DAVID HARVEY

THE ENIGMA *of* CAPITAL

AND THE CRISES *of* CAPITALISM

The Enigma of Capital

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The Enigma of Capital and the Crises of Capitalism

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Preamble

This book is about capital flow.

Capital is the lifeblood that flows through the body politic of all those societies we call capitalist, spreading out, sometimes as a trickle and other times as a flood, into every nook and cranny of the inhabited world. It is thanks to this flow that we, who live under capitalism, acquire our daily bread as well as our houses, cars, cell phones, shirts, shoes and all the other goods we need to support our daily life. By way of these flows the wealth is created from which the many services that support, entertain, educate, resuscitate or cleanse us are provided. By taxing this flow states augment their power, their military might and their capacity to ensure an adequate standard of life for their citizens. Interrupt, slow down or, even worse, suspend the flow and we encounter a crisis of capitalism in which daily life can no longer go on in the style to which we have become accustomed.

Understanding capital flow, its winding pathways and the strange logic of its behaviour is therefore crucial to our understanding of the conditions under which we live. In the early years of capitalism, political economists of all stripes struggled to understand these flows and a critical appreciation of how capitalism worked began to emerge. But in recent times we have veered away from the pursuit of such critical understanding. Instead, we build sophisticated mathematical models, endlessly analyse data, scrutinise spread sheets, dissect the detail and bury any conception of the systemic character of capital flow in a mass of papers, reports and predictions.

When Her Majesty Queen Elizabeth II asked the economists at the London School of Economics in November 2008 how come they had not seen the current crisis coming (a question which was surely on everyone’s lips but which only a feudal monarch could so simply pose and expect some answer), the economists had no ready response. Assembled together under the aegis of the British Academy, they could only confess in a collective letter to Her Majesty, after six months of study, rumination and deep consultation with key policy makers, that they had somehow lost sight of what they called ‘systemic risks’, that they, like everyone else, had been lost in a ‘politics of denial’. But what was it that they were denying?

My early seventeenth-century namesake William Harvey (like me, born a ‘Man of Kent’) is generally credited with being the first person to show correctly and systemically how blood circulated through the human body. It was on this basis that medical research went on to establish how heart attacks and other ailments could seriously impair, if not terminate, the life force within the human body. When the blood flow stops the body dies. Our current medical understandings are, of course, far more sophisticated than Harvey could have imagined. Nevertheless, our knowledge still rests on the solid findings that he first laid out.

In trying to deal with serious tremors in the heart of the body politic, our economists, business leaders and political policy makers have, in the absence of any conception of the systemic nature of capital flow, either revived ancient practices or applied postmodern conceptions. On the one hand the international institutions and pedlars of credit continue to suck, leech-like, as much of the lifeblood as they can out of all the peoples of the world – no matter how impoverished – through so-called ‘structural adjustment’ programmes and all manner of other stratagems (such as suddenly doubling fees on our credit cards). On the other, the central bankers are flooding their economies and inflating the global body politic with excess liquidity in the hope that such emergency transfusions will cure a malady that calls for far more radical diagnosis and interventions.

In this book I attempt to restore some understanding of what the flow of capital is all about. If we can achieve a better understanding of the disruptions and destruction to which we are all now exposed, we might begin to know what to do about it.

