CHARTIST
For democratic socialism

Paradigm Shifts

After 30 years of neo-liberalism Frank Lee argues the current crisis should sound a wake-up call for the left. Capitalism is again exposed as not the end of history but as a system of booms and slumps with huge dangers for the wellbeing and peace of people the world over. Keynsianism may have worked in the immediate post-war period of reconstruction but it is no longer a solution in the face of globalisation and financial meltdown. Responsible capitalism is a chimera. More systemic, indeed socialist, change is required.

Some years ago I reviewed a book - *State Building* - by Francis Fukuyama. This was one of Mr Fukuyama's lesser-known works. He is more famous for being the theorist of the 'end of history' – a view promulgated during the halcyon days of the neo-liberal counter-revolution *circa* the 1980s. After the collapse of communism in Eastern Europe, and with social democracy effectively throwing in the towel in Western Europe, Mr Fukuyama postulated that liberal, deregulated, market capitalism was now the historical norm, and if countries had not arrived at this terminal point in their history, then in the fullness of time they surely would. This view was to become the received wisdom in official circles, and I would argue still is, at least among the political, financial and media elites. Paradoxically, this new consensus – let's call it the Thatcher/Reagan settlement - represented almost a theoretical mirror image of the cruder types of Marxist historical materialism. Of course both were extremely contestable since the human agency was excised from the historical process – a process apparently beyond human volition and control; almost a force of nature. It followed from this, therefore, that politics was no longer about choice – according to the post-modernist fraternity, the grand political narratives were at an end – henceforth politics was to be simply about administration: the relevant question being who could run the system more efficiently. To be fair, Fukuyama has now admitted that he was wrong, and the more humanistic interpretation of Marxism – as espoused by *inter alia* Lukacs and Gramsci – does allow for human intervention in the historical process, in fact it insists upon this. Marx also, at least in his early years, put forward the famous dialectic. 'Men make history, but they do not do it as they please.' This is to say that they were creatures of their time and made political choices, but these choices were historically conditioned and constrained.

However, it seems commonplace among the journalistic types and other jobbing mediocrities to think that history is something in the past and that the present is the point of arrival. They have a tendency to take the empirically given as somehow natural and inevitable - its permanence is taken for granted. And of course those who have most to gain from the present dispensation will fight tooth and nail against any attempt to change this state of affairs. Reforms *are* possible – even though these will be generally opposed by these same entrenched interests – but the fundamental structures and institutions of the system will be left broadly unchanged. This is true at all times and in all places, including our own.

We can say, therefore, that the present world crisis and its various explanations are thus all based upon the notion that the liberal capitalist order is inevitable and permanent. Even erstwhile radicals like Will Hutton and Paul Krugman believe this to be the case. These are essentially a mainstream Keynesians, who argue for a more regulated capitalism that they regard as viable, whilst their opponents – including the free-market Hayekians Peter Schiff and US presidential contender Ron Paul – believe in less or even no regulation. But of course both are committed to the capitalist system, so the argument is something of an in-house debate between the two establishment views.

That the system is in crisis is self-evident. These two contending views I think require a necessary examination of what possible solutions might be found to the present global travails.

The Hayekian/Austrian School

For a long time after the Second World War these particular theorists were exiled to a virtual leper colony of macro-economic theory. This was a period of the Roosevelt/Attlee settlement, the spread of communism over Eastern Europe, China and Indo-China. The catastrophe of depression, fascism and war, all emanating from uncontrolled markets and market crashes, followed by trade wars of the 1930s and then by the shooting wars, was rejected absolutely by the electorates of the western world as well as by their leaders. But Von Mises, Hayek, Menger *et al.* bided their time until their moment came. This moment came in the 1970s when the post-war boom petered out. They found a populariser of their beliefs – albeit in a crude form – in Milton Friedman of the Chicago School and what was called monetarism. These ideas then migrated from academia via the broadsheet press and finally to the right-wing political parties headed by Thatcher and Reagan

