

Forth, the transfer of township governments should follow the train of thoughts to eliminate the “economic function” and intensify the political function and social service function of which. For the control and governing of villages and towns, it is necessary to abandon the unilateral mode having formed for a long time, and cultivate a multilateral and interactive governing mode.

Fifth, whether township governments can transfer successfully also depends on a balanced arrangement between administrative powers and financial powers.

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A Marxism Economic Analysis on the Current Financial-Economic Crisis

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Abstract: In 2008 the United States suffered a terrible financial crisis. A series of unexpected "changes" extremely shocked the world. Due to the tremendous influence of United States economy, the financial crisis has been extended to the whole world and became a global economic crisis. Facing with the economic crisis, scholars on behalf of different classes and schools have made different interpretations. In this paper, both the direct and the underlying causes of the crisis are analyzed according to Marxist political economy theories. The inevitability of this crisis is pointed out. In another word, this crisis, rooted in the capitalist economic system itself, is the result of basic contradiction of capitalism. In dealing with the crisis, our highest priorities should be the consolidation of the socialist economic system with public ownership as the mainstay, the adherence to the socialist production purposes, and the constant improvement of living standard and consumption level of ordinary people. Thus, various measures should be taken as soon as possible to promote the rapid increase in the capacity to pay for their demand.

Key words: Global Financial-Economic Crisis, Marxist Political Economy Analysis,

Socialistic Economy System

In 2006, when the world economy was still blooming, the Subordinated Debt crisis, which did not arouse much attention, began to emerge in the United States. Many economists treated it as a regional event, which was insufficient to affect the prosperity of the world economy. However, with the constant development, subprime mortgage crisis deeply shook the U.S. economy and then became the top concern of the United States government. Meanwhile, because the United States is the global financial center, the financial panic extended to worldwide, and triggered a global financial crisis and credit crunch. In China, share prices had fallen by more than 75 percent in six months, while no less than 50 percent in South Korea and Hong Kong, and over 40 percent in Europe France, Germany, and the United Kingdom stock market. Iceland was even facing the threat of a National Bankruptcy. The United States, though an international economic giant, also witnessed a stock market decline by more than 30 percent. So far, it remains unknown when this global financial-economy would meet its end.

I. Origin and Growth of the On-going Financial-Economic Crisis

Generally speaking, financial crisis means the sharp, short-term and ultra-cycle deterioration of most of the financial indicators, such as short-term interest rates, monetary assets, securities, real estate, land prices, the number of commercial bankruptcy and financial institutions closed down.

Due to the subprime lending problem, bankruptcy of banks gave rise to the global financial crisis. That confirms what Karl Marx said that “ we note the phenomenon that crises do not show themselves, nor break forth, first in the retail business, which deals with direct consumption, but in the spheres of wholesale business and banking, by which the money-capital of society is placed at the disposal of wholesale business.”¹

The subprime crisis we mention here is the fluctuation, panic and crisis in the international financial markets, which is caused by credit crunch and the steep rise in the rate of US subprime mortgage defaults. The subprime mortgage loan is among the credit types of subprime lending with high risk and profit as well. Although there is no standardized definition, in the US subprime loans are usually classified as those where the borrower has a [FICO score](#) below 680. The main difference between subprime loans and prime conventional loans is that the borrowers' necessary credit scores and ability to pay back of the former is much lower than that of the latter, but the interest rate is higher. Thus those who are rejected by prime conventional loans lenders because of bad credit records

1 Marx, Capital. Chicago: Charles H. Kerr and Co., 1909, Volume III, Part IV, Chapter 18, pp359

and reduced repayment capacity would turn to subprime mortgage loans.

With the excess liquidity in western countries these years, the criteria for borrowing became less restricted. First-time home buyers could make no down payment even without payment documents. One high-risk option was the “NO Income, No Job and no Assets” loans. That boomed the subprime mortgage loans. However, situation changed. In 2006, the housing bubble in US began to burst, and the housing price started to fall. Thus many subprime mortgage borrower could not make payment any more, neither could they get enough money by selling their houses, the price of which was going down. Then the mortgage lenders succumbed to the pressures of tighter credit, tumbling home prices and rising foreclosures. Even worse, at the heart of the portfolios of many of these institutions were investments whose assets had been derived from bundled home mortgages. Exposure to these mortgage-backed securities, or to the credit derivatives used to insure them against failure, threatened an increasing number of firms such as Lehman Brothers, AIG, Merrill Lynch, and HBOS.

