CASINO CAPITALISM AND GLOBAL RECESSION: HISTORICAL BACKGROUND AND FUTURE OUTLOOK[1]

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Origins of Casino Capitalism

When capitalism first began to emerge as the dominant economic system around the turn of the 19th century in Western Europe and North America, the role of the financial sector in the system was simple and straightforward. When individuals or groups wished to set up a new company, they sold shares in the company to the public in order to raise the initial start-up capital. These shares were generally purchased by people who had accumulated some capital from existing or previous business ventures – industrialists, traders, land owners and wealthy professionals. In general, then, the people who owned these shares were themselves involved in producing and distributing goods and services – what is commonly termed "the real economy" nowadays. They bought shares in the hope that they would generate a better return than the low deposit interest rates available from the banks, and were usually quite happy if the shares gave a return of 5-10%.

The role of the banking system – at least in the Anglo-Saxon economic model – was largely confined to providing loans to firms in the form of working capital, providing loans to consumers to facilitate purchases, and providing foreign currency to facilitate international transactions. In other words, banking existed as an adjunct to the economic system, with its prime function being to facilitate the smooth functioning of that system.

Over time, however, significant changes began to take place in the way the system operated. An inherent and recurring feature of capitalism is its tendency to accumulate capital more quickly than the ability of the underlying economy to absorb this capital in the form of reinvestment. This is because of the way added value is distributed between profits and wages. Because individual capitalists seek to limit wages in order to maximise their competitiveness, in aggregate this means a lack of effective demand, since workers ultimately are the main consumers of the products produced by capitalist firms. Neoliberal economists argue that the economy will work most effectively if each individual pursues their own individual interests. However, competition between capitalists inevitably leads to a tendency towards

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[1] Much of this article (and the accompanying Appendix) has been drawn from the following sources: John Bellamy Foster "The financialization of capital and the crisis" Monthly Review, April 2008, 1-19; John Bellamy Foster and Fred Magdoff "Financial implosion and stagnation" Monthly Review December 2008, 1-29; Editorial, Monthly Review March 2009; John Bellamy Foster "The world crisis of capitalist globalization and its impact on China" Monthly Review March 2009 1-23; Maria João Rodrigues (Professor of Economic Policy in the Institute of European Studies (Université Libre de Bruxelles) and in the Lisbon University Institute) "A new progressive recovery plan for the European Union" TASC/FEPS Seminar Dublin May 11 2009.

overproduction of goods relative to the ability of consumers to purchase these goods due to downward pressure on wages and overaccumulation of capital.

The welfare states which emerged in the west in the 1950s produced a useful antidote to this tendency by exacting high taxes on profits and wealth, the resultant revenues then being used to support the incomes (and therefore consumption capacity) of the poor, boost mass-demand public services (e.g. health and education) and invest in infrastructure. In those countries where the welfare state was most developed (mainly Scandinavia), capitalists tended to accept the role of the state in maintaining demand for their products and therefore to tolerate the accompanying high taxation without repercussions on business vitality.

In seeking outlets for the growing store of excess capital which emerged as the 19th century progressed, capitalists were inclined to make increasingly risky investments. Some of these were in the real economy, such as the railway mania which prevailed in the mid-to-late 19th century. However, an increasing share tended to find its way into financial speculation. This tendency was fuelled by another important change taking place in the way the system worked as we moved into the 20th century. This was the fact that those with the excess capital were, to a growing extent, not those who had earned it but those who had inherited it. These people had little contact with the real economy, and began to look at investment as a kind of game. Thus, stocks and shares were bought, not because this would facilitate an expansion of production in the real economy or would generate a steady income, but in the hopes of making a profit from selling the shares at a higher price.

Such activities were not just confined to buying and selling company shares. A key development in this respect was the creation of “futures”, where a capital value was put on a promise to make future payments - either one-off payments (e.g. purchasing a delivery of oil or wheat) or payment streams, as in bonds and bank loans. Speculators bought and sold these, those purchasing them hoping they might make a killing if, for example, the price of oil soared. Over time, the range and complexity of such so-called “financial instruments” grew, and a whole industry grew up around such speculative investments in the form of investment bankers and dealers of various kinds. As a result, a rapidly growing share of total investment activity was dedicated to such speculation, rather than investments in factories, mines, roads and offices.