David Harvey
New York, October 2009

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The Disruption

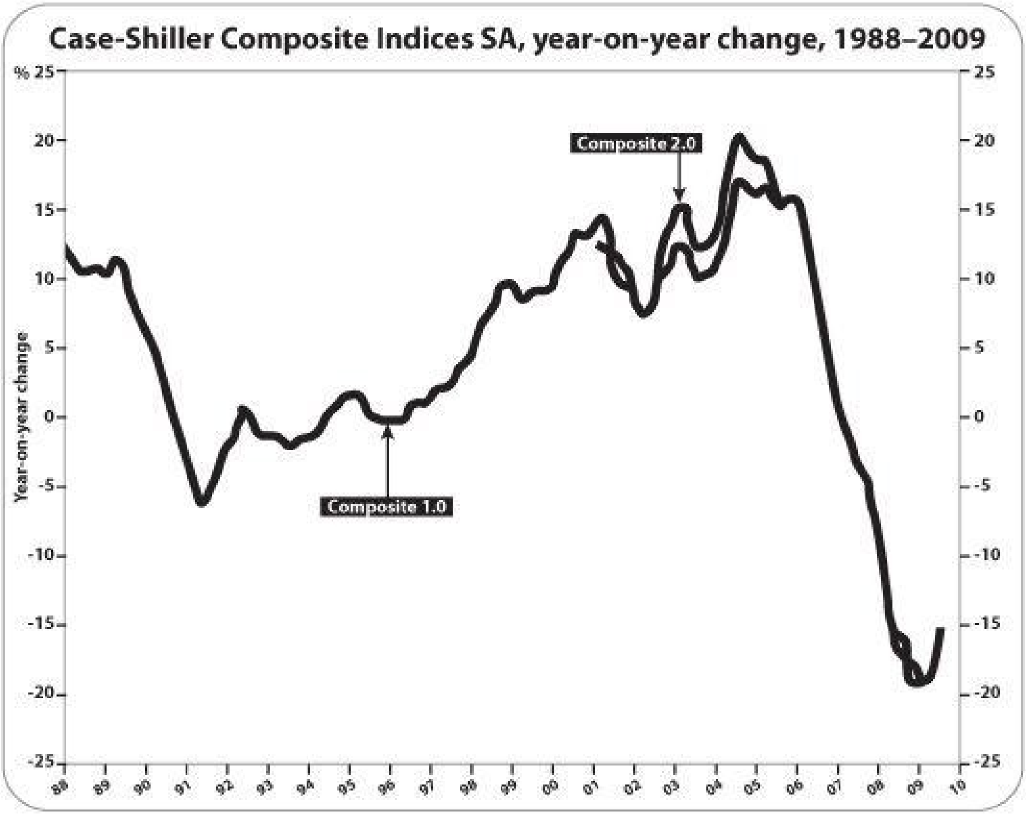
Something ominous began to happen in the United States in 2006. The rate of foreclosures on housing in low income areas of older cities like Cleveland and Detroit suddenly leapt upwards. But officialdom and the media took no notice because the people affected were low income, mainly African-American, immigrant (Hispanics) or women single-headed households. African-Americans in particular had actually been experiencing difficulties with housing finance from the late 1990s onwards. Between 1998 and 2006, before the foreclosure crisis struck in earnest, they were estimated to have lost somewhere between $71 billion and $93 billion in asset values from engaging with so-called subprime loans on their housing. But nothing was done. Once again, as happened during the HIV/AIDS pandemic that surged during the Reagan administration, the ultimate human and financial cost to society of not heeding clear warning signs because of collective lack of concern for, and prejudice against, those first in the firing line was to be incalculable.

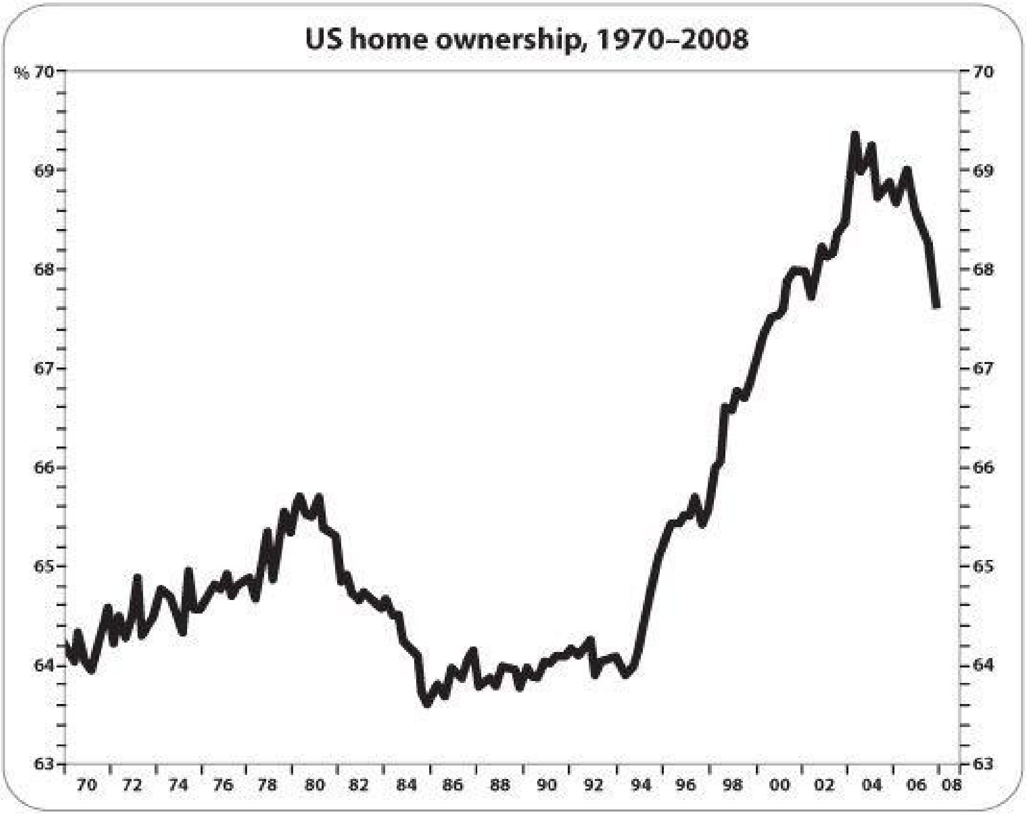
It was only in mid-2007, when the foreclosure wave hit the white middle class in hitherto booming and significantly Republican urban and suburban areas in the US south (particularly Florida) and west (California, Arizona and Nevada), that officialdom started to take note and the mainstream press began to comment. New condominium and housing tract development (often in ‘bedroom communities’ or across peripheral urban zones) began to be affected. By the end of 2007, nearly 2 million people had lost their homes and 4 million more were thought to be in danger of foreclosure. Housing values plummeted almost everywhere across the US and many households found themselves owing more on their houses than they were worth. This set in motion a downward spiral of foreclosures that depressed housing values even further.