The Austrian school believe that attempts to control capitalism through state intervention will fail and will in fact be positively counter-productive. This is because such interventions distort the price mechanism leading to misallocation of resources, inflation and asset price bubbles. A good example of this would be the credit/property boom that was enabled by the accommodative actions of the central banks and Treasuries around the world, but particularly by the Bank of England and the US Federal Reserve Board. Interest rates were kept low. The policy was supported by both heads of the two respective central banks as well as Treasury officials, Gordon Brown and Edward 'light touch regulation' Balls in the UK, and the Fed boss Alan Greenspan in the US. Thus the natural cyclical tendencies immanent in the capitalist system were given an additional push by government monetary policy. Why? The answer is disarmingly simple: booms and bubbles (at least during the up-phase) are popular with the masses, and are therefore good politics. Who can ever forget 'the-end-of-boom-and-bust' triumphalism of the period.

Furthermore, it is argued that booms and busts are intrinsic to the system. One cannot exist without the other. During the boom phase of the cycle investors and consumers tend to become overconfident and make foolish investment and purchasing decisions. Prices start to rise due to the continual demand for factor inputs, growth becomes more and more febrile, banks make foolish loans (Northern Rock comes to mind), and then, when rises in income can no longer support rises in asset prices, the whole thing collapses. This is what happened in 2007; the bust part of the cycle begins. All the bad investments and overspending now come to light. Companies go bust, unemployment mounts, debts are written down simply because debtors cannot pay, and all the misallocations of resources can clearly be seen with half finished empty houses standing as the self-evident physical symbols of the manic bubble period which preceded them. Here Andrew Gamble explains:

> *"For the Austrians the business cycle had a necessary and important function within capitalism. The crisis phase of the cycle was crucial if capitalism was to renew itself, and purge itself of the false values and the misallocation of productive resources which had grown up during the boom phase. The crisis was a moment of truth, when suddenly the plans, the claims and the expectations which had been formed during the upswing were put to the test. Many of them would be found wanting, and those responsible for them would have to face the consequences. The process was not just to keep capitalism efficient, it was also necessary to keep capitalism moral. Only if agents bore full responsibility for their actions would the values of prudence, reliability and sound judgement and trust, on which capitalism relied, be upheld. The crisis purged capitalism in a double sense: both practically and morally. To many of its defenders the two were equally important. It was what gave capitalism its moral legitimacy and its practical dynamism."*
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> (***The Spectre at the Feast,*** **Andrew Gamble**)

Recovery would not be achieved by bail-outs, Keynesian deficit spending, or by rescuing companies which were simply inefficient or did not supply consumers or investors with their preferences as demonstrated by the market price mechanism. Such policies would simply create 'moral hazard' a tendency for investors and consumers to carry on as usual with losses being underwritten by the state; in this situation there was no intention or incentive for improving their business efficiency. These bailed-out entities were the economy's living dead, kept alive on state support - zombie banks as in Europe and Japan and zombie auto companies like Fiat, Kia, and GM, or insurance companies like AIG, all of which should have been allowed to fail. With their failure more competitive efficient companies would arise in their place.

Recovery could only get underway when, as during classical depressions, prices fell, which meant that if wages and interest rates fell more slowly – if at all - then disposable income would start to increase. This being the case consumers would start to spend again. Similarly bankrupted and distressed firms would be bought out at fire – damage prices by the more efficient firms with more up to date equipment. Growth now resumes given the destruction of existing capital values. The process of accumulation can restart.

What is striking about this theory is its similarity to Marx's view of trade cycles. But much of both theories were formulated in an earlier phase of capitalism. But for all that the Austrian theory's analysis of the bust is quite plausible and sophisticated.

> *The anti-deflation policies which have been adopted* (i.e., Keynesian demand management) *are largely a policy of price-fixing, a policy of preventing the market from exposing capital misallocations and then liquidating them. The root causes of the crisis remain in place and the underlying problems un-addressed …The economy cannot realistically be expected to rectify itself if the market is not allowed to liquidate capital misallocations. The state has erected a protective fence around the most dislocated sectors of the economy* (house prices for example) *trying to keep market forces outside. As long as it lasts no true recovery is possible.*
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> ***(Paper Money Collapse,*** **Detlev Schlichter)**

