

## THE THIRD GREAT DEPRESSION

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Although Clinton's problems captured more headlines, the most significant news of 1998 was the continuing awesome and enduring strength of the American economy, which loomed like a colossus over a troubled world. Two million new American jobs were created, many of them high-paying positions in technology, pharmaceuticals, finance, and health ('The Economy', from *Encyclopaedia Britannica, Year in Review 1998: World-Affairs*).

As the US economy sinks, the economists need a scapegoat. They have found it in the new war on terrorism. They can blame their own failure to predict and prevent the downturn on the events of 9/11. More importantly the backroom and more sinister section of the right wing economists can promote a resuscitation of the Cold War. Whether the political and economic theorists of the present administration or of the ruling class understand the nature of the Cold War and its contemporary copy is not clear. It is more likely that they are driven by the logic of events towards the same form.

The stock exchanges of the developed countries dropped precipitously and then rose to the previous level, only to fall again and again. The drop was explained by 9/11 but it is quite clear that Wall Street was on its way down in any case. Profits have been falling for some time, officially from 1997. The real question was why it was taking so long to fall. However, there was a fall after the rise, taking the developed stock exchanges back to 1996 levels, where with ups and downs they seemed to remain. After each rise, there was a fresh spate of figures and comments proving that the downturn had come to an end.

Thus we read in May 2002:

US-Retail Spending: 'US spending raises hope of sustained recovery' "The Commerce Department said retail sales leapt in

## Third Great Depression

April by a seasonally adjusted 1.2% from a month earlier, the fastest pace of monthly growth since October.”

In the same report, however, we are told that the jobless rate grew from 3.9% in late 2000 to 6% in April 2002.<sup>1</sup>

So, on the one hand, they spoke of the recession – so-called – coming to an end, but on the other the reality for most people was the reverse.

It is also noteworthy that most of the so-called emerging countries stock exchanges have not recovered. Capitalists only take risks where there is a very slight chance of losing money. In spite of the mountain of books justifying profits on the grounds of risk, capitalists are not fools and they are not going to send money to a Third World country knowing that there is every chance the local company, or even the local economy, will be bankrupt in a finite time. It is interesting that the IMF is now promoting the idea of country bankruptcy. For all of 2001, only \$104 billion was expected to flow to such countries for direct investment, 37% down on 2000. Portfolio investment is concentrated in four countries: China, China-Hong Kong, South Korea, South Africa and India. Given the tendency for such investment to come from expatriates, this does not speak of globalized investment.

The collapse of the so-called new economy paradigm became total with the announcement that US manufacturing had fallen for three quarters in succession in 2001 and that productivity in the 1990s had not risen much above the average depending on the comparative post-war period taken.

The Argentinean collapse has to be seen in this context. In an editorial (22 December 2001) the Financial Times pointed out that whereas Latin America had received some \$144 billion in the period 1996-1998, only \$10 billion had flowed into the area in 1999-2001. “Within this total net lending by banks was minus \$13 billion.”

In other words the collapse in Argentina is playing the same role in the current downturn as Thailand did in 1997-8: it is just the start of a major collapse in Third World countries, which, in turn, is only a reflection of a real crisis in the developed countries and so capitalism as a whole.

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<sup>1</sup> Financial Times-15-05-02. p6

## Critique 34

By July 2002 the domino effect on Uruguay (where Argentineans withdrew their bank deposits) and Brazil had become clear. Thereafter, Lula was elected as the new President of Brazil and the situation has remained on a knife-edge. In Brazil the political nature of modern economics is clear. If Lula concedes to the left in his party, the IMF (and capital in general) has made it clear they will create havoc.

Naturally, some economists spoke of an upturn, even in these circumstances, while other optimists said that such a low level meant that the bottom had been reached. And yet we read: "Reuters reports that the total amount of corporate debt in default or distress hit \$879 billion, which is 45% of the entire high-yield market and nearly one-third more than the GDP of Canada. The disturbing analysis was done by Edward Altman, a professor at NYU."<sup>2</sup>

The question of unemployment is discussed below.

### **CAPITALISM AND WAR**

In capitalism, war can perform the political-economic function of disciplining and uniting the working class with the bourgeoisie in the face of the common enemy.