On March 13, 2007, the New York Stock Exchange delisted New Century Financial Corporation. But the prelude of the crisis did not attract much attention. But things developed and finally burst in September. First, on September 7, 2008, the US Treasury took over the biggest two mortgage companies Fannie Mae and Freddie Mac. And on September 14, it was announced that then Lehman Brothers, the fourth-largest investment bank, would file for bankruptcy. At the same day, the sale of Merrill Lynch, the third largest investment bank, to Bank of America was announced. On September 16, the Federal Reserve created a credit facility to American International Group, or AIG, for up to 85 billion US dollars in exchange for a 79.9% equity interest, and the right to suspend dividends to previously issue common and preferred stock. At the close of that week the Secretary of the Treasury and President Bush announced a proposal for the federal government to buy up to 700 billion US dollars of illiquid mortgage backed securities with the intent to increase the liquidity of the secondary mortgage markets and reduce potential losses encountered by financial institutions owning the securities. The draft proposal of the plan was received favorably by investors in the stock market. Details of the bailout remained to be acted upon by Congress. On Sunday, September 21, the two remaining investment banks, Goldman Sachs and Morgan Stanley, with the approval of the Federal Reserve, converted to bank holding companies, a status subject to more regulation, but with readier access to capital.

Now the crisis in Wall Street caused by subprime crisis turns out to be a global financial crisis. And it even does harm to the real economy. Generally speaking, there were four steps. The first one was debt problem. The subprime mortgage lender could not make payment. Then came the liquidity crisis. Many institutions with limited liquidity could not meet the customers' withdraw demand due to the debt problem. The third phase is the credit crisis phase. People lose the confidence on financial services based on credit. And then

came the final phase, the global crisis.

II. The direct causes

There are a number of explanations on the global financial crisis. The following reasons could be apparently seen.

1. The overdevelopment of fictitious economy

The US economy is highly dependent on fictitious economy or the movement of financial capital. In 2006, nearly a quarter of GDP of the United States was covered by output of financial services whose profit covered 44 percent of all the profit made by the United States. The profit from manufacturing only took up almost 10 percent. Karl Marx had made systematic statement on fictitious capital in *The Capital*. He argued fictitious capital, such as stock, bond and mortgage, was based on lending capital and bank credit system. The main difference between fictitious capital and real capital is that the fictitious capital which has no value by itself could bring about profit in the process of movement. However, without the support of real economy and the proper regulation measures, fictitious economy would turn to bubble economy.

Driven by the United States economy, the total market value of fictitious economy around the world reached 140 trillion U.S. dollars in 1997. That was the 4 times the size of the integrity amount of global GDP, which was 28.2 trillion dollars. However, in 2007, the trading volume of international foreign exchange and financial derivatives, which was 3259 trillion dollars, was 76 times the size of global GDP in the same year. It can be seen that fictitious economy had run too far from the real one. And that meant the burst of the American housing bubble and the explosion of global financial crisis was just a matter of time. It had been pointed out by Marx that¹ ,” In a system of production, in which the entire connection of the process of reproduction rests upon credit, a crisis must obviously occur through a tremendous rush for means of payment, when credit suddenly ceases and nothing but cash payment goes. At first glance, therefore, the whole crisis seems to be merely a credit crisis and money crisis. And in fact it is but a question of the convertibility of bills of exchange into cash money. But the majority of these bills represent actual sales and purchases, and it is the extension of these far beyond the demands of society which is at the bottom of the whole crisis.”

2. Overdevelopment of Financial Derivatives, and Overleverage

According to banks for international settlements, the trading volume of financial

1 Marx, *Capital*, Chicago: Charles H. Kerr and Co., 1909, Volume III, Part V, Chapter 30, pp575

derivatives, which was over 1000 trillion US dollars, was 16 times the size of the sum of GDP all over the world. The main reason why subprime mortgage-backed securities, which was worth merely 1.2 trillion US dollars, could give rise to such a huge financial crisis is the risky leverage transactions financial institutions took to pursue high profit.