Interestingly enough, Marx had already identified the 'underlying problems' of capitalism some time prior to this: The ultimate reason for all real crises always remains the poverty and restricted consumption of the masses as opposed to the drive of capitalist production to develop the productive forces as only the absolute consuming power of society constituted their limit. (*Das Capital*, Volume 3)

Summing up, capitalism is intrinsically cyclical. The Growth periods tend to run out of control resulting in bad investments and resource misallocation. This process is fed by easy credit and excess liquidity. Asset price inflation rises to a level that can no longer be sustained by rises in income or further borrowing. The boom turns into a bubble and the bubble bursts. Then the whole process swings into reverse - the bust has arrived. However, the bust rectifies the situation by liquidating all the mal-investments and making way for a re-configuration of the system on a more sustainable and efficient basis. Capitalism restructures itself through these types of crises.

Although the Austrian – and indeed Marxist – analysis of the bust is, I would argue broadly speaking correct, the policy prescriptions of the Hayekians seem frankly alarming. The scope and interdependence of the system is such that the notion of simply letting the bust take its course would lead to quite massive economic, political and social dislocations on a global scale – a catastrophe that would dwarf the depression of the 1930s. In a strictly logical sense the reasoning of the Austrian school is correct but their policy prescriptions are simply too terrible to contemplate.

> *The Libertarians are actively promoting policies sure to bring about immediate economic hell, in the faith that punishment and suffering are the prerequisites to an economic afterlife in a better world. While in the*

end their philosophy of economic karma may ultimately prove correct, before accepting the remedy through collapse, other approaches should be put to the test. Economic reincarnation could take a lot longer than the Libertarians anticipate. The Renaissance did follow the fall of Rome – but only after 10 centuries.

(*The New Depression*, Richard Duncan)

So what about the alternatives?

Keynes and his followers

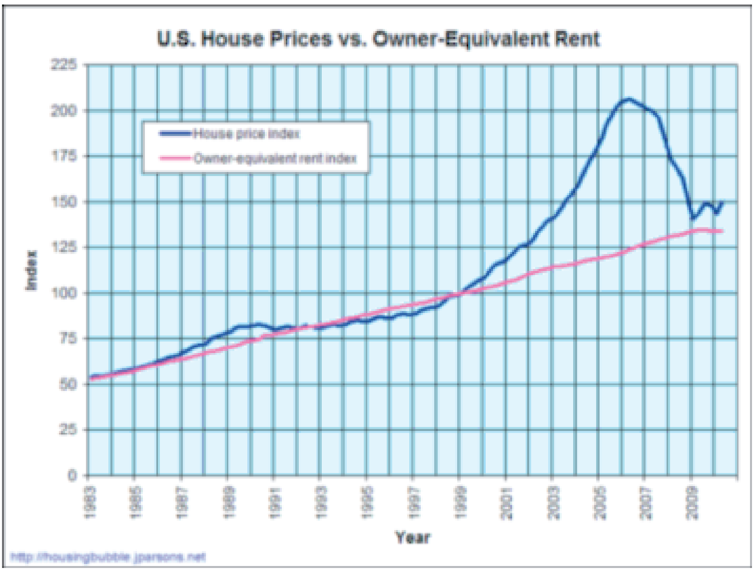
We need to clear up one or two things about Lord Keynes before we start. Keynes was emphatically not a socialist, if anything he was actively hostile to socialism. He opined that: "The class struggle will find me on the side of the educated bourgeoisie". (1925). We might legitimately enquire who, apart from Keynes himself, might the 'educated bourgeoisie' be exactly! Further, *The Labour party is a class party, and the class is not my class (Am I A Liberal,* in *Essays in Persuasion).* Again, "How can I adopt a creed – Socialism – which, preferring the mud to the fish, exalts the boorish proletariat above the bourgeois and intelligentsia who, with whatever faults, are the quality in life and surely carry the seeds of all human advancement". (*A Short View of Russia, Ibid*.) It seems necessary to state this since there is a widespread belief on the left that Lord Keynes was indeed some sort of (closet)-socialist. This could not be further from the truth: Keynes' main aim in life was to save capitalism from itself.