Whether by good chance, or by some sinister design, the right have found an excuse to have a renewed but mini Cold War. It is important to understand why the Cold War worked to see whether this one will achieve its underlying goals. For the moment it is enough to say that the expenditure involved is too trivial to match that of the Cold War era and to mark a return to the previous paradigm.

In the USA the height of military expenditure in the last 20 years amounted to 6.4 per cent of National Income whereas today it is closer to 2.5% of National Income. As around \$300 billion was actually spent on the military before 2001, the increase required to reach the same level of effectiveness is some \$600 billion. In reality the US government and Congress were talking of around \$40 billion of war expenditure with another \$90 billion being spent on tax cuts and other measures that are likely to have little effect. Even if these figures are doubled with new measures for 2003, they are not

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<sup>2</sup> McLean, B, 'Street Life'. 4 October 2002: Fortune.com.

## Third Great Depression

sufficient to cause an upturn. Since the budget surplus has necessarily turned into a deficit – and the economic orthodoxy limits deficits – the government has a limited repertoire with which to deal with the downturn.

The Iraq war cannot achieve this object either because the sums involved are too limited and the actual war itself is too short. The newspapers are talking of costs which range up to 200 billion dollars but that leaves out of account the simple fact that the US military is paid in any case and its missiles and other weapons have to be regularly upgraded. The Iraq war is little more than an extended military exercise, looked at from the point of view of military accounting. The fact is that contemporary wars are not comparable with those of the Cold War- such as in Korea and Viet Nam and the permanent brush wars in the third world. It has to be noted that the Gulf War, on the contrary, was followed by a considerable downturn. The Cold War needed a permanent worldwide enemy capable of penetrating the metropolitan countries. The enemy was known to be oppressive but also known to be expansive and capable of attracting support worldwide. Defeating such an enemy needs a huge defence apparatus as well as an internal state apparatus which can prevent any infection. The Cold War is irreplaceable.

The second major function of the Cold War lay in its ability to discipline and control the working class in the United States through the ideology of anti-communism, and the fear, secrecy and acceptance of mobilization that goes with war. This type of conformism, and so unity with the ruling class, is somewhat more evident today. The ruling class has used the occasion:

- To reduce the elementary rights of the working class – in relation to free speech – and so limit the right to organize;
- To dismiss workers as redundant;
- To refuse to pay redundancy on grounds of national emergency;
- To demand that workers do not take industrial action on pain of being unpatriotic, a condition so evil that any such action would have to be crushed by the sheer weight of righteous opinion.

It may take time for the US working class to recover from this blow, but it is unlikely to take very long. If no other measures show themselves in the United States, and little else has emerged, it is more than likely that the ruling class will lose its war with the working class. It doesn't take long to

## Critique 34

work out that the ruling class has launched an undeclared civil war and workers must be forced to defend themselves.

The sword is also double-edged: if they talk of a national emergency and of unity, they cannot unilaterally break that unity. That means the government must be seen to be helping workers keep their jobs and less desperate firms will find it hard to fire workers without throwing oil on the flames.

The new permanent anti-terrorist war won't provide the kind of stability that the Cold War successfully maintained for so long. In large part the 'war on terror' will fail because the ruling class is afraid to reflate. They fear that, under conditions of full employment, the working class will be too strong to control. Hence, those measures that are taken to stabilize the economy are skewed: direct help to workers is avoided, strategic preference being given to protection for steel companies and subsidies for farmers.

The fact that the USSR was considerably weaker than the USA, both economically and militarily, was carefully hidden – to pretend to be more powerful than they actually were was advantageous to the USSR elite.

There is, however, no such power today – real or fictional. China has no international presence and is, in any case, heavily dependent on US capital. The more successful US intelligence is in preventing any repeat of 9/11, the less likely it is that anyone will believe that Al-Qaeda is a permanent threat. Indeed, the patent failure of Al-Qaeda to do anything beyond its original act of destruction was inevitable. All terrorist and anarchist type acts are of limited duration and invariably call upon themselves retribution far worse than their own original act. Equally, the organs of repression always use these events as an excuse to arrest, repress or otherwise neutralize forces of change. Although the working class is immediately demoralized, the very success of the security forces limits their credibility. The frequent alerts, in the USA and UK, that terrorists are about to commit an outrage can only make people cynical unless there actually is some dreadful act. But here the security services are in a bind, since any failure on their part will bring retribution on the relevant agency, while success leads to public complacency.