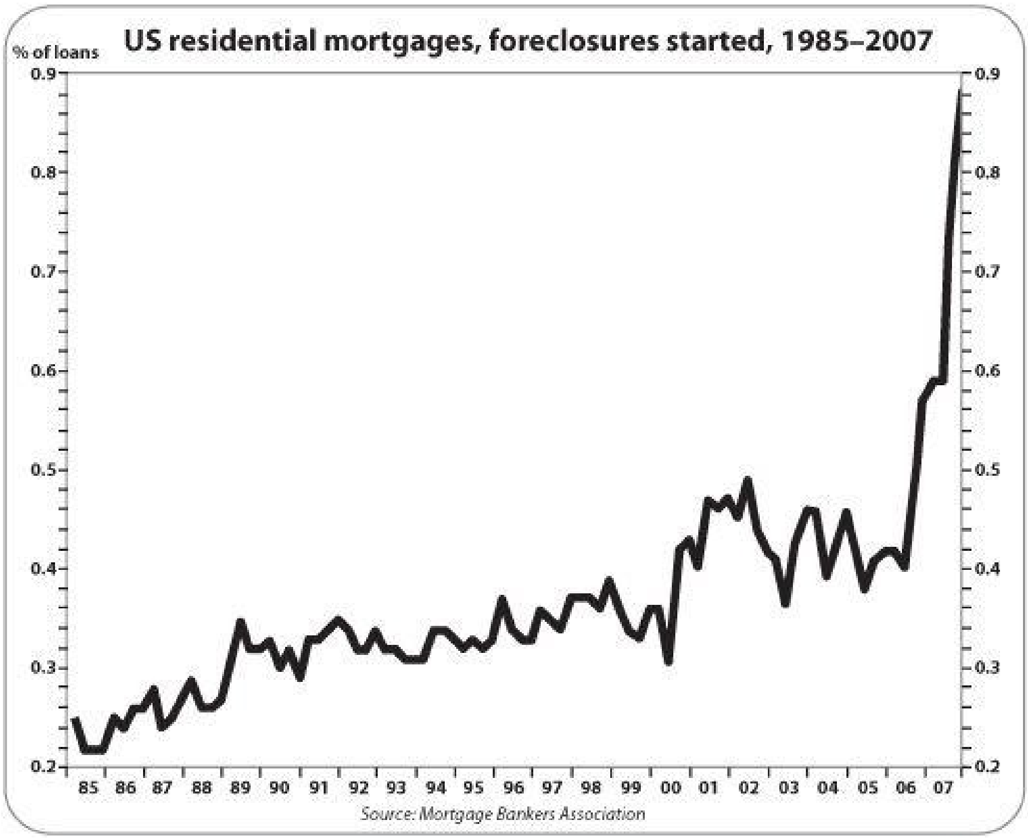
In Cleveland, it looked like a ‘financial Katrina’ had hit the city. Abandoned and boarded-up houses dominated the landscape in poor, mainly black neighbourhoods. In California, the streets of whole towns, like Stockton, were likewise lined with empty and abandoned houses, while in Florida and Las Vegas condominiums stood empty. Those who had been foreclosed upon had to find accommodation elsewhere: tent cities began to form in California and Florida. Elsewhere, families either doubled up with friends and relatives or turned cramped motel rooms into instant homes.

Those who stood behind the financing of this mortgage catastrophe initially appeared strangely unaffected. In January 2008, Wall Street bonuses added up to $32 billion, just a fraction less than the total in 2007. This was a remarkable reward for crashing the world’s financial system. The losses of those at the bottom of the social pyramid roughly matched the extraordinary gains of the financiers at the top.

But by the autumn of 2008 the ‘subprime mortgage crisis’, as it came to be called, had led to the demise of all the major Wall Street investment banks, through change of status, forced mergers or bankruptcy. The day the investment bank Lehman Brothers went under – 15 September 2008 – was a defining moment. Global credit markets froze, as did most lending worldwide. As the venerable ex-chair of the Federal Reserve, Paul Volcker (who five years earlier, along with several other knowledgeable commentators, had predicted financial calamity if the US government did not force the banking system to reform its ways) noted, never before had things gone downhill 'quite so fast and quite so uniformly around the world'. The rest of the world, hitherto relatively immune (with the exception of the United Kingdom, where analogous problems in the housing market had earlier surfaced such that the government had been forced to nationalise a major lender, Northern Rock, early on), was dragged precipitously into the mire generated primarily by the US financial collapse. At the epicentre of the problem was the mountain of 'toxic' mortgage-backed securities held by banks or marketed to unsuspecting investors all around the world. Everyone had acted as if property prices could rise for ever.