Keynes' *magnum opus, The General Theory of Employment Interest and Money* first published in 1936, represented the culmination of his earlier writings in which he elaborated what he believed to be the problem situation which had arisen in the world economy during the 1930s, and what he believed to be the solutions. Keynesianism is not really a theory of the trade cycle, nor is it a *general* theory (elaborated upon later). It is more a theory of bust and possible ways out of economic depressions. The bust period in a capitalist economy generally follows a period of excess credit and hence debt-fuelled growth. This was the case during the roaring 20s with runaway credit (debt) fuelling growth until – pop went the weasel! Credit duly contracted as the defaults multiplied, and so the Roaring '20s transmuted into the depressed '30s.

> *In 1930 the US money supply comprised currency held by the public (9%) and deposits held at commercial banks (91%). Banks used these deposits to fund their loans. When the credit that fuelled the Roaring 20s could not be repaid, the banks began to fail. When a borrower defaults it not only destroys credit, it also destroys the deposits that funded the credit. Between 1930 and 1933, 9,000 US banks failed. The corresponding destruction of deposits caused the country's money supply to contract by a third from $46 billion in 1928 to $31 billion in 1933. As the money supply shrank the happy economic dynamic that expanding credit had made possible, went into reverse, and the global economy spiralled into catastrophe.*
>
> **(*The New Depression,* Richard Duncan)**

Post-crash, the problem was not excess demand but insufficient demand. This became known as debt-deflation. This is where Keynes and his co-thinkers entered the scene. With consumers and investors not spending, aggregate demand in deflationary conditions is flat, or even falling. Therefore the solution could only be increased spending by the government. This to be carried out by a mixture of monetary policy (lowering interest rates and Open Market Operations now referred to as Quantitative Easing) and/or fiscal policy (taxation and public spending). This is, of course, something of an oversimplification of Keynes' theories which were somewhat more radical than most of his enthusiasts found to their taste, but it broadly captures the gist of what he said. The increase in aggregate demand would feed through to the rest of the economy and so induce an increase in output which would be eventually self-sustaining. Governments would find it necessary therefore to run budget deficits during this period. Q.E.D.

This approach was taken up by the Roosevelt administration when it came to office in 1933. At that time unemployment in the US stood at the alarming figure of 25%. A raft of policy measures including the Works Programme Administration (WPA), National Recovery Act (NRA), Tennessee Valley Authority (TVA) Civilian Conservation Corps, were implemented. Unemployment fell to 14% by 1936, but then rose



again during a new recession in 1937/38 to 20%. So the track record of Keynes policies seems patchy to say the least.

In our own time we have seen almost a repeat of the 1930s debacle. The long boom of 1980-2007 was floated on a sea of debt. The present crisis is, however, much larger and more global than that of the 1930s. The whole credit/property induced boom came to a shuddering halt when the sub-prime borrowers in the US defaulted. House prices, which had been rising by double digit percentages since the early 90s, collapsed in 2006 and have been falling, apart from one or two transient minor upturns, ever since (see chart).

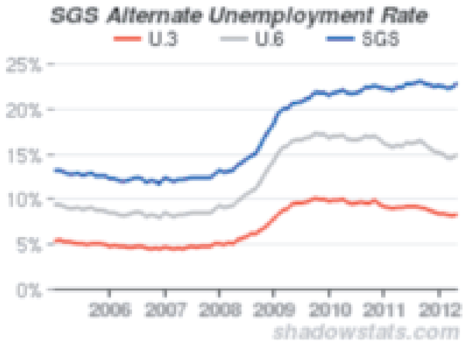
Given that the Eurozone crisis has received saturation coverage we will move on to the UK. Here we have a bizarre mismatch of policies: a loose monetary policy, with the Bank of England lowering the base rate to 0.5% and engaging in money printing – otherwise known as Quantitative Easing – and a tight fiscal policy with the Treasury cutting back on public spending. The result? The worst of both worlds, inflation and stagnation – good old 1970s stagflation. No end to the slump in sight

