crisis and the associated crisis of confidence in the Third World economy that caused and provided justification for the infamous IMF Structural Adjustment Programs of the 80s and 90s

The 'End of History': The defeat of the Left

The 1980s were a turning point which saw the defeat of the working class both in both the West and the Global South.Capital,through its increased power via the freedom of movement granted by financial markets was able to force governments to implement pro-capital, pro- market policies and abandon the expansion in social spending which had defined capitalism since the end of World War 2.

It's also worth mentioning that the contractionary policies of the Reagan administration were directly undermined by its deficit spending. Reagan, while committed to the fairy-tale idea of 'the magic of the marketplace', was even more committed to the equally fairy-tale idea of defeating the 'evil empire' (i.e. the USSR). He massively increased military spending while cutting taxes bringing the top rate down from 70% to 38% in a matter of years. These tax cuts were based on a theory famously advanced by Arthur Laffer, on the back of a napkin while having dinner with Dick Cheney, Donald Rumsfeld and others. This theory, known as the Laffer curve arguedthat as taxes got higher people worked less and saved less, and therefore that raising taxes could decrease tax revenue. The idea follows that in order to raise tax revenue you should cut taxes. Needless to say, it didn't work and the US spiralled into debt. This continued under the Bush Sr.

administration, which followed Reagan. Between the two administrations the federal debt rose from a postwar low of 33% of GDP in 1981 to 66% in 1993.

By the mid-nineties the defeat of the left and the working class was secure. The old communist parties crumbled and the old social democrats scrabbled for the 'third way'. By the mid-nineties, former leftists began coming to power again. In late 1992 Bill Clinton was elected on the back of a campaign that focused clearly on the economy. His unofficial campaign slogan was 'It's the economy, stupid.' After the long years of the 1980s and the jobless recovery following the 1990/91 recession, Americans were eager for something new.

The Clinton Boom

Fortunately for Clinton he was president during an unexpected surge in productivity growth, i.e. the amount of value created by an hour's work. The average annual rate of productivity growth from 1947 to 1973 had been 2.8%, but following the crisis of the late 60s/early 70s productivity growth slumped to 1.4% between 1973 and 1995. Unexpectedly, productivity growth surged in 1995 and from the second half of that year through to the second half of 2000 productivity growth averaged 2.7% annually. This growth in productivity laid the basis for the boom of the mid-late 90s, the now infamous 'New Economy'. This boom was further facilitated by the lax monetary policy of the Fed under Alan Greenspan.

When the Phillips curve ceased to operate in the 1970s, some economists, most famously Milton Friedman, argued there was a 'natural rate of unemployment'. When unemployment was at this rate, decreasing the interest rate would fail to stimulate the economy or reduce unemployment but would simply drive inflation. This was their theory of how stagflation occurred. As this theory grew in popularity the 'natural rate of unemployment' was quickly renamed the more diplomatic 'Non- Accelerating Inflation Rate of Unemployment' or NAIRU.

Through the 1980s and into the 90s the Fed had adhered to this doctrine and estimated that NAIRU was 6%-6.2%. So, when unemployment fell below 6% in 1990, Greenspan increased interest rates to prevent inflation, or 'overheating' of the economy. This interest rate increase slowed down the economy and helped cause the 1990/91 recession. Again in 1994 when unemployment began to fall below 6% he hiked up the interest rate. However, in the second half of 1995 when unemployment fell to 5.7% and he saw no inflationary pressures he broke from the NAIRU theory and didn't increase interest rates. Greenspan then let unemployment fall even further without increasing the interest rate. It fell below 5% in 1997, went to 4.5% in 1998 and in 1999 and 2000 settled at 4%; the lowest unemployment rate since 1969. Throughout this there was little change in the underlying rate of inflation and little change in the interest rate.

The Stock Market Boom and Bubble

This productivity boom drove a stock market boom. However, another major factor contributing to the stock market boom worth mentioning was the increase in stock ownership. This was driven by the changing nature of the pension industry. Historically, most workers' pension plans were 'defined benefit' pension plans, while today most workers have 'defined contribution' pension plans. The names of these plans explain the difference between them. Under a defined benefit plan, the benefit that workers receive when they draw their pension is defined. Under

a defined contribution pension plan, the contribution that workers make to the plan while still working is defined. Defined contribution plans grew in America following changes in the tax code in the late 70s. These changes encouraged workers to agree to defined contribution plans where workers and their employers put money into a tax-sheltered retirement account, such as 401(k) accounts. The money held in these accounts, these pension funds, was then invested on the financial markets. This meant that workers' pensions were then dependent on the performance of these investments, as under defined contribution plans the benefit at the end is not defined.

The growth in productivity, the expansion in demand in the financial markets caused by the growth of pension funds, a growing amount of delirium caused by the newness of the technology driving the productivity boom and the fact that a similar boom hadn't been seen since the 60s, all combined to cause a massive boom in the stock market which quickly turned into a bubble. As share prices grew and grew, a lot of nonsense began to be expounded. Talk developed of a 'New Economy' where share prices could only go up, where recessions were a thing of the past, where the business cycle was over, where productivity growth could only increase and increase. Many bought into this euphoric idea, and as shares prices were driven up and up, more and more people started speculating on the stock market driving shares further upwards. The demand for shares was seemingly insatiable and as such their price only went up. New Internet companies, the dotcoms, which had little to no real assets, saw their share value go through the roof as everyone looked for the new Yahoo, or AOL. Even people who saw that share prices were artificially inflated entered the market thinking that, provided they got out before the bubble burst, they'd be safe. And, of course, as with all bubbles, burst it did. In March 2000 the value of shares in dotcoms and IT companies began to tumble. Between 2000 and 2002, $5 trillion dollars in market value of technology companies was wiped out.