The leverage ratio of ordinary investment bank is 1to30, while that of derivative operators, such as hedge funds, etc. could reach 1 to 100 or even 1 to 200. According to Basel Accords, an authorized commercial bank must has a Capital Adequacy Ratio no less than 8%. That is to say based on 1 dollar equity a commercial bank can offer 12.5 dollars risk weighted credit exposure or 12.5 dollars if the risk weighting is 100%. But banks usually use credit defaults swaps to protect themselves from the risk of default. Then the risk weighing could be cut down from 100% to say 20%. And thus the leverage ratio would be 1 to 62.5, and the capital adequacy ratio 1.6%. So with the development of securitization, deregulation and growing leverage ratio, banks became more and more vulnerable to the default risk of subprime mortgage, though those financial innovations seemed to eliminate risk and improve efficiency. That is the reason why the ill effect of the default of only 1.2 trillion dollars subprime mortgage could be amplified and could shake the whole global financial markets. That also proved what Marx said, the capitalist credit system “develops the incentive of capitalist production, the accumulation of wealth by the appropriation and exploitation of the labor of others, to the purest and most colossal form of gambling and swindling.¹”

3. Deregulation and Incomplete Information

In 1999, the Glass-Steagall Act, or the Banking Act of 1933, which introduced the separation of bank types according to their business, was repealed by Gramm-Leach-Bliley Act, which facilitates the mixed operation. Due to the deregulation, securitization became more and more popular, and fostered the growth of financial bubbles. After a long period of high speed increase in US economy in 1990s', the burst of dot-com economy forced The Federal Reserve to cut the benchmark interest rate again and again. In June 2003 the Federal Reserve lowered the benchmark rate to 1%, and had kept it for 1 year since then. This situation gave rise to housing bubble. Though the benchmark rate was raised 17 times later, the US currency, with excess supply, was still in the process of depreciation.

At the same time, when subprime-backed securities were issued, the information was incomplete. When subprime mortgage loans were securitized and sold to investors, the buyer did not have access to confirm the payment capacity of subprime mortgage lenders. Furthermore, the credit ratings were inaccurate. Government left private rating agencies so much room that the rating standard was too lax to provide accurate information on subprime mortgage backed securities. And the structure of derivatives was too complex.

1 Marx, Capital, Chicago: Charles H. Kerr and Co., 1909, Volume III, Part II, Chapter 27, pp522

Investors could hardly know what the base of the securities they bought was neither did even the issuers know the way to price those structured products.

4. The vulnerability of global financial institution under globalization

Due to the characteristic, financial industries are exposed to certain risk and uncertainty. Leverage practices make financial capital more unstable. Because of neoliberalism, institutions, regional financial markets have become knots on the international financial web. Even a small disturbance on the web, such as credit panic in certain regional market, depreciation of any financial products or failure of a financial institution, will make other institutions and global markets suspect the stability of whole system. Let's take an instance. If a small disturbance takes place, the probability for each financial institution to keep the financial capital is 98%. At the early stage of global financialization, the probability to maintain a stable financial system might be 98% of the power of 10, or 81.7%, when global financialization deepens, more institutions are included. The probability might be 98% of the power of 100, or 13.2%. The earlier one could take measures to avoid risk, the less loss he will get. Thus the fear against risk will kill the whole system.

5. Defects of global economic growth pattern

After the Second World War, US dollar became the only toll for international settlement. And the US promised to fix the price of gold at 35 US dollars per ounce. Then all currencies pegged to the dollar. Even when Bretton Woods system broke down, US dollar is on the top of reserve list of many countries because the US economy is the biggest one on the earth. The domain situation of US dollar remained unchanged. Recently, many growing economies, such as China and India, chose an import-oriented growth pattern, and became more independent on US market than before. On one hand, China, for instance, taking the advantage of low labor cost in international trade, earned a large amount of US dollars. On the other hand, those US dollars flows back to the United States when China buys the United States Treasury bills. Thus the United States became the debtor and consumer at the same time, while developing countries like China the manufacturer. However, this unbalanced international trade structure is unsustainable.