The British economist Susan Strange coined the term “casino capitalism” to describe this emerging economic system which was increasingly focused on investment designed to make a killing rather than expanding the productive base of the economy.

Financial bubbles

A recurring feature of financial speculation is its tendency to create financial bubbles, formed by excessive investment in a particular product, sector or geographical area. This tendency arises from another inherent feature of speculative behaviour i.e. herd behaviour, where followers blindly follow the lead of innovative entrepreneurs. Being the first in the field, these entrepreneurs succeed in generating substantial profits which attracts further investors seeking to make similar profits. This then sparks off an investment mania as word spreads about the profitability of the sector in question

and money begins to pour in. However, where the initial investors made money from the inherent product which was the focus of their investment, subsequent investors make their money by selling stocks, shares and bonds to the next wave of investors – in other words, investment becomes detached from the product which sparked it off in the first place.

Eventually, however, confidence in the sector declines, investors begin selling off their investments and this reproduces a second bout of herd behaviour, except in the opposite direction, as investors seek to get rid of their holdings before they lose further value – thereby guaranteeing that this is exactly what will happen. In essence, the bubble gets so inflated that it simply bursts or, to use another analogy, the stampede of the herd is only halted when the entire herd jumps over a cliff. We have yet another example here of how individual behaviour by capitalists has the effect of generating mass destruction for all.

The globalisation of casino capitalism

Up to the 1970s, most advanced capitalist economies were largely self-contained, so that the effects of financial bubbles tended to be contained within national boundaries. The 1970s saw a major economic downturn in the advanced economies, as the long period of economic prosperity ushered in at the end of the Second World War finally petered out. This downturn presented a massive problem for the huge store of capital which had built up over the previous thirty years, and the desire to find outlets for this capital was a key driving force behind the globalisation process which began in that decade. Thus, currency exchange controls and restrictions on the international movement of capital were lifted, with speculation in currency itself becoming a major feature of casino capitalism. Central to all of this was the USA, by far the world's largest economy, with the dollar being the currency in which most international capital movements were transacted.

Boosted by the advent of new information technology, capital became hypermobile, with vast flows of money moving around the world virtually every minute of the day. This has had the effect of moving financial bubbles onto the global stage with the after-effects of burst bubbles also being felt all around the world. However, with national governments everywhere showing a willingness to bail out distressed investors, usually on the grounds of protecting the integrity of the banking system, the main victims of burst bubbles tended to be the little people who got caught up in the webs of capital flows upon which the bubbles are built.

A couple of figures will help to give some idea of the extent to which the real economy has become a sideline to the economy of international finance. In 2002, global sales of goods and services amounted to $32 trillion (trillion = 1,000 million) while sales of foreign exchange and financial derivatives amounted to over $1000 trillion, of which only $8 trillion were related to financing international trade. Less than 2% of foreign exchange transactions are related to international trade of goods and services. The other 98% are related to currency speculation.

The current economic crisis

This brings us then to our account of the most recent bubble whose demise has reduced the Irish economy to the status of an economic basket case. In the USA, this bubble became known as the subprime mortgage bubble and came hot on the

heels of another bubble, the notorious dot.com bubble of the late 1990s, which involved a massive surge of investment in companies set up to provide various services on the Internet. Most of these companies never made any profit at all, and when the plug was finally pulled in the year 2000, a sharp economic downturn ensued, mainly because the IT hardware sector had ramped itself up in anticipation of a major surge in demand for computers and related technologies, and now found itself with major spare capacity on its hands.

Such was the rapidity with which the dot.com bubble was followed by the subprime mortgage bubble that the transition has been referred to in some quarters as the “great bubble swap”. In fact, there were significant links between the two. In an attempt to boost economic investment following the dot.com downturn, the US Federal Reserve Bank began a series of interest rate cuts which saw the prime lending rate fall from 6% in January 2001 to just 1% in June 2003. This in turn set off a surge in mortgage borrowing as householders sought to make maximum use of the cheap credit available.