This bursting of the bubble was worsened by the attacks of 9–11. The New York Stock Exchange, the American Stock Exchange and the NASDAQ were closed until September 17th following the attacks. When markets reopened the Dow Jones Industrial Index fell 7.1%, its biggest ever one day fall. By the end of the week it was down 14.3%, its biggest ever one week fall. $1.4 trillion dollars in stock value was lost over this week.

Post 9–11 Jobless Recovery, Property Bubble, Debt

The Fed responded by cutting interest rates sharply from 3.5% down to 3.0%. Then following the bankruptcy of Enron and the accounting scandals that followed, the rates were cut even further to a 50 year low of 1%.It stayed at this level until 2004 when it was gradually increased until it reached 5.25% in 2006. These low interest rates stimulated the economy and it rise out of recession, meaning that the 2000/2001 recession was one of the briefest and mildest in history.

However, this recovery was not based on growth in employment and did not result in increased earnings for the working class, but was almost exclusively fuelled by borrowing. Instead of job growth, 2002 saw net job losses, which continued into 2003. By November 2004 the economy had still not regained the number of jobs it had lost in the 2000–2001 recession. Wage growth at first stalled, decreasing from 1.5% per annum in the late 90s to 0% by 2003. Then wages began decreasing! From mid 2003 to mid 2005 the median hourly wage fell by more than 1%.

People have referred to the post 9–11 recovery as a jobless recovery. This 'jobless recovery' was almost solely driven by consumer demand and government spending. Despite falling income, consumer spending from November 2001 to August 2004 surged by 9%. This was driven by a $4 trillion increase in household borrowing between 2000 and 2005. The government was also borrowing heavily, running a current account deficit of more than $700 billion, the equivalent of 6% of GDP.

This borrowing-driven boom was fuelled firstly by house price inflation and secondly by foreign borrowing, in particular from China.

Housing prices exploded between 2001 and 2007. The incredibly low interest rates of 2001-2004 had made it extremely easy to borrow and acquire credit. This availability of credit enabled more and more people to buy or invest in property driving up the price of property and thereby causing a housing boom.

It important to note that house price inflation is not wealth creation. House prices do not go up because houses become more productive; they go up because of a decrease in supply or, as in this case, an increase in demand. House price inflation does not contribute to the productive capacities of an economy; it merely transfers wealth from the house-buyer to the house-seller. As the Economist points out, *"[f]or a given housing stock, when prices rise, the capital gain to the home-owners is offset by the increased future living costs of non-home-owners. Society as a whole is no better off. Rising house prices do not create wealth, they merely redistribute it."* In August 2007 the housing bubble burst, and more than a year later we are still feeling the brunt of this.

US Debt and its Dependence on China

The US was spending far beyond its means during the 2001–2007 period. This behaviour was financed primarily by foreign borrowing, largely from emerging economies, China in particular.

China was buying large amounts of dollar denominated assets, in particular US Treasury bills or T-bills. By buying these assets it drove up the dollar, increasing US demand for Chinese goods & driving down the Yuan keeping the price of Chinese goods low on the international market. An added reason for China (and other emerging economies) to buy dollar denominated assets was to mitigate risk. Following the 1997–98 East Asian Crisis most East Asian countries have tried to accumulate large stocks of dollar denominated assets in order to be able to respond should a speculative attack on their economy occur.

The decreased health of the US economy and its increased dependence on foreign credit has left the US in a significantly decreased position of world economic power. It is no longer possible to say that there are no free- market economies that rival the US in terms of size. It is expected that the Chinese economy will exceed the size of the US economy by 2030, and added to this is the increased integration of the EU economy and the growth of India.

How the decreased economic significance of the US will play out over the forthcoming years is anyone's guess. It is worth remembering that Europe lost its position as global economic hegemon largely due to excessive borrowing from the US in the first half of this century. Considering how indebted the US is today, this certainly doesn't bode well for its future. However, as of yet the US faces no realistic challenger and we certainly shouldn't rule out the US economy bouncing back and reasserting its centrality in and hegemony over global capitalism.

This is the second of a series of articles covering the financial and money markets from a critical perspective. However, this article is completely independent of the first article, 'Financial Weapons of Mass Destruction', which appeared in the previous issue of Red and Black Revolution. Despite being part of a wider research project, the author, time-frame and most of the subject matter of both articles are totally separate and the two need not be read together.

In 'Financial Weapons of Mass Destruction' Paul Bowman examined the derivatives market and promised that the succeeding article would cover the 'story of the historical development of successive regimes of global financial orders' and would explain the role of the Eurodollars market 'in undermining the Keynesian Bretton Woods system'.In the interests of space and relevance however, this article only tells the story of the historical development of the regime of global financial order under US hegemony. It begins by examining how the centre of capital accumulation shifted from Europe to the US in the first half of the twentieth century, and how following World War II the global financial order became centred around the US through the Bretton Woods system. It then looks at how the Bretton Woods System was undermined, concentrating as much on the role of workers militancy as on the role of the Eurodollars market. After considering the response to the crisis of Bretton Woods, it concludes by looking at the Clinton boom, bringing us up to the current situation of the US's current heavy dependence on foreign borrowing.

The Anarchist Library
Anti-Copyright

George Stapleton
Imperial Finance
The historical development of the global financial order under US hegemony
2009

Retrieved on 15th November 2021 from www.wsm.ie
Published in *Red & Black Revolution* No. 15 — Spring 2009.

theanarchistlibrary.org