In the United States, with money flowing back from other countries, liquidity became excessive. Banks had to deal with the money to make profit and make up for the interests. So they lowered the requirement level of mortgage, and lent money to many low-income lenders even without down payment requirement. In order to avert risk, subprime mortgage loans were securitized. After complex structuring, investors could not figure out the dimension of risk. However when housing bubble burst, default rate skyrocketed, securities backed by subprime mortgage were sold. Then the crisis exploded. Thus the unbalanced growth pattern also fostered current crisis.

III. The Root of Current Global Financial Crisis

Marx said, “The superficiality of Political Economy shows itself in the fact that it looks upon the expansion and contraction of credit, which is a mere symptom of the periodic changes of the industrial cycle, as their cause.¹” Though there seems to be many apparent reasons, the only real root is the basic contradiction of capitalism, which is the conflict between socialized production and private property ownership in the means of production. The contradiction could be seen from two aspects. The first one is the contradiction between the trend of unlimited expansion of production and people’s relative contraction of pay-off capacity. Another one is the contradiction between the organized production of individual enterprises and the anarchic production of society as a whole. It is this objective economic rule Marx revealed long ago that is the root of current crisis.

1. The Aim of Capitalist Production, the Maximum of Profit

The aim of Capitalist production, the maximum of profit, causes the contradiction between the unlimited expanding production and relatively shrinking consumption.

The apparent cause of the current crisis is excessive consumption, but the real one is surplus in production, which is a relative not absolute one caused by the gap between huge amount of product and relatively small purchasing power. Under capitalist wage-labor system, profits and wages are always antagonistic. But the only way to deal with the surplus production capacity is to simulate individual consumption. Then consumption loan becomes popular in western world. On one hand, it meets the needs of profit-chasing capitalists to sell their product now. On the other hand, ordinary people can buy what they want now but at the cost of long-term benefits.

However, consumption loans, which just trade long-term benefits for current consumption, could just postpone the explosion of crisis, instead of getting rid of it, which would be inevitable once the expectation becomes pessimistic. The subprime mortgage, which gave rise to current crisis, is among the various kinds of consumption loans, other kinds of which would also cause crisis sooner or later, as long as this consumption pattern exists.

Marx pointed out that, “the credit system appears as the main lever of overproduction and overspeculation in commerce solely because the process of reproduction, which is elastic in its nature, is here forced to its extreme limits, and is so forced for the reason that a large part of the social capital is employed by people who do not own it and who push things with far less caution than the owner, who carefully weighs the possibilities of his private capital, which he handles himself.” “It constitutes an immanent fetter and barrier of

1 Marx, *Capital*, Chicago: Charles H. Kerr and Co., 1909, Volume I, Part VII, Chapter 25, pp:693

production, which are continually overstepped by the credit system.1”

It can be seen that all capitalist crisis share the same essence, production surplus. In the past, the performance was inadequate effective demand overstock of goods, while now it would be over-consumption through loans. The changes of performance postpone the explosion of crisis but make it even more sever. Despite of those changes, the current could be seen as a copy of the Great Depression in some way, because they have too many characteristics in common.

2. Free market system

The capitalist free market system deteriorates the contradiction between the organized production of individual enterprises and the anarchy of social production. The development of socialized production, division of labor and collaboration build the highly organized production in enterprises. However, the private ownership of means on production leads to anarchy and chaos in society.

The current crisis, the inevitable aftermath, reflects the spontaneity of capitalist free market economy. In order to maximizing profit, players in capitalist market economy will take every measure they can imagine to speculate and expand market share. The Profit-chasing expansion will lead to anarchy, surplus production, the unbalanced national economic structure, and finally the crisis. And the unbridled speculation will break the balance of credit and real goods and trigger financial crisis.

Financial derivatives, which were lavished to speculate in financial market, went too far from the needs of material production. But speculation, including all kinds of bonds, funds, etc., chases the profit without considering methods and social results and has become the normal character of capitalism. The spontaneity and blindness of economy driven by speculation in capitalist market, stimulates the turmoil of capitalist production, imbalances the national economy. Thus the financial liberalization led to the uncontrollable deregulation of financial market, and triggered financial crises.