Hence, there is no replacement for the Cold War.

## Third Great Depression

### THE NATURE OF THE DOWNTURN

In 2001 The Economist argued that the recession would not be brief and mild (their statistics are incorporated below).<sup>3</sup>

If we look at the real situation, the permanent optimism of stockbrokers and economists looks very misplaced. In the last period profits have fallen further than at any time since 1930s, margins on goods sold are at their lowest for 50 years. We are now witnessing the longest unbroken fall in industrial production over 12 months since 1945. Simultaneously, overcapacity is at it's highest since 1983: industry's capacity utilization fell to 75.5%.<sup>4</sup>

The situation with unemployment is in considerably worse than the above statistics imply, largely because unemployment has been rising over three decades and governments prefer to hide the real statistics.

The real levels of unemployment are three to four times as high as officially proclaimed. In the UK real levels of male unemployment are nearer 20% than the official level of about 5%.<sup>5</sup> In the USA it is probably higher because of the real levels of illegal immigrant unemployment, which is never counted. Women who cannot find work are frequently regarded as attending to the family and therefore uncounted. In the Third World the statistics are already catastrophic. In South Africa, for instance, the numbers employed have actually gone down since Nelson Mandela became President in 1994, and the numbers of black unemployed are officially over 40% and probably nearer 60%. These huge levels of unemployment can only rise and become more common in the Third World.

Essentially, capitalism has a considerable surplus of capital. In some industries, such as telecoms, steel, airlines, bulk chemicals, etc, the oversupply is leading to bankruptcies worldwide. In other industries, such as computers and electronics, large firms are attempting to merge to reduce

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<sup>3</sup> 'How far down?', *The Economist*, 20 October 2001, p101-2.

<sup>4</sup> *ibid.*, p101-2.

<sup>5</sup> "The economically inactive proportion of the working age population was 21% in 1992 and is still 21% today despite the economic upturn. So if we are looking at the success rate in placing people in jobs, there has been no improvement – there is even a deterioration if allowance is made for the business cycle." Comment and Analysis (London), *The rise of the inactive man*. 21 June 2001: Financial Times, p23. The point is that the economically inactive are not counted as unemployed, even if they are involuntarily unemployed.

## Critique 34

their individual losses; HP and Compaq are two examples. Inevitably mergers and bankruptcies increase levels of unemployment and reduce markets for supplies.

This stage, however, must be regarded as the beginning not the middle or the end. The surplus in capital and in goods remains while unemployment and overcapacity continues to grow. Both consumption and investment must fall. As workers lose their jobs, or their wages are cut to maintain firms in existence, they have to limit their purchases. In fact, the fear of future loss of income is, in itself, enough to reduce consumption. Unprofitable firms or firms with reduced profits can only invest if they borrow money to maintain or expand production, but the inevitable result of increasing defaults on debts is that banks have to limit credit.

By July 2002, these processes were clearly under way. Banks like Citibank and J.P.Morgan Chase with exposure to the Enron bankruptcy showed lower profits. We are already in a credit squeeze even though interest rates are being lowered by Central Banks. In Japan, the interest rate is close to zero and there is a banking crisis, which means that credit expansion is necessarily limited. Employment expansion had diminished by July 2002 in the USA and elsewhere. In Germany, of course, unemployment was (and is) rising. Consumers are cutting down on purchases.

The absurd aspect of this development in the crisis was the way journalists and economists argued, earlier in 2002, that the recession was over and that it was the mildest on record. The later statistics dealt a fatal blow to their view. The argument that there was now a double dip recession – a ‘W’ recession, not a ‘U’ or a ‘V’, was equally ludicrous as it was so hard to talk of a real recovery. This view was consonant with the still earlier viewpoint that there was no recession, which was superseded by ludicrous claims that the recession was over just as it had begun or would be over in a few months.