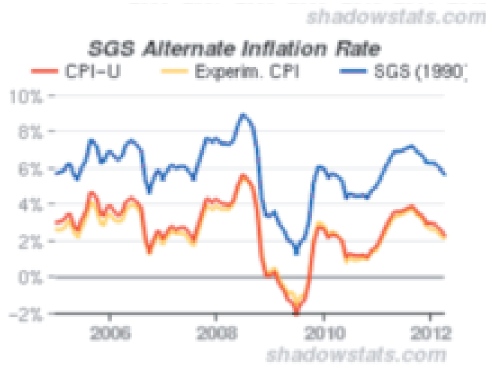
The same was to also happen in Ireland, the UK and Spain who had also built their policies around house-price inflation. Mortgage backed derivatives – i.e., those financial products which were based upon these repackaged dubious mortgages – were parcelled up and sold as new financial products to brain-dead investors around the world, after being given the triple AAA seal of approval by the ratings agencies. These derivatives were only producing a stream of income so long has the mortgagees continued to pay their instalments.

When they defaulted, the derivatives became worthless, the banks – who among others such as pension funds had been purchasing these debt instruments – then found their newly acquired ‘assets’ had turned into liabilities, overnight. Many banks were effectively insolvent and the great bank panic of 2008 spread around the world. Governments found it necessary to bail-out these institutions in order to avoid a global melt-down. So the banks simply transferred their junk ‘assets’ onto the sovereign nations’ balance sheets. Needless to say this was only the opening of the great recession of 2007 which is ongoing. The crisis has now apparently moved from the US – whose fundamental problems remain unresolved however – to Europe where the problem seems more acute.

Since the nadir of 2008/09 there has been a stabilisation rather than what we might meaningfully call a recovery in the global economy. Growth is flat or falling in Europe, although there are very marked regional disparities, and very weak (and as I write, beginning to actually stall) in the USA, again with regional disparities. Interestingly, perhaps with all the clamour regarding austerity in the Eurozone, no mention is made of the 40 or so US states – some effectively insolvent - which are over-seeing swingeing austerity programmes, California and Wisconsin come to mind.

Concomitant with this there are high levels of unemployment on both sides of the pond. Official figures for US unemployment, as found in the Bureau of Labor Statistics, are completely fraudulent since whole swathes of *de facto* unemployed have been disappeared off the register simply by definition. The same disappearing trick was used with the core inflation figures (See chart on next page). On the left is the chart that gives three levels of unemployment according to how the word is defined. In fact there are six definitions U1-U6.





The Bureau of Labor Statistics uses U3 but the figure for U6 is double. And if the same definition was applied as used to be the case then unemployment would be almost four times the official account. The same jiggery-pokery is used when defining-inflation. Each redefinition gives a lower figure.

It was the late Lord Gilmour who once said of his government's unemployment reduction: *Now we have reduced the unemployment figures, perhaps we can make a start on reducing unemployment*. I am afraid the pollution of statistics is the same for inflation, GDP growth and various other economic statistics. These statistics are not some measurements of objective facts, but simply political constructions. (In this connection see ChrisMartenson.com *Crash Course, Fuzzy Numbers* and John Williams *Shadow Government Statistics*).

The general Keynesian response to the present situation has been a hue and cry for stimulus at all costs. Keynesian counter-cyclical policies consist of two key tools: 1. Monetary policy - this comes under the remit of the central bank and consists of control of interest rates and money supply; 2. Fiscal policy, which is the remit of the Treasury consisting of taxation and public expenditure. This has not been adopted in the Eurozone, has been partially adopted in the UK and adopted in the US. In the Eurozone the policy of deflation – very much the German approach – has been adopted. This has put the weaker economies in the peripheral zone through the wringer of a grinding depression. No stimulus policies have been undertaken, since it is argued this would pile more debt onto unprecedented levels already extant. Results have to say the least, not been exactly encouraging, particularly in the southern periphery. This situation has received press coverage *ad infinitum* much of it justified, but much incredibly biased and ignorant, but hey, this is the white noise democracy in action. Given that the Eurozone crisis has received saturation coverage we will move on to the UK. Here we have a bizarre mismatch of policies: a loose monetary policy with the Bank of England lowering the base rate to 0.5% and engaging in money printing – otherwise known as Quantitative Easing – and a tight fiscal policy with the Treasury cutting back on public spending. The result? The worst of both worlds, inflation and stagnation – good old 1970s stagflation. No end to the slump in sight.