Just like what Karl Marx said, the capitalist corporation “..... reproduces a new financial aristocracy, a new variety of parasites in the shape of promoters, speculators and simply nominal directors; a whole system of swindling and cheating by means of corporation promotion, stock issuance, and stock speculation. It is private production without the control of private property2.” “.....credit gives to these few more and more the character of pure adventurers. Since property here exists in the form of shares of stock, its movements and transfer become purely a result of gambling at the stock exchange, where the little fish are swallowed by the sharks and the lambs by the wolves.3” “Hence, the credit system accelerates the material development of the productive forces and the

1 Marx, Capital, Chicago: Charles H. Kerr and Co., 1909, Volume III, Part V, Chapter 27, pp:522

2 Marx, Capital, Chicago: Charles H. Kerr and Co., 1909, Volume III, Part V, Chapter 27, pp519

3 Marx, Capital, Chicago: Charles H. Kerr and Co., 1909, Volume III, Part V, Chapter 27, pp520

establishment of the world-market. It is the historical mission of the capitalist system of production to raise these material foundations of the new mode of production to a certain degree of perfection. At the same time credit accelerates the violent eruptions of this contradiction — crises — and thereby the elements of disintegration of the old mode of production.¹”

Karl Marx has pointed out that the credit system, the main lever to accelerate production surplus and business speculation excessively, reinforces the process of reproduction extremely in capitalism, thereby intensifies the capitalist basic contradiction into the financial crises, and finally lead to the collapse of capitalist institution. “Two natures, then, are immanent in the credit system. On one side, it develops the incentive of capitalist production, the accumulation of wealth by the appropriation and exploitation of the labor of others, to the purest and most colossal form of gambling and swindling, and reduces more and more the number of those, who exploit the social wealth. On the other side, it constitutes a transition to a new mode of production.²” The new mode of production is socialist institution. But certainly, the process is very zigzag and complicated. Thus it can be seen that the main cause of the crises is the capitalist institution. The economic crises shall be exploded sooner or later if this old institution was not annihilated. It’s the historical inevitability.

IV. Outlook the influence of the world financial crises

With the bell knelling again, Capitalist institution is facing the dangerous of collapse because the development of productivity is tied to the relations of capitalist production seriously. But the road of the history development has many twists and turns. The prospect of the world economy is complex\complicated and volatile owing to the interaction of all kinds of complicated factors\complications.

Some people believe that the supreme status of dollars shall be influenced by financial crises. But this viewpoint is not practice for the moment. The financial station of American can’t be shook at least in the forecast future. First of all, the fundamental of American economy is robust with strong economic engine. For example, American scientists made a clean sweep of Nobel Prize in the aspects of nature and science, and the latest ranking of universities worldwide showed that the US, due to the strength of science & technology and the abilities of innovation is still the top leader in the world. No countries or organizations can contend with her in a long time. From the exterior environment, we can see that the situation of the other countries is no better than that of American. Dollars is still the most trustworthy currency in the world. According to latest data, the possess of dollars keeps

1 Marx, Capital, Chicago: Charles H. Kerr and Co., 1909, Volume III, Part V, Chapter 27, pp522

2 Marx, Capital, Chicago: Charles H. Kerr and Co., 1909, Volume III, Part V, Chapter 27, pp522

rising, which means that the international society still remains confidence in dollars, or maybe only the huge American economy can assimilate the financial crises. Moreover, Federal Reserve poured a huge fund into the financial system in time. That increased the liquidity, reduced the possibility of systemic crises aroused from the deterioration in part.

Although the financial status of American can't be shook, there is still a distinct influence to American economy in a short time. The American economy had seen the rare big depression in 2008. According to the analysis of econometric model build by UBS economists, the coincidence of a one percent rise in capital cost and a ten percent drop in price of stocks and housing will cause a 2.6 percent drop in US economic growth, and a big recession as well. Then, why there is still many people insisting in that the damage caused by the money-market plight is limited? The main reason is that they predicted that Federal Reserve will save market by cut interest rates. But the analysis of UBS showed that the cut of interest rates can't alleviate all the pains. The growth rate of American may slow down more than 1 percent. Although the analysis is not perfect, the American economy will definitely go to depression when the house price would have a double-digit drop, even if the Federal Reserve would lose the monetary policy.