### **DIVISIONS AND THE COLD WAR**

The capitalist powers cannot end the present crisis through monetary means alone. Governments have to increase expenditure in order to employ workers, raise their wages, and the rate of investment. Monetarism or so-

## Third Great Depression

called neo-liberalism, which is only the doctrine of finance capital, has reached its limit.

At one level, many capitalists prefer to maintain the downturn in order to be able to dismiss workers easily, a feat that would be more difficult in better times because of the relative strength of the working class or of trade unions.

On the other hand, the downturn threatens many corporations with takeovers or bankruptcies and these capitalists want an end to the downturn. This division is true of every depression, but today the capitalist class is more divided than in previous crises.

The end of the Cold War removed the form of cohesion of the capitalist class in which it united against a common enemy. Finance capital has been ruthless and rapacious in its actions and industrial capital bears no love for such financial corporations. As the United States and Great Britain are the two finance capitalist powers, this division has also taken a national form. It is no accident that the Anglo-Saxon powers have stood shoulder-to-shoulder against the continental industrial powerhouses of France and Germany. It is, in part, a division of finance capital against industrial capital.

The increasing proletarianization of the professions has driven the so-called middle class into unions and against government policy. This impacts on managers who are finding their own jobs are at risk. Managers, therefore, become more insecure and collaborate with finance capital in its short-termist approach. The result is that finance capital stands opposed to industrial capital, while those sections of industrial capital dominated by finance capital stand opposed to other sections. Then, too, successful capitalists want to take advantage of the downturn to remove their competitors. In turn, finance capital, which is dominated by US capital, squeezes the maximum return out of the Third World. As a result, the national bourgeoisies find themselves increasingly subjugated and even impoverished. So national capital stands opposed to imperial capital, which is, above all, finance capital.

In every depression the capitalist class splits between those losing out and those who are riding out the storm. This time, however, the divisions are more extensive and deeper. As a result, the capitalist class can only muddle through, taking first one tactic and then another.

## Critique 34

Whereas in an earlier period the capitalist class was very concerned to maintain a 'middle class' as a buffer between itself and the working class, today it regards it as an unnecessary cost and burden. The increasing insecurity, unemployment and impoverishment of this sector drive it into the working class proper. Sections have become militant. The depression itself can only deepen this process. While this process is occurring in the United States and Western Europe, it is intensified in the Former Soviet Union and Eastern Europe and in most of the Third World. The subjective has yet to follow objective reality: most proletarianized professionals still expect that their position is temporary. They anticipate that they will return to their former positions as poor relations of the bourgeoisie.

The move to war against an invented aggressor, such those named in the 'axis of evil', Iraq, North Korea and Iran, has the advantage that it potentially unites the disparate sections of the capitalist class, both nationally and internationally, and reduces levels of discontent among the middle and working class. The problem, however, is that much of the population sees through the strategy and hence the war cannot serve its purpose for a sufficient time.

### **THE SHAPE OF THE GRAPH**

When the United States officially accepted that it was in a recession, economists and stock brokers declared that it would end shortly. The graph would take the form of a 'V'. They also argued that it would never take place, that it was over before it started, and that it would end by December 2001. Every day, at first, they declared that it would be over very quickly and pointed to whatever data was to hand. At one point Wall Street rose to higher levels, and they used this to prove their point. Yet there is historical precedent to indicate that this rise need not herald economic recovery. The 'Great Depression' of the 1930s followed the same pattern: nearly every day the newspapers proclaimed the end of the depression and in the first year of the depression, 1929-30, the stock exchange rose to where it had been before the downturn.

One may argue that this false optimism can be ignored in an analysis of the downturn and it is unnecessary to gloat over the shortsightedness of bourgeois forces. In reality, their failure to grasp the seriousness of the situation is turning what might have been a downturn in the shape of a 'U'

## Third Great Depression

into something that will be more like a 'U' with an elongated horizontal line followed by a truncated diagonal. In other words, the downturn will be deep and long followed by a weak upturn which will not reach real 1999 levels for a long time, if ever.