By autumn 2008, near-fatal tremors had already spread outwards from banking to the major holders of mortgage debt. United States government-chartered mortgage institutions Fannie Mae and Freddie Mac had to be nationalised. Their shareholders were destroyed but the bondholders, including the Chinese Central Bank, remained protected. Unsuspecting investors across the world, from pension funds, small regional European banks and municipal governments from Norway to Florida, who had been lured into investing in pools of 'highly rated' securitised mortgages, found themselves holding worthless pieces of paper and unable to meet their obligations or pay their employees. To make matters worse, insurance giants like AIG, which had insured the risky bets of US and international banks alike, had to be bailed out because of the huge claims they faced. Stock markets swooned as bank shares in particular became almost worthless; pension funds cracked under the strain; municipal budgets shrank; and panic spread throughout the financial system.

It became clearer and clearer that only a massive government bail-out could work to restore confidence in the financial system. The Federal Reserve reduced interest rates almost to zero. Shortly after Lehman's bankruptcy, a few Treasury officials and bankers including the Treasury Secretary, who was a past president of Goldman Sachs, and the present CEO of Goldman, emerged from a conference room with a three-page document demanding a $700 billion bail-out of the banking system while threatening Armageddon in the markets. It seemed like Wall Street had launched a financial coup against the government and the people of the United States. A few weeks later, with caveats here and there and a lot of rhetoric, Congress and then President George Bush caved in and the money was sent flooding off, without any controls whatsoever, to all those financial institutions deemed 'too big to fail'.

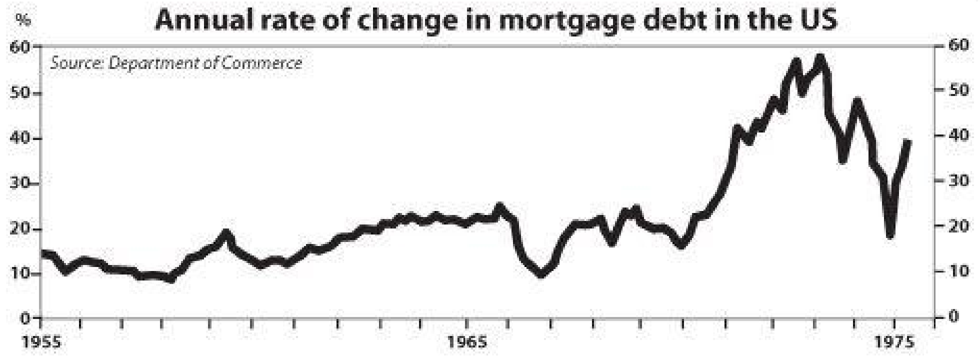
But credit markets remained frozen. A world that had earlier appeared to be 'awash with surplus liquidity' (as the IMF frequently reported) suddenly found itself short on cash and awash with surplus houses, surplus offices and shopping malls, surplus productive capacity and even more surplus labour than before.

By the end of 2008, all segments of the US economy were in deep trouble. Consumer confidence sagged, housing construction ceased, effective demand imploded, retail sales plunged, unemployment surged and stores and manufacturing plants closed down. Many traditional icons of US industry, such as General Motors, moved closer to bankruptcy, and a temporary bail-out of the Detroit auto companies had to be organised. The British economy was in equally serious difficulty, and the European Union was impacted, though unevenly, with Spain and Ireland along with several of the eastern European states which had recently joined the Union most seriously affected. Iceland, whose banks had speculated in these financial markets, went totally bankrupt.

