Hi everybody,

One of the interesting things that is happening in economics circles as the current world economic crisis drags on and intensifies is that bourgeois economists are getting more testy with each other, and more and more disagreements and alternative proposals about what to do are coming to the fore. Some of the conflicting ideas might ease the situation for a short while, while many others would only make things qualitatively worse—by speeding up the negative developments which are eventually going to come about in any case.

In the article attached below from Britain’s Financial Times (their equivalent of the Wall Street Journal) we see one example of this with a German anti-Keynesian weighing in against the dominant Keynesianism of those now in charge in the U.S. and most other countries. Which side is “right” in disputes like this?

Well, actually, neither side is. But from the perspective of the near-universal desire to postpone as long as possible any further intensification of the crisis, the most ardent Keynesians are certainly correct.

The cause of this crisis—like almost all other economic crises in the last couple hundred years—lies in the fundamental nature of the capitalist relations of production themselves. In a nutshell, the capitalists pay their workers only a fraction of the value of the goods and services that they produce. They could not stay in business if they didn’t constantly generate this “surplus value” (part of which becomes their stated profits). This means that the working class—which is by far the biggest part of the market—cannot possibly buy back all that they actually produce. As Engels put it, the big problem with capitalism is that production increases faster than the generated market for that production.

There are two main ways that the capitalists and their governments have developed to deal with this problem—for a while! The first, and most important of the two, is to simply lend money to the workers and other sections of the masses so that they can then buy more of what the capitalist factories produce. But obviously, for this to work, the working class must build up its debts to an ever greater extent. This has in fact happened over the entire period from World War II on, and has now reached the level of many trillions of dollars. People are up to their necks in debt, including mortgages they are having an increasingly hard time making payments on, credit card debt, auto payments, and all the rest. In short mass debt is at or very near its limits.
The other thing that can be done to keep things going (for a while!), especially if the workers cannot afford to buy any more of what is produced, is to have the government buy it. But the government cannot just use tax money to do so; that would only mean that the workers and others who are taxed would have an equivalent amount less to spend and the government expenditure would have no net positive effect. So to be effective in keeping the economy going government expenditures must come from either borrowing money from the capitalists or else by simply printing up the money. These are the two methods of promoting what is called “Keynesianism” [Keynesian deficits]. But the first method leads to greater and greater government debt, and the second method leads to ever-increasing inflation. But obviously, in the U.S. (and everywhere else) there are now already dangerously high levels of state debt and inflation is also starting to get quite worrisome. So it appears that Keynesianism too, is approaching its limits.

(For more on all this see my long essay in progress, “An Introductory Explanation of Capitalist Economic Crises”, at: http://www.massline.org/PolitEcon/crises/Crises_0.htm )

So if Keynesian deficits along with consumer debt are what has been keeping the U.S. and world economies going, would it make any sense to follow the advice of those who want to cut deficit spending? Of course not! That would merely lead to a quick intensification of the crisis. (Note: It is true that the rate of increase of U.S. government debt was cut back for a while during the Clinton administration while much of the debt continued to be hidden—by stealing from the Social Security fund for example—but at the same time consumer debt tremendously mushroomed during that period which allowed Clinton to get away with his supposed “balanced budgets”. Because consumer debt is now close to its limit that is no longer possible.)

However, because government debt and inflation are also getting close to their limits, and because of the excessive use of these means in recent years especially, the U.S. dollar has also been falling dangerously fast. This means that many economists are starting to worry about the serious consequences of continuing to follow the Keynesian path they have been on for so long. And that is why alternative proposals are now being bandied about.

But what it all comes down to is that the economy is getting harder and harder to keep going even at its present fairly weak level. The two basic methods of keeping things going are both either at or near their limits. Thus, no matter what the government decides to do, the long-developing crisis of overproduction will continue to develop, and—while there will still be small ups and downs within the general course of things—overall the crisis will continue to worsen.

Moreover, for reasons I won’t get into here, at some point there will be a qualitative worsening to the point where we will have to start talking about not just “recession”, but intractable “depression”. And one of the sorts of things that might more quickly bring about this further collapse would be to follow the suggestions of economists like the guy below to simply let the crisis “run its course”. People who say things like that have no conception of just how bad that “course” might prove to be!

