A Ballad of American Capitalism

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September 2008 marked a turning point of the world economy towards a severe recession carrying within itself seeds of a prolonged depression. New York stock markets crashed; banks failed; industries collapsed across the world. Nothing like it people have seen since the Great Depression of 1929-39.

The latest economist Nobel-laureate and professor at Princeton, Paul Krugman, absolves America from the responsibility for the economic plight, and instead blames Asia. 'The causes lay not in America but in Asia.' 'If you want to know where the global crisis came from," he adds, 'then, think of it this way: we're looking at the *revenge of* [saving] *glut*,' (italics added).

THE MYTH OF GLUT

Literal meaning of 'glut' is oversupply. In 2005, former professor at Princeton and current chairman of the Federal Reserve (Fed) of the United States, Ben Bernanke, argued that within a few years since 1999, Asian countries (read China) had saved a large chunk of their national income and spent that sum on foreign assets such as dollars, US Treasury securities, direct investment in American industries, stocks, bonds, and derivatives. The result was a world (read, the US) awash with cheap money. By contrast America saved too little, far short of what it invested.

The extravagance of America coupled with the frugality of China had two consequences. One: the international trade balance of America was in deficit; and, two: the accumulated savings of China was made available to America to pay for its trade deficit. Bernanke called this America-China 'imbalance' of savings a 'global saving glut.'

But where is the glut, the oversupply? The US gratefully absorbed the entire savings offered by Asia in global markets in exchange of American assets.

Krugman accepts Bernanke's conception of saving glut. He accuses also American banks of incompetence in channelling the borrowed funds to productive investment. Empowered by a quarter-century of deregulatory zeal, bankers led the world finding sophisticated ways to enrich themselves by hiding risks and fooling investors. Had the bankers been prudent and efficient in their jobs, the alleged saving glut would have received instead a glorified appellation. Krugman maintains that "the saving glut is still out there, which provided an outlet for all those excessive savings, and has turned into a worldwide bust."

AN OLD STORY

Economics textbooks say, other things remaining same, a decline in the volume of saving in a country's national account shows up as an equivalent increment of trade deficit in its balance of payments and warrants foreign capital inflows. In the US the rate of saving, relative to national income, had been shrinking since the 1960s at an almost constant speed through the decades. So, trade deficit rose, calling for external borrowing.

In the sixties the ratio between saving and national income in America was 12 percent. It eroded more than two-percentage points per decade to hit the low level of three percent by 2000-07. No other country in the world has had such a miserable record in the matter of saving.

Since the 1980s, America imports more than what it exports. To repeat, trade deficit is the flip side of saving deficit and the concomitant capital inflows. During the first two decades, 1980-1999, the US borrowed from elsewhere rather than Asia. But that situation was not labelled by Bemanke a 'global saving glut.' The global variance of saving had been there for ever. In distant past, colonies were coerced to export more to the emperor's land than what they received in return. As of now, each year, foreign capital of two trillion dollars enters the US of which 700 billion dollars goes to pay for the country's excess imports and the rest is recycled as investment overseas.

THE CRUX OF THE MATTER

How is it that America's saving ratio is so low and falling? All people split their income into two parts: consumption, and saving. They spend money to buy day-to-day necessities; that expenditure is called consumption. Remaining part of the income is known as saving. So it is for the economy as a whole. The quantum of saving depends, first of all, on the amount of income. As income rises, the amount of saving usually tends to go up, and so does the ratio between saving and income.

But, it is not necessarily so in all cases. To rich persons, with a heap of wealth, the size of monthly income is not much of a factor to determine how much to spend for consumption; the wealth effect adds momentum to the income effect on consumption. Luxurious lifestyle of the affluent may use up all of the income, leaving no saving at all. So, if a substantial bulk of the national income accrues to extra-rich individuals, the rate of saving in the country may well be low, if not nil. This precisely seems to have happened in the US, a low-saving country.

In America the 1980s had been an era of fabulous fortune for the dealmakers in management of existing firms' ownership. Deregulation of markets was the official doctrine initiated by Margaret Thatcher in 1978 and accelerated 20 months later by Ronald Reagan. There has been a structural shift in control, away from either the original owners or the original management, through the mechanism of company takeover or leveraged buyout (LOB). There has been a massive shift in financing, away from equity, and toward debt. In the process a number of people in finance made a lot of money. Never in modern history has so much money been made by so few people in so little time.

The next decade witnessed a saga of dot-com boom that spawned many a millionaire, and ended with a bust, followed by an economy-wide downturn. 'I was puzzled by the course the 2001 recession was taking,' admitted Alan Greenspan, the then Fed chairman. 'It was like nothing I have ever seen." To stem the turmoil, the Fed adopted an easy money policy that came to sustain the festival of conspicuous consumption. In 2007, personal savings sank to near zero. Trade deficit rose rapidly, sucking in foreign capital.

Meanwhile, income distribution had gone skewed in favour of the rich. Wage and salary accrual to the working class had descended from 57 percent of national income to 53 percent in five decades between 1960-69 and 2000-07. That means the share of profits, interest and rent in national income had gone up. No surprise, the affluent class had enjoyed lavish luxury.

The nature of American capitalism has muted over centuries. The 19th-century 'robber-barons' capitalists made fortunes slowly by hard work of building mile by

mile railroads, steel mill by steel mill, refinery by refinery. By contrast, huge fortunes of the 1980s came swiftly, sometimes in a matter of weeks. The emergence of sudden wealth in the financial markets is one of the dazzling spectacles of the season.

The Marxian formula of capitalism was: M-C-M, that is, capitalists invest money to produce commodities, to be sold in market for money. The mantra of American capitalism nowadays is different, namely, M-M-M, that is, invest money in money-markets in order to multiply money. This latest mode of production likely spells the sunset of American capitalism. And the sun may rise elsewhere, sooner or later. □□□

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