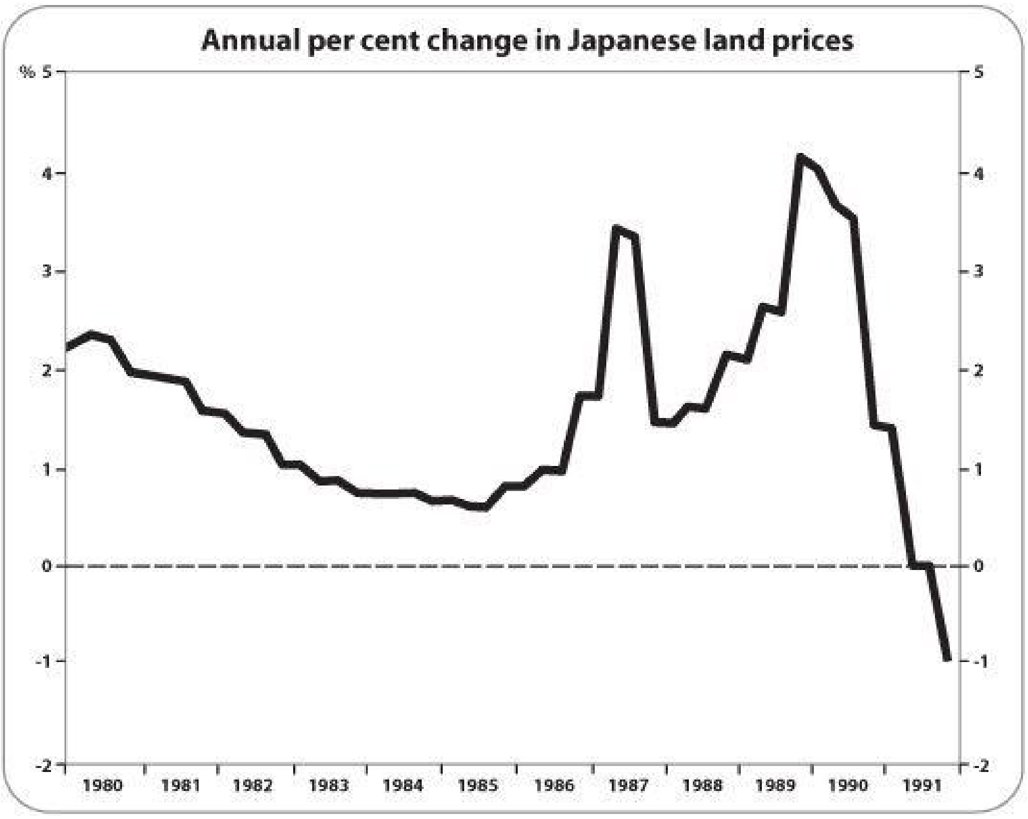
By early 2009 the export-led industrialisation model that had generated such spectacular growth in east and south-east Asia was contracting at an alarming rate (many countries like Taiwan, China, South Korea and Japan saw their exports falling by 20 per cent or more in just two months). Global international trade fell by a third in a few months creating stresses in export-dominated economies such as those of Germany and Brazil. Raw material producers, who rode high in the summer of 2008, suddenly found prices plunging, bringing serious difficulties for oil-producing countries like Russia and Venezuela, as well as the Gulf States. Unemployment began to increase at a startling rate. Some 20 million people were suddenly unemployed in China and troubling reports of unrest surfaced. In the United States the ranks of the unemployed increased by over 5 million in a few months (again, heavily concentrated in African-American and Hispanic communities). In Spain the unemployment rate leapt to over 17 per cent.

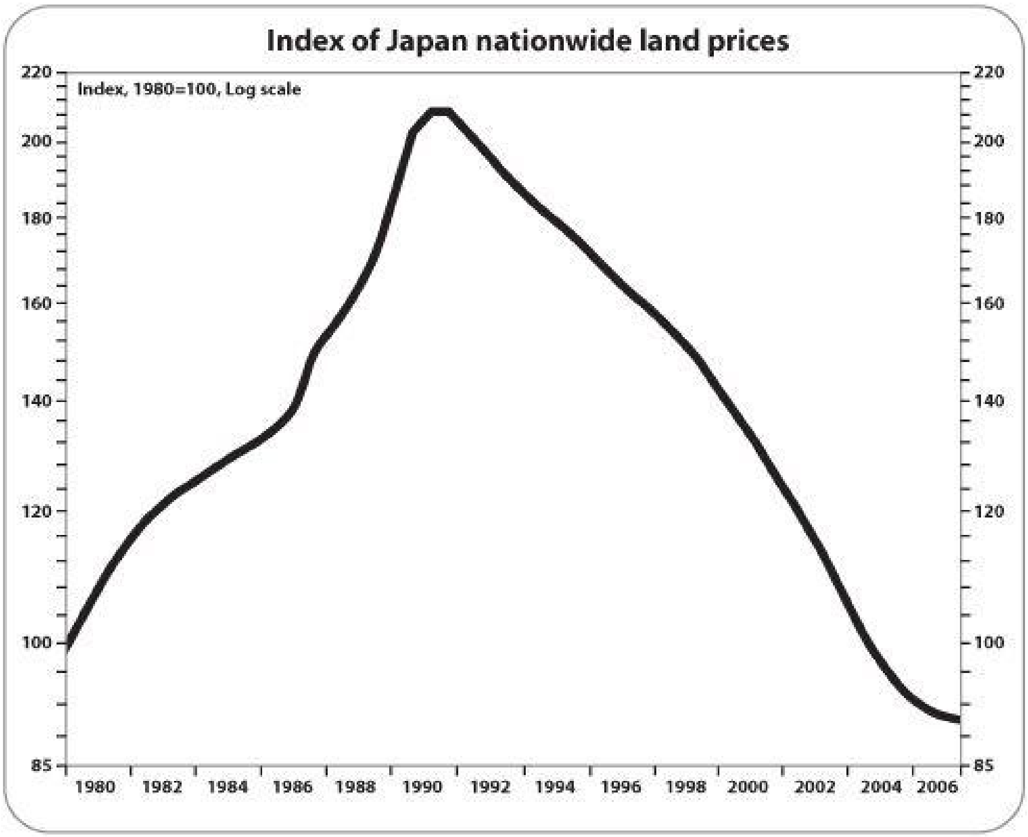
By the spring of 2009, the International Monetary Fund was estimating that over $50 trillion in asset values worldwide (roughly equal to the value of one year's total global output of goods and services) had been destroyed. The US Federal Reserve estimated an $11 trillion loss of asset values for US households in 2008 alone. By then, also, the World Bank was predicting the first year of negative growth in the global economy since 1945.