As long as finance capital thinks that the present situation is one which is limited and in the end controllable, they can continue to speculate and operate on a short-termist basis. The credit relationships and purchase of derivatives are arcane and opaque in present-day capitalism. The collapse of Enron has had major consequences for finance capital in general, just as the collapse of Argentina must unravel the imperial relationship for much of the Third World. As long as an end is believed to be in sight, banks and the IMF/World Bank can shore companies and countries up. Once it becomes clear that it is one-way bet – downwards – both individual capitalists and institutions will try to save what they can by bailing out.

Already insurance companies and pension funds are moving into a vicious spiral downward that threatens to depress share prices. Any pension or endowment fund that had substantial share holdings has made a loss in the past period. As the fund has to pay the pensions and endowments on maturity, it also has to ensure that it is solvent. Permanently declining or even static share prices threaten that solvency.

Although regulators have loosened the numbers within which these companies operate, continued falls compel the reduction of the percentage of funds held in shares, which, of course, helps to further reduce share prices, which in turn compels further such pension funds, etc, to sell shares.

Up to now the decline in share prices has been relatively slow, but a crash looks ever more likely. Individual institutions have been forced to take drastic measures to ensure solvency, including the reduction of pensions for existing pensioners, as in the case of the oldest British mutual pension fund, Equitable Life.

### **INTERVENTION: INFLATION AND DEFLATION**

The US government has caused the situation to worsen by its relatively intransigent free-market stance. Deregulation and privatization have reduced the area of direct governmental intervention. As mentioned above, the

## Critique 34

measures taken after 9/11 have had the usual warlike reflationary effect but only on a limited scale.

At the same time, unless there is considerable direct government intervention (which is quite likely, see below), there is a strong chance that the world economy will go into a deflationary cycle, as in Japan, though possibly worse. The gap between value and price is today very considerable, largely through the growth of the unproductive sectors such as finance, advertising and retailing, but also with the vast increase in managerial pay. As the downturn continues to bite, firms are reducing managerial numbers and pay while cutting down on marketing in general. Prices can then be forced down towards overall values (more correctly towards prices of production). This process causes the numbers of unemployed to increase both among the formerly prosperous and among the working class and demand declines, compelling the same firms to find further ways of reducing costs.

Totals of both new investment and consumption decline and the rate of profit moves downwards. The downturn will only end when profits begin to move upwards, but that is only possible when the rate of reduction in the costs of labour power and constant capital, i.e.: raw materials and machinery, exceeds the rate of price downturn.

This process is so threatening to the capitalist system that it is not at all surprising that the US Federal Reserve Bank has considered measures to prevent such a process. It seems that the US Federal Reserve Bank was prepared to buy equities and property in the event that the downturn begin to spin out of control.<sup>6</sup> It appears that they discussed what they would do if the decline in interest rates were insufficient to stop a deflationary process similar to that in Japan, and they considered taking the extra-ordinary step of moving towards temporary nationalization of property in order to hold up

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<sup>6</sup> Despeignes, P., 'Fed considered emergency measures to save economy', (*Financial Times*, March 25, 2002, p6): Washington. "Minutes which summarised the meeting were released last week. A full transcript will not be available for five years but a senior Fed official who attended the meeting said the reference to 'unconventional means' was 'commonly understood by academics'." "The official, who asked not to be named, would not elaborate but mentioned "buying US equities" as an example of such possible measures, and later said the Fed "could theoretically buy anything to pump money into the system" including "state and local debt, real estate and gold mines - any asset".

## Third Great Depression

the capitalist economy.<sup>7</sup> While, the discussion regards this event as extreme, the fact that it was discussed at all is epoch making. Nationalisation is the enemy of private property, and the death of the market, the source of all economic growth, we are told. It is argued that the Soviet Union was inefficient precisely because it had nationalised property. Yet, US capitalism has to be propped up through therapeutic nationalisation. Of course, this would not be the first time. The massive de facto nationalisation of the Savings and Loans banks and of the Continental Illinois bank in the eighties showed that the US government will do its best to avoid any minor or major repetition of aspects of the Great Depression.

Clearly market ideology is in trouble. But it is more than the ideology that is in trouble.