The poster child for the Keynesians is the United States, which has thrown everything but the kitchen sink at the problem in both fiscal and monetary terms. This has produced some low growth and a slight fall in unemployment, albeit from a very high level, and recently reversed, but each additional stimulus has had less of an impact than the one preceding it. A sort of law of diminishing returns has set in, whereby more and more of the 'fix' is needed to get any sort of result.

> *"...in the 1970s the increase in GDP was about 60 cents for every dollar of increased debt. By the early 2000s this had decreased to close to 20% of GDP growth for every new dollar of debt."*
>
> **(*The Great Financial Crisis*, Foster and Magdoff)**

The Federal Reserve has already initiated two rounds of QE injecting literally trillions of $s into the economy. In addition it lowered interest rates to 0.25% - zero to all intents and purposes. The Fed's purchase of paper assets was facilitated with the printing of paper monies. These paper assets consisted of US Treasury bonds and junk securities from government sponsored enterprises such as Freddie Mac and Fanny Mae, the two government agencies whose remit as to issue mortgages to prospective US homebuyers. This meant that the assets purchased by the Fed were nothing more than debt, un-redeemable debt at that. This is a weird situation where the US central bank was buying US bonds issued by the Treasury department so that the US Federal government could pay its current bills. And where did the Fed get its money from? Out of thin air apparently, it simply printed the stuff! When the stage is reached where governments have to pay their current expenditures by printing money then the alarm bells should start ringing. An idea of the monies involved is described as follows:

Before the first round of QE began, the Fed held roughly $900 billion of assets. When it ended on March 31 2010 the Fed's balance sheet had more than doubled to $2.3 trillion. There is no precedent for fiat money creation on this scale in the US during peacetime. (*Richard Duncan, Ibid.*)

Increasing the supply of paper money in the economy in the absence of demand for it can only produce one result – inflation, albeit after a time lag. It will be objected, however, that the US rate of inflation is only 2.3%. True. But bear in mind that the both food and fuel price increases are left out of the calculation in what is termed US 'core inflation'; another egregious example of officialdom's statistical sleight of hand. Were those price rises added in then at the very least the US inflation figures would almost certainly double. (See above chart 2). Moreover, the global effects of the Fed's policies has been to export this inflation around the world as a mass of greenbacks flew out of the US looking for more favourable investment outlets.

The global supply of these Eurodollars (i.e., US Dollars circulating outside of the US) had ballooned, and this led to an inflationary impact globally as food and commodity prices (notably oil) have spiked. This in turn has led to food riots and political disturbances throughout the world, particularly in the Middle East. A sort of unforeseen justice was done, however, when higher oil prices hit the price of gasoline in the US – a

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boomerang effect. The inflationary effect of the Fed's money printing also meant that local currencies were put under pressure. When the dollar tsunami entered a country their own currency was subject to an upward revaluation, which meant a higher exchange rate.

They therefore faced with two choices: one, do nothing and let their export markets contract since their currency was now more expensive, or two, maintain the value of their currency against the US$ by purchases of more of these dollars with their own currency. This would mean that their own money supply would expand and become inflated. Thus US inflation had become global inflation. Yes, devaluation is a great way to start a currency war.

As far as fiscal policy goes the US has consistently run budget deficits since the 1990s when it actually recorded a small surplus. The cost of the government takeover of Fannie Mae and Freddie Mac, the cost of ongoing wars in the middle east, the cost of bailouts to various financial institutions, the cost of fiscal transfers to cash-strapped states (due to end in June) and various stimulus programmes has raised the US budget deficit to $15.5 trillion. This, given that the Gross Domestic Product of the US as of May 2012 was $15.6 trillion, makes the ratio close to 100%. Even before the economic crisis, the U.S. debt grew 50% between 2000-2007, ballooning from $6-$9 trillion. Now the implications of this are indeed sobering. According to the authors Reinhart and Rogoff (*This Time Is Different,* Reinhart and Rogoff) when debt to GDP ratio reaches 90% this will constitute a drag on future growth. Longer terms implications of America's chronic debt problem are manifest.