This was, undoubtedly, the mother of all crises. Yet it must also be seen as the culmination of a pattern of financial crises that had become both more frequent and deeper over the years since the last big crisis of capitalism in the 1970s and early 1980s. The financial crisis that rocked east and south-east Asia in 1997–8 was huge and spin-offs into Russia (which defaulted on its debt in 1998) and then Argentina in 2001 (precipitating a total collapse that led to political instability, factory occupations and take-overs, spontaneous highway blockades and the formation of neighbourhood collectives) were local catastrophes. In ,the United States the fall in 2001 of star companies like WorldCom and Enron, which were basically trading in financial instruments called derivatives, imitated the huge bankruptcy of the hedge fund Long Term Capital Management (whose management included two Nobel Prize winners in economics) in 1998. There were plenty of signs early on that all was not well in what became known as the 'shadow banking system' of over-the-counter financial trading and hence unregulated markets that had sprung up as if by magic after 1990.



There have been hundreds of financial crises around the world since 1973, compared to very few between 1945 and 1973; and several of these have been property- or urban-development-led. The first full-scale global crisis of capitalism in the post-Second World War era began in spring 1973, a full six months before the Arab oil embargo spiked oil prices. It originated in a global property market crash that brought down several banks and drastically affected not only the finances of municipal governments (like that of New York City, which went technically bankrupt in 1975 before ultimately being bailed out) but also state finances more generally. The Japanese boom of the 1980s ended with a collapse of the stock market and plunging land prices (still ongoing). The Swedish banking system had to be nationalised in 1992 in the midst of a Nordic crisis that also affected Norway and Finland, caused by excesses in the property markets. One of the triggers for the collapse in east and south-east Asia in 1997–8 was excessive urban development, fuelled by an inflow of foreign speculative capital, in Thailand, Hong Kong, Indonesia, South Korea and the Philippines. And the long-drawn-out commercial-property-led savings and loan crisis of 1984–92 in the United States saw more than 1,400 savings and loans companies and 1,860 banks go belly up at the cost of some $200 billion to US taxpayers (a situation that so exercised William Isaacs, then chairman of the Federal Deposit Insurance Corporation, that in 1987 he threatened the American Bankers Association with nationalisation unless they mended their ways). Crises associated with problems in property markets tend to be more long-lasting than the short sharp crises that occasionally rock stock markets and banking directly. This is because, as we shall see, investments in the built environment are typically credit-based, high-risk and long in the making: when over-investment is finally revealed (as recently happened in Dubai) then the financial mess that takes many years to produce takes many years to unwind.





There is, therefore, nothing unprecedented, apart from its size and scope, about the current collapse. Nor is there anything unusual about its rootedness in urban development and property markets. There is, we have to conclude, some inherent connectivity at work here that requires careful reconstruction.

How, then, are we to interpret the current mess? Does this crisis signal, for example, the end of free market neoliberalism as a dominant economic model for capitalist development? The answer depends on what is meant by that word neoliberalism. My view is that it refers to a class project that coalesced in the crisis of the 1970s. Masked by a lot of rhetoric about individual freedom, liberty, personal responsibility and the virtues of privatisation, the free market and free trade, it legitimised draconian policies designed to restore and consolidate capitalist class power. This project has been successful, judging by the incredible centralisation of wealth and power observable in all those countries that took the neoliberal road. And there is no evidence that it is dead.

One of the basic pragmatic principles that emerged in the 1980s, for example, was that state power should protect financial institutions at all costs. This principle, which flew in the face of the noninterventionism that neoliberal theory prescribed, emerged from the New York City fiscal crisis of the mid-1970s. It was then extended internationally to Mexico in the debt crisis that shook that country to the core in 1982. Put crudely, the policy was: privatise profits and socialise risks; save the banks and put the screws on the people (in Mexico, for example, the standard of living of the population dropped by about a quarter in four years after the financial bail-out of 1982). The result was what is known as systemic ‘moral hazard’. Banks behave badly because they do not have to be responsible for the negative consequences of high-risk behaviour. The current bank bail-out is this same old story, only bigger and this time centred in the United States.