The Bush administration was so worried that Glenn Hubbard, the Chairman of the Council of Economic Advisers to the President wrote a substantial article arguing that deflation was not an issue. His views were less than convincing and his article looked more like special pleading to hold the worst off for a period of time.<sup>8</sup> We are told that “A deflation scare is preoccupying fund managers.”<sup>9</sup> Preventative measures have to be undertaken. The continued lowering of interest rates has reached its limit in the United States.

The question, however, is how far they can go before their measures began to conflict with the law of value. At some point the capitalist class would

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7 Minutes of the Federal Open Market Committee, 29-30 January, 2002: “At this meeting, members discussed staff background analyses of the implications for the conduct of policy if the economy were to deteriorate substantially in a period when nominal short-term interest rates were already at very low levels. Under such conditions, while unconventional policy measures might be available, their efficacy was uncertain, and it might be impossible to ease monetary policy sufficiently through the usual interest rate process to achieve System objectives. The members agreed that the potential for such an economic and policy scenario seemed highly remote, but it could not be dismissed altogether. If in the future such circumstances appeared to be in the process of materializing, a case could be made at that point for taking preemptive easing actions to help guard against the potential development of economic weakness and price declines that could be associated with the so-called ‘zero bound’ policy constraint.”  
<http://www.federalreserve.gov/fomc/minutes/20020130.htm>

8 Hubbard, G., ‘Comment & Analysis: America is not in danger of deflation’. 10 October 2002, *Financial Times*, p21. He argues, remarkably, that there is no housing bubble, that consumption is holding up endogenously, and that inflation on consumer goods has turned up.

9 Riley, B., ‘FT report – FT fund management: Fighting that deflated feeling: The Last Word’. 21 October 2002, *Financial Times*, p28. Asset prices and classes can be hit if inflation hits negative territory.

## Critique 34

worry that the working class were becoming too demanding, but also that the private sector was being squeezed by the public sector. Inevitably, such moves would prevent firms going bankrupt or being taken over and competitors would object. The point of balance would depend on the class equilibrium at any one time.

In other words, any government in capitalist country has to find a point of balance between reflation and deflation, if they are to retain the support of the capitalist class and some credibility among the working class. Such a point does not exist and hence the governments will be driven first one way and then another until they are exhausted. The long years of two alternating but near identical governing parties are approaching an end. Political parties must inevitably come to reflect the polarisation in society.

At the present time, we are still in the early stages of the depression, when the reduction in prices of labour power and the items of constant capital are still to show their effects. In my view, while the downturn has some way to go, there will nonetheless be an upturn, even if it does not go back to the starting point, as it were. Its exact form and its duration will depend in large part on the class struggle at the time. The long-term nature of the present situation has already been partly discussed in previous issues of Critique<sup>10</sup> and will be addressed again in further issues.

In short the present crisis is the end product of the exhaustion of finance capital and the end of the Cold War combining with the subjective-triumphalist stupidity of the ruling class.

In reality, every capitalist crisis becomes a crisis of the capitalist system because it must become a trial of strength between the wage-labourers and the capitalist class, where the capitalist class attempts to regain its position in command over the workers. In this instance, there are two aspects to it. On the one hand, the capitalist class wants to ensure, empirically, that it can expand without having to raise wages while, on the other hand, they want to inflict an historic defeat on the working class which will roll back history to the period before 1917.

In my view, we continue to live in a world stalemate between the classes. The capitalist class cannot operate an unfettered law of value, while the

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<sup>10</sup> See my articles in *Critiques* 30-31, 1998; 32-33, 2000.

## Third Great Depression

working class cannot take power. As a result, capitalism malfunctions to an even greater degree than a capitalism in decline would in any case malfunction. History demands a resolution and the present crisis is part of that dynamic. As there is no party to take the working class forward, but the working class is sufficiently strong to prevent a ruling class victory, the crisis can only resolved on a very short term basis, if at all.

In short, until the working class acts, the present global crisis will have no end even if there are fluctuations in growth rates. There is no way back to the stability of Stalinism and the Cold War. The conclusion is at once chilling and optimistic. It is chilling because it implies a return to the barbarism and irrationality of the 1930s, even if in a different and hopefully less drastic form. It is optimistic because history is propelling the working class forward as the only saviour of mankind. The long dark night of Stalinism is at an end. The emergence of credible working class parties is clearly on the agenda.