A second important contributory factor in the subprime bubble was the creation of complex new financial instruments which, among other things, allowed banks and other lending institutions to circumvent government regulations regarding the balance between deposits and loans, and between liabilities and capital assets. These new instruments combined risky subprime mortgages with more reliable mortgages in composite packages, with the idea that the sound performance of the more reliable mortgages would more than offset any defaults in the subprime sector. These packages were then sold off to speculators and became part of the merry-go-round of casino capitalism.

Armed with these new instruments, and desperate for possible outlets for their excess capital, banks and other lending institutions rather recklessly pursued potential mortgagees, offering 100% mortgages, frequently with an initial 3-5 year moratorium on the payment of interest and/or repayment of capital. As is typical of financial bubbles, the ensuing investment frenzy became a self-fulfilling spiral. Growing demand for mortgages drove the price of houses up, so that those who purchased houses quickly found themselves with positive equity as the value of their houses surpassed the nominal value of their mortgages. This in turn had the effect of attracting further mortgage applicants, driving the spiral higher and higher. The availability of finance to feed this investment frenzy was greatly boosted by a major inflow of foreign capital into the US mortgage market – in the first five years of the decade, an estimated $1 trillion flowed into this market from abroad, mainly from China and the oil-exporting countries.

The housing bubble in turn had the effect of creating a spin-off consumer boom, as householders with rapidly appreciating assets remortgaged their properties to finance refurbishments, the purchase of second homes, purchases of cars and consumer durables, etc. By the end of 2005, mortgage debt in the USA was the equivalent of 70% of GDP – an extremely high level.

The growing demand for housing and the associated consumer boom began to make itself felt by 2005 in the form of rising inflation, to which the Federal Reserve Bank responded by raising interest rates significantly in 2006. This had a major impact on

the mortgage market. The rate of uptake of new mortgages slowed down as potential customers were put off by the higher interest rates. This immediately had the effect of putting a brake on the rate of growth in house prices. More importantly, many mortgage holders, faced with higher repayments, simply defaulted. The fact that many of them did not have to put a penny of their own money into their house purchases, and in many cases had never had to pay back principal, made it easy for them to default. With repossessed houses being sold off cheaply, house prices began to fall, creating a situation of negative equity for many more mortgage holders, setting off a further round of defaults. Thus, the spiral of constantly rising house prices which had driven the investment bubble was now put into reverse, as falling house prices accelerated the rate of default leading to further falls in prices.

The banks and other financial institutions which had bought up the complex packages of mixed mortgages were now faced with a dilemma, as it was next to impossible to predict how these packages would perform. Their basic reaction was to simply hoard their assets as a protection against defaulting packages and refuse to lend out any money to anyone, thus sending the economy into its worst recession since the 1930s. This recessionary situation has been further exacerbated by a fall-off in consumer spending. Rising mortage repayment costs means that mortgage holders have less money to spend on consumption. Consumers are also inclined to hoard whatever money they have in the expectation that things are going to get worse and it is important to set money aside for the impending rainy day – thereby in effect ensuring that things will, in fact, get worse. Furthermore, with prices falling, consumers are inclined to hold off spending in anticipation of further price falls.
The US government has responded to the crisis by propping up the banks with cash and pumping vast amounts of additional funds into the economy in an attempt to boost consumption and thereby investment, but thus far to limited effect.

Given the extent to which the US economy is intertwined with the rest of the world, the spinoff effects of the US crisis have been felt globally. Stung by their experiences with investing in the USA, and concerned about the prospect of further bank defaults, institutions with spare capital have become very cautious about lending money to anyone, leading to a credit crisis. The retreat of the US economy has also impacted on those countries – of which there are many – for which the US is an important export market. The sharp decline of the American dollar has also made it more expensive to export to that country. In many countries, the negative impact of the US recession has been further exacerbated by the fact that they had engaged in their own financial bubble, following the lead set by the USA – the United Kingdom being a good case in point.