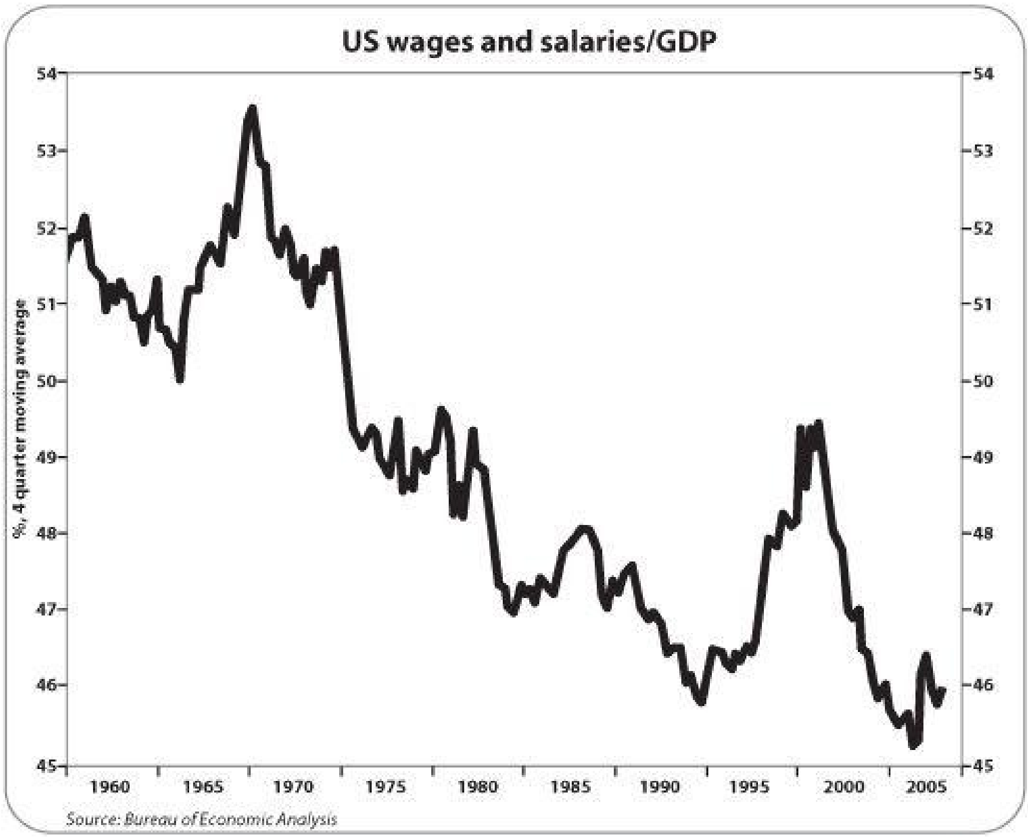
In the same way that neoliberalism emerged as a response to the crisis of the 1970s, so the path being chosen today will define the character of capitalism's further evolution. Current policies propose to exit this crisis with a further consolidation and centralisation of capitalist class power. There are only four or five major banking institutions left in the United States, yet many on Wall Street are thriving right now. Lazard's, for example, which specialises in mergers and acquisitions, is making money hand over fist and Goldman Sachs (which many now jokingly refer to as 'Government Sachs', to mark its influence over Treasury policy) has been doing very well, thank you. Some rich folk are going to lose out, to be sure, but as Andrew Mellon (US banker, Secretary of the Treasury 1921–32) once famously remarked, 'In a crisis, assets return to their rightful owners' (i.e. him). And so it will be this time around unless an alternative political movement arises to stop it.