Somebody thinks that American economy was surely influenced to some extent, but unapt to the depression. The main reason is the share of architecture industry in GDP is about 5.1 percent, and that of the real estate and relating tenancy industry is 10.1 percent. So, even if the decrease of the sale of the real estate can influence American's economy, the scale can only be about of 15.2%. So the decrease of real estate can only slow down the economy to some extent. But the influence is not only on the real estate industry. The double-digit drop of house price plunged more mortgage debtor to financial crises, and the problem has already been showed up through other debt. For example, the rate of default in credit card is increasing. The loan institute may face more intractable complexion. With the house-owners feel poorer than before, expenditure shall be restrained, especially in the circumstance of stock market continue to slide.

As far as the influence on the other economies, the aftermath shall be more serious, because American could have much bigger influence on global economy than any other countries. Although its current account deficit is in decrease, it still takes up 6 percent in GDP. And the sudden decrease of demands will hurt other economies inevitably for US consumes more than it produces. The countries which experienced the prosperity of house market and consuming, especially in England, Ireland, Australia, Canada and Spain, will be hit too. Several years ago, Iceland, which implemented bank privatization and dropped the financial supervise, now have to face the plight of national bankruptcy, because the bank debit and credit were so excessive that they can't reimburse the loan of the foreign debtor now.

What about the influence on China? Firstly, the developing mode of relying on foreign

capital, trade and foreign exchange firmly is facing challenges now. The dependence on foreign trade keeps rising from 2001 to 2007, up to 69 percent in 2007. The financial crises lead to the decrease of consumption needs in Europe and American. This will cut down the export of Chinese products inevitably. The export decreased by 2.8 percent in Dec. 2008. It has been the worst performance since 1999. HSBC estimated that in the first season of 2009, the export will shrink by 19 percent. It may probably decline for the first time after the past 25 years. Second, the huge reserve of foreign exchange will not only suffer a numerous lost because of the decrease in the value of American bonds and securities but also be vulnerable to the exchange risk caused by the depreciation of dollars. For example, the amount of 376.3 billion dollars bonds from Fannie Mae and Freddie Mac and the amount of 150 billion ABS bonds may almost have gone. Third, stable goods in the world were calculated by dollars, and the depreciation of dollars means the increasing price. Meanwhile, lots of hot-money will flow to China for arbitrage under the depreciation or the expectation of depreciation in dollars. International capital and financial group will speculate the prices of big goods, push the prices of bulk cargo like oil and iron ore up, and then increase the import cost of materials.

But the problem is more than the influence of financial crisis, the key point is the serious structural problems existing in the economics body. And the most severe one is the lack of domestic consumption demand caused by the big gap between rich and poor. And now, the situation shall be quite serious with the function of the two factors together. The GDP only increased by 6.8 percent in the fourth quarter of 2008, according to the National Bureau of Statistics of China in Jan.22. It's the lowest increase rate in the recent seven years, and it dropped down for the first time lower than 8 percent from the second quarter in 2003. Those data showed the serious shock to China economy by the global financial crises. This growth rate led to the 9-percent GDP only growth rate in 2008, 4 percent lower than that of 2007, which was 13 percent, and reversed the double-digit quick increasing for the last five years. China economy may enter the period of depression. In the last five years, the annual growth rate of electric power products is 15 percent, but down to 6 percent in 2008. In order to alleviate the shock to China economy and employment problem caused by the decrease of export, central government has take measures to enlarge the domestic demands to boost the growth. But it's hard to fill up the gap in a short time. China is facing a huge structural challenge, the transition from the unsustainable model featured by excessive independency on export to the domestic production and sales of high valued-added products, so as to raise wages and consumption level. Even at the best circumstance, this transformation will need quite a long time. It is predicted that the economic running of China will be very difficult in 2009.

The research and the countermeasures to solve these problems is too weak and need to be strengthened in China.

American has the problem of scarcity in domestic demands, or the lack of capacity of