The economic crisis in Ireland

This brings us, finally, to a brief review of the crisis as it has unfolded in Ireland. There has been some debate on the extent to which the crisis here can be attributed to external events, or to which it was self-inflicted. As the most globalised country in the world, Ireland was always going to be negatively affected by the global downturn which followed the collapse of the US bubble. In particular, the USA is Ireland's largest export market, taking 20% of total merchandise exports in 2007. In addition, other export markets have been hit by the globalisation of the post-bubble downturn. However, to suggest, as the so-called Financial Regulator did when the recession first began to bite deeply in Ireland last September, that the emerging crisis was

entirely due to external events was simply outrageous. Thankfully, this individual was relieved of his post shortly after making this assertion. The fact is that Ireland has been much more heavily impacted by the recession than other European countries, and the reason for this is the complete disarray into which our banking system has fallen due to its own reckless dealings in the internal property market. In one sense, Ireland was unfortunate with the timing of its own bubble, which coincided with that of the USA – although this is in no way to excuse the irresponsible behaviour of the Irish banks in financing the bubble, and the dereliction of duty on the part of the Irish government which not only did not exercise any meaningful regulatory supervision over the banks, but in fact fanned the flames with its own expansionary policies.

Ireland's own property boom accelerated gradually through the 1990s on the back of the massive expansion of the domestic economy in this period. With the build-up of confidence in the economy and the growth of earnings and savings, potential home-owners were increasingly inclined to take the plunge and purchase their own house as the new decade unfolded. As in the USA, they were further prompted in this direction by historically low interest rates and the increasing availability of 100% mortgages. Rapidly rising house prices themselves acted as a stimulus to purchase, as potential buyers sought to get into the market before prices rose further, happy in the expectation that further price rises would quickly put them into a position of positive equity. These were all classic symptoms of bubble behaviour.

We will never know what exactly would have happened to the Irish bubble had the American bubble not burst first. However, it was obvious to most observers for several years that the level of investment in Irish property was unsustainable and a collapse was certain to come sooner or later.

Conclusion

We are now faced with the very painful task of trying to clear up the mess created by the unholy alliance of the Irish banks and property developers, and we are far from reassured that the very government whose incompetence and venality led us into the mess in the first place is now charged with the burden of getting us out of it. In the Appendix below we offer some views on what a progressive approach to handling the crisis might look like. Meanwhile, we finish the main section of this paper with two extracts from recent issues of of the American socialist journal, *Monthly Review*. While composed with particular reference to the crisis as it has unfolded in the USA, these extracts provide some salutary lessons for us here in Ireland, and some pointers to the likely consequences of the current course of action being followed by the Irish government. These extracts have been slightly rewritten in the interests of compositional clarity.

The first extract is from an article by John Bellamy Foster and Fred Magdoff entitled "Financial implosion and stagnation" in the December 2008 issue:

"Who will pay to get us out of the mess? In the past, it is those at the lower end of the social spectrum who have always borne the bulk of the costs of economic crises. If this is repeated, it means that the old game of privatization of profit and socialisation of losses will be replayed for the umpteenth time. The population will be called upon to "tighten their belts" and to "foot the bill"…The capacity of the larger

public to see through this deception will depend on an enormous amount of education by trade union and social movement activists.

"It is important to discount any attempts to present the current crisis as a kind of "natural disaster". The cause of the crisis lies in the system itself. Those at the top of the economy have been the main beneficiaries of the system, shamelessly enriching themselves at the expense of the rest of the population. They should be held responsible for the main burdens now imposed on society. It is the well-to-do who should foot the bill, not only for reasons of elementary justice, but also because they collectively and their system constitute the reason that things are as bad as they are…There should be no golden parachutes for the capitalist class paid for at taxpayer expense".

The second extract is taken from the editorial in the March 2009 issue:

"The current proposal being pushed by the US Treasury is to create a so-called "bad" bank under government ownership that will buy up the toxic wastes from the private financial sector…thus socialising the losses without nationalising the banks themselves. The secret of this gigantic fraud needs to be exposed. The whole operation…requires that a vast gift of public funds be handed over to the care and custody of the obscenely rich incompetents who helped engineer the catastrophe in the first place. The nature of the salvage operation would thus most likely require that the government purchase this toxic waste at a price far in excess of its largely non-existent value".