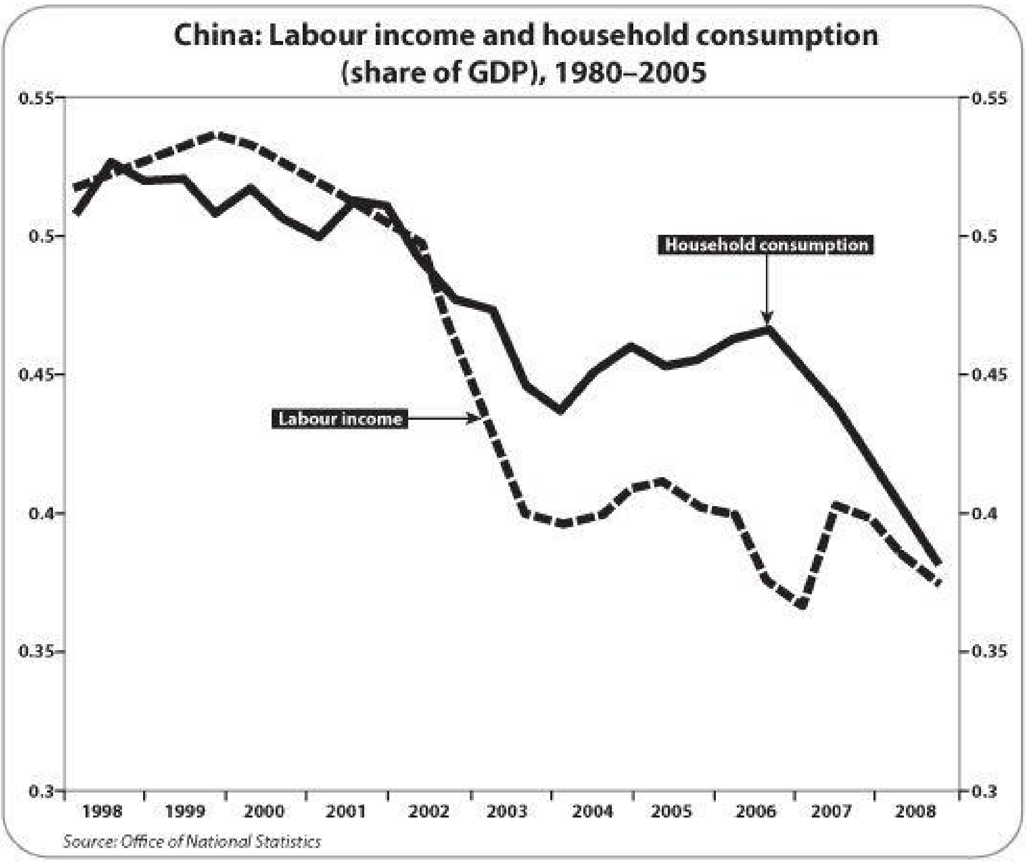
Financial crises serve to rationalise the irrationalities of capitalism. They typically lead to reconfigurations, new models of development, new spheres of investment and new forms of class power. This could all go wrong, politically. But the US political class has so far caved in to financial pragmatism and not touched the roots of the problem. President Obama's economic advisers are of the old school – Larry Summers, director of his National Economic Council, was Secretary of the Treasury in the Clinton administration when the fervour for deregulation of finance crested. Tim Geithner, Obama's Treasury Secretary, formerly head of the New York Federal Reserve, has intimate contacts with Wall Street. What might be called 'the Party of Wall Street' has immense influence within the Democratic Party as well as with the Republicans (Charles Schumer, the powerful Democratic senator from New York, has raised millions from Wall Street over the years, not only for his own political campaigns but for the Democratic Party as a whole).

Those who did the bidding of finance capital back in the Clinton years are now back at the helm. This does not mean they are not going to redesign the financial architecture, because they must. But who are they going to redesign it for? Will they nationalise the banks and turn them into instruments to serve the people? Will banks simply become, as influential voices even in the *Financial Times* now propose, regulated public utilities? I doubt it. Will the powers that currently hold sway seek merely to clean up the problem at popular expense and then give the banks back to the class interests that got us into the mess? This is almost certainly where we are headed unless a surge of political opposition dictates otherwise. Already what are called 'boutique investment banks' are rapidly forming on the margins of Wall Street, ready to step into the shoes of Lehman and Merrill Lynch. Meanwhile, the big banks that remain are stashing away funds to resume payment of the huge bonuses they paid before the crash.

Whether we can get out of this crisis in a different way depends very much upon the balance of class forces. It depends upon the degree to which the mass of the population rises up and says, 'Enough is enough, let's change this system.' The average Joe and Jean (even if he or she is a plumber) has good reason to say that. In the United States, for example, household incomes since the 1970s have generally stagnated in the midst of an immense accumulation of wealth by capitalist class interests. For the first time in US history, working people have failed to share in any of the gains from rising productivity. We have experienced thirty years of wage repression. Why and how did this come about?

One of the major barriers to sustained capital accumulation and the consolidation of capitalist class power back in the 1960s was labour. There were scarcities of labour in both Europe and the US. Labour was well organised, reasonably well paid and had political clout. However, capital needed access to cheaper and more docile labour supplies. There were a number of ways to do that. One was to encourage immigration. The Immigration and Nationality Act of 1965, which abolished national-origin quotas, allowed US capital access to the global surplus population (before that only Europeans and Caucasians were privileged). In the late 1960s the French government was subsidising the import of labour from North Africa, the Germans were hauling in the Turks, the Swedes were bringing in the Yugoslavs, and the British were drawing upon inhabitants of their past empire.





Another way was to seek out labour-saving technologies, such as robotisation in