> *Over the next 20 years, the Social Security Trust Fund won't have enough funds to cover the retirement benefits promised to Baby Boomers. That means higher taxes, since the high U.S. debt rules out further loans from other countries. Unfortunately, it's most likely that these benefits will be curtailed, either to retirees younger than 70, or to those who are high income and therefore aren't as dependent on Social Security payments to fund their retirement.*
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> *Second, many of the foreign holders of U.S. debt are investing more in their own economies. Over time, diminished demand for U.S. Treasuries could increase interest rates, thus slowing the economy. Furthermore, anticipation of this lower demand puts downward*

pressure on the dollar. That's because dollars, and dollar-denominated Treasury Securities, may become less desirable, so their value declines. As the dollar declines, foreign holders get paid back in currency that is worth less, which further decreases demand.

The bottom line is that the large Federal debt is like driving with the emergency brake on, further slowing the U.S. economy.

(Article updated March 3, 2012)

Now if we add in private debt to the equation – i.e., the debts of household sector corporate sector, business sector, non-corporate businesses, State and local government – then the debt soars to something like $50 trillion, or 363% of GDP. Then of course there is the chronic deficit on current account that adds a further dimension to the problem, but hey, let's not labour the point. The seriousness of the situation is only matched by the complacency of the US authorities who seem to think they can go on raising the budget borrowing ceiling and that overseas investors will simply keep on buying their Treasury bonds forever. If ever there was a definition of unsustainable this is it.

In fact the structural problems in the US economy could well be fatal if these colossal debt levels are not reined in or simply stabilised. The US is being kept afloat by their ownership of the global reserve currency and the willingness – for now – of investors, mainly China, Japan and the oil-rich states in the middle-east to keep purchasing US Treasury paper – paper assets of dubious value and paltry yields.

Overseas investors are aware of this situation and have begun lower their exposure to the US dollars and dollar-denominated assets by diversifying into other assets, and have also started to trade in their own currencies rather than the dollar.

Straws in the wind perhaps, but indicative of future trends.

Taken by themselves, Keynesian demand-side policies of stimulating the economy hardly begin to grapple with the problem. This is because deeper problems are on the supply-side not the demand-side of the economy. They can be classified as follows: Deindustrialisation as the manufacturing base is hollowed out or emigrates to cheaper venues, ageing populations, rising energy costs and scarcity, saturation of markets, lack of leadership at the political level, finance running amok, the ability to create paper money and assets without limit, an inadequately trained workforce, skills and investment deficits, structural unemployment brought about by new technologies. Of course I could have added in the issue of climate change but didn't want to depress readers unduly. Keynesianism is fixated on the demand-side. But in a world beset by the sort of supply-side problems listed above traditional demand-management policies used since the war will not be effective. It is also worth adding that both Germany and Japan, where the wartime devastation was manifest both recovered strongly without Keynesian demand management. This actually serves to validate the Austrian and Marxist theory that upturns and booms in a capitalist economy are the result of the destruction of existing capital values. Japan and Germany roared ahead because their own industries and infrastructure was decimated and they had to install the most modern up to date capital equipment and technologies and again start from scratch. Economies that start from a low base tend to have very high rates of growth.

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> *"Keynes' theory that government spending could stimulate aggregate demand turns out to be one that works in limited conditions only, making it more of a special theory than a general theory that he had claimed. Stimulus programmes work better in the short run than in the long run. Stimulus works better in a liquidity crisis than and insolvency crisis, and better in a mild recession than a severe one.* ***Stimulus also works better for economies that have entered recessions with relatively low levels of debt at the outset…None of these favourable conditions for Keynesian stimulus was present in the United States in 2009."***
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> **(*Currency Wars,* James Rickards)**

It has been calculated that growth would have to be at the rate of 6% per annum which when inflation is factored in reduces to actual growth of 2% to make any inroads into the huge debts. This seems very, very unlikely, although this is what the US authorities will attempt to do.

One final point with regard to Keynesian policies: They are often thought of as an alternative to austerity, when in fact they are simply austerity by other means. It is an open secret, though never admitted, that both the Fed and the Bank of England are attempting to monetize the debt levels in both countries. This entails keeping inflation one or more jumps ahead of wages, pensions, benefits and interest rates.