Scott
Recession is not the worst possible outcome

By Wolfgang Münchau

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If this had been a mere financial crisis, it would be over by now. The fact that we are suffering its fourth wave tells us there might be something at work other than merely financial euphoria and bad regulation. Maybe this is not a Minsky moment after all. Hyman Minsky, the 20th century US economist, formulated the long forgotten, and recently rediscovered, financial instability hypothesis, according to which capitalist economies, after a long period of prosperity, end up in a vicious circle of financial speculation. The Minsky moment is the point when what economists call this “Ponzi game” collapses.

But there might be better explanations. As the Bank of International Settlements said in its latest annual report, subprime might have been the trigger for this crisis, but not the cause. We do not have a full understanding yet of what happened but the BIS suggested that fast expansion of money and credit must have played a role. I would go further and say this is not primarily a crisis of financial speculation, but one of economic policy. Its principal villains are therefore not bankers, but economists — not in their role as teachers and researchers, but as policy advisers and policymakers.

So who are they? I recall a wonderful episode told by Jagdish Bhagwati in his book In Defense of Globalization when he quoted John Kenneth Galbraith as saying: “Milton’s [Friedman’s] misfortune is that his policies have been tried.” In fact, this is not the worst that could happen. The worst is for economists to try out their own theories themselves. This happened to several highly respected academics who have since become central bankers or finance ministers. If, or rather when, they turn out to be wrong, they risk a double reputational blow — as policymakers and as academics. So do not count on them to change their mind when the facts change.

Several of them have been leading proponents of an economic theory known as New Keynesianism. It is, in fact, probably the most influential macroeconomic theory of our time. At the heart of the New Keynesian doctrine stands the so-called dynamic stochastic general equilibrium model, nowadays the main analytical tool of central banks all over the world. In this model, money and credit play no direct role. Nor does a financial market. The model’s technical features ensure that financial markets have no economic consequences in the long run.

This model has significant policy implications. One of them is that central banks can safely ignore monetary aggregates and credit. They should also ignore asset prices and deal only with the economic consequences of an asset price bust. They should also ignore headline inflation. An important aspect of these models is the concept of staggered prices — which says that most goods prices do not adjust continuously but at discrete intervals. This idea lies at the heart of some central bankers’ focus on core inflation — an inflation index that excludes volatile items such as food and oil. There is now a lively debate — to put it mildly — about whether an economic model in denial of a financial market can still be
useful in the 21st century.

So when economists tell us that we need to keep real interest rates negative, just as we did for long periods in the past 15 years, or that we now need to bail out homeowners and banks and raise our national debt in the process, or ignore any considerations of moral hazard while the crisis is raging, we might want to question whether the recipes that got us into this mess are also most suited to get us out again.

If we believe, as the BIS does, that a rapid expansion of money and credit has either caused, or significantly contributed to, the build-up of asset price bubbles and higher inflation, the opposite policy conclusions might be more appropriate.

Under this setting, the priority might be not to impede the fall in asset prices. Real house prices in the US, the UK and several other economies might end up falling by some 40-50 per cent, peak-to-trough, in the downward phase of this cycle. Let this happen and do not implement policies to prevent this fall; such policies might alleviate some pain in the short run for some people but will make the adjustment last a lot longer.

Second, monetary policy should be geared towards price stability first and foremost. When inflation expectations rise, real interest rates should be positive. This would necessitate a large interest rate increase in the US and further interest rate increases in the eurozone as well.

Third, allow some defaulting banks to go bust.

Fourth, implement long-term policies designed to reduce volatility. Among these are: a change in the monetary policy framework to take explicit account of asset price developments; the removal of pro-cyclical incentives in the banking sector; stricter regulation of mortgages, such as the encouragement of fixed-rate loans and the imposition of maximum loan-to-value ratios; more exchange-rate flexibility in countries with fixed or semi-fixed exchange rates and, of course, the development of alternative energies to reduce our reliance on oil.

We might run a greater risk of a recession in the short term. But a recession is not the worst possible outcome. The worst is for this crisis to go on and on, for Minsky’s moment to become an eternity.

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