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Staring into Black Water

BySander

How can the economy’s need to wipe out a mountain of fictitious value be squared with its need to maintain social control? Sander considers the prospect of deflation, reflation and/or stagflation

Predicting the short term economic future is like staring into pitch black water and trying to see how deep it is. It’s very, very deep, that much seems certain. But nobody knows how much fictitious capital is out there and how much of it must disappear before the rest of the economy is sufficiently unburdened to catch its breath. By now, the crisis has already devoured more than 15 trillion dollars in the USA alone and trillions elsewhere, and the end is nowhere in sight. Like an avalanche crushing everything in its path and growing ever bigger in its rush downward, the debt-deflation becomes more devastating with time, as its effects (falling prices, plummeting assets, constipated credit markets, spreading bankruptcies and growing unemployment) reinforce each other.

One option for the ruling class is to do more or less nothing. Let the avalanche rush on until it has hit the bottom. After all a crisis is a moment of correction and, if the correction is not allowed to proceed, the underlying problem will not go away. But the crisis is not a surgical instrument that eliminates the sick parts and leaves the healthy untouched. The shrinking market, falling profit rate and tight credit are dragging everybody down. No capitalists are saying, âdon’t help us, we’re willing to sacrifice ourselves for the greater good of capitalism’. And no state can feel confident that it has enough control over its population to allow such a ferocious process to unfurl without risking major social convulsions. So this option is out. The laissez faire approach to the crisis, even in a moderated form, will not happen. The capitalist class will desperately try to contain it. The question is: does it have the means to do so?

The limited reach of monetary tools is already painfully clear. Even a zero interest rate is not low enough to get credit flowing again if there is no confidence in tomorrow. Even if Ben Bernanke were to throw money at people from a helicopter, as he once joked that he would do at a time like this, most people would still spend as little of it as possible, given their insecurity and the likelihood that they will pay less if they postpone buying. For the same reason tax cuts, which can at best only compensate for a small fraction of the losses, will not restore confidence and not significantly alter economic behaviour. That leaves direct government spending on public works, social programmes, subsidies to industry, etc. It would have to be really massive to make a dent. Obama says he’s ready to lead the way. âWe can’t worry about the deficit. We’ve got to make sure that the economic stimulus-plan is large enough to get the economy moving again’, he stated at a recent press conference. The fact that next year’s budget deficit is thought to reach one trillion dollars made some people gasp, but this figure is quite puny compared to the devalorisation, and thus destruction of purchasing power, in process. My educated guess is that it will be much larger. It will have to be to slow, not to mention stop, the deflationary avalanche. It will be politically imperative in order to maintain capitalism’s grip on society.

The circumstances create some room for a massive reflation led by the US. The deflationary environment eliminates the danger that it will immediately lead to rising prices. The deflationary wave has other beneficial side effects for the strongest capitals. The fact that it affects the weakest competitors first and hardest lowers the import bill for the most developed countries (and will probably further stimulate globalisation, with peripheral countries engaging in competitive devaluation to stem their market losses). Production costs (wages, energy, etc.) are falling dramatically, despite OPEC's cutbacks. Stronger capitals fatten themselves on the corpses of the weaker ones and seize the opportunities to grab their market shares. These are counteracting trends that could help reflation to take hold. Only the US could launch it, given its control over the world's currency. It can launch it because it can bet that the Asians, Europeans, Arabs and, of course, the Americans too will not stop buying the treasury notes that back its spending, regardless of how wild it becomes, because their vital need for the American market and their fear of seeing the value of their vast dollar reserves plunge leaves them no choice. Furthermore, the tendency of capital, in this climate of insecurity, to seek refuge in a âsafe haven', to stay away from production and to park in treasury-bonds at yields of near zero, removes, for the near future, any danger of capital flight from the US which would have to be stemmed by raising interest rates.

All this makes it seem likely that the US will embark on a reflation policy that will push its deficits far beyond current projections. The best possible outcome of this would be that a modest level of growth would be restored, while the growth of dollars in circulation, compared to the anaemic growth of value in the real economy, would lead to a further decline of the dollar and inflationary pressure in the US and the countries that followed the US on the reflationary path: stagflation. This is by no means certain. It may be that the loss of purchasing power as a result of the deflation of real estate and other assets is just too great to be compensated for, and that the deflationary wave, after slowing for a while, will accelerate again. Keeping alive weak companies will only postpone their demise and in the meantime lower the profit rate of their stronger competitors. And the capacity of Asian and other foreign capital to absorb US debt depends on their profits in the American market and dwindles with them.

So the great stimulus plans may all be in vain, but there is no other option. Capitalism will make this move like a chess player getting his king out of a checkmate position, without worrying about the next moves. But the next moves will be troublesome. The crisis of confidence will move from confidence in the banks to confidence in the state. The latter could bail out the banks but there will be no higher instance that can come to the rescue when there is no safe haven left for value.

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