APPENDIX: A progressive proposal for dealing with Ireland's economic crisis.

We need a sober analysis of what brought the current crisis about, and we need to draw up a plan to prevent a recurrence.

In this respect, what we do not need are short-term measures which only paper over the cracks in the system. We have tried to show here that the kind of crisis which we are now experiencing is not a once-off affair due to a conjuncture of unusual circumstances, but a recurring and inherent feature of the way the capitalist system works. It is a systemic problem which requires a systemic response.

The crisis was not caused by trade unions, the public service or the level of public spending, which is quite low by international standards. Furthermore, a recent report by the National Competitiveness Council concluded that the productivity of the Irish public sector is favourable by international standards. A lot of commentators have seized on the current crisis to pursue old hoary agendas.

At national level, we need much more effective leadership than we have got from the present government. We need to get across-the-board agreement on what needs to be done, and a commitment to supporting the agreed recovery programme from all stakeholders and interest groups.

We need a national forum of experts (not just economists) to advise the government – reliance on just one economic advisor is just not good enough.

We need a comprehensive plan for national recovery and development with clear strategies, priorities, and targets – not the kind of piecemeal approach to reforms and savings which An Bord Snip and the Commission on Taxation represent.

We should press for a pan-EU approach to dealing with the crisis, rather than each member state doing its own thing, leading inevitably to clashing policies. As a fragile economy which has been most badly hit, Ireland has a lot to gain from making recovery an EU-wide project.

EU structural funding should be expanded, partly in order to act as a stimulatory mechanism for expanding demand and employment, but also to focus member states on supporting investment in key areas such as green technology and knowledge-based economic sectors.

The European Central Bank should support member states by purchasing bonds issued by their banks and governments while also implementing an EU-level bank surveillance and regulatory system.

In the medium to long term, the EU should promote greated economic cooperation between member states with a view to avoiding wasteful forms of competition and supporting a coordinated approach to the development and application of new technologies.

In this context, trade unions and left-leading political groupings should take the lead in campaigning for reconstituting/strengthening the welfare state as a means of combatting the build-up of excess capital and maintaining effective demand for the products of the private sector. The view that high taxes are a deterrent to economic activity – presented as axiomatic by neoliberal economists – needs to be challenged. High taxes in the Scandinavian welfare states go side by side with business vigour which sees all these countries appearing among the wealthiest in the planet.

Ultimately, the crisis is a global crisis, and we need to build global-level and effective governance structures to reform the system to prevent a recurrence.

At home in Ireland, the current crisis and the widespread public anger to which it has given rise provides an historical opportunity to ask profound questions about the nature of the economy and of Irish society which has left us in the mess in which we now find ourselves. It is clear that a political system based on petty localism does not provide us with the kind of political leadership required of a modern globalised economy. It is also clear that a “planning” system founded on corruption and speculation is simply unable to deliver affordable housing, a sustainable transport infrastructure and adequate community services. Progressive elements should seize the moment and take the leadership in calling for a new vision for Irish society, rather than a band-aid approach to patching up our current difficulties without putting in place systems and structures which can prevent a recurrence of these difficulties.

Among the key elements of this new vision should be the following:

Priority must be given to meeting ordinary people’s basic needs: food, housing, health, education, sustainable environment

Unemployed people should be employed creatively in community and environmental work at a small payment above the dole

Empty housing should be purchased by the government at knockdown prices to provide social housing.

A single and unified national pension and health insurance scheme should be introduced.

The elimination of speculative investment in land development in order to create a planning system based on community need.

Implementation basic reforms to create a responsible banking system capable of supporting broad sustainable development in Ireland.

The delivery of most day-to-day public services (including health, education, social welfare and community facilities) should be transferred from central to local government, partly in order to increase efficiency of delivery, partly in order to strengthen the status of local government and enhance local democracy and partly in order to focus national parliament on national-level policy formulation and implementation. The current political system is dysfunctional and incapable of rational, smart or long-term decision-making.