This inflation is engineered by the central bank that devalues the currency – supposedly to make exports more ‘competitive’ and printing money through QE. Devaluation leads to an increase in import prices that will tend to feed through the rest of the economy causing domestic inflation. The time-honoured claim made by Harold Wilson in 1967 that the proposed 17% devaluation of the pound ‘would not affect the pound in your pocket’ was simply a barefaced lie. When a country devalues its currency it makes itself poorer (‘competitive’ is of course the preferred description). That is its whole *raison d’être,* and in this respect it is no different from a policy of deflation. Thus the disposable income of the mass of the population is effectively pushed down as prices rise, and the most acutely affected will be the poorer sections of the community or anyone who keeps their assets in cash.

The more opulent, however, will be able to switch into stronger currencies, and physical assets such as precious metals, property, *l’objets d’Art* which will appreciate in price. Inflation will help debtors since their debts will be effectively amortized, i.e. grow less as inflation lowers the magnitude of the debt. Of course the principal debtor is the government. Forcing down interest rates to near zero in an inflationary environment gives savers two options. Do nothing and watch their savings melt away, or just go out and blow the lot. Similarly investors will be forced into more risky investments as they see the paltry return to safer boltholes such as gilts being eaten away by inflation. It all sounds like a re-run of 2002-2007 credit-fuelled growth madness. It rather reminds me of a sketch in the Rory Bremner series where a young woman is reproved by two government officials – John Fortune and John Bird – for actually saving to buy a car! Aren’t you being rather irresponsible! Why don’t you do the responsible thing and borrow the money! The whole approach, to quote Keynes, albeit in a different context: *“...is not intelligent...is not beautiful...is not just...is not virtuous – and it doesn’t deliver the goods”* (1933).

And paradoxically, because disposable income is crimped by such a policy, aggregate demand falls and this gives another push to deflation - the law of unintended consequences.

Keynesians see the problems of past and present capitalism as purely technical. They apparently believe that capitalism can be 'fixed' using appropriate tools and that it would therefore be possible to have permanent semi-boom conditions. This is clearly expounded by economists such as the American Keynesian Paul Krugman in his book *Peddling Prosperity,* first published in 1994. Having spent most of his life during the post-war boom, he is apparently dumbfounded that it suddenly ended in the early 1970s. He intoned that…*In 1973, the magic went away*. Well 'magic' had nothing to do with it. Capitalism was beginning to enter a periodic systemic convulsion that is now reaching its climax.

What to Do

"Can Capitalism survive? No I do not think it can."

"Can Socialism work? Of course it can."

(*Capitalism, Socialism and Democracy,* Joseph Schumpeter)

On the first point Schumpeter was wrong, but it is now a question that needs to be raised again. On the second point, he has to be right. But this is a political rather than a purely technical question. The present crisis will be solved sooner or later (preferably sooner) but the question is how, by whom, and for whom? The question for socialists is what should the strategy be for the coming struggles with this system – a system which cannot go on in its present form for the simple reason that it needs to grow at a compound rate of 3% forever – **this is not possible for both economic and environmental reasons.** Socialism or a collapse into semi-barbarism seems to be on the agenda once again. But we shouldn't be surprised by this; it is surely what we have been expecting since the trouble started brewing in the late 60s. After all capitalism moves in huge cyclical convulsions, and this is one of them.

> *A short-run revival of growth, as opposed to proliferating distress, can...buy time for longer term solutions to the transition to be worked out.* ***But bought time is only useful if it is put to good use.***
>
> (***The Enigma of Capital,*** **David Harvey)**

This is a huge question and I can only allude to possible areas of political action. The first thing to realise is that the historical window for a social-democratic Keynesian solution to the crisis is now closed. It was only made possible by a specific conjuncture of political and economic circumstances. The Thatcher-Reagan settlement and globalization marked the death-knell of the Keynes/Beveridge consensus. Does this mean that socialists should not support a policy of reform within the system? Not at all. **But this support must perforce have in view the objective of forcing a paradigm shift away from what has been a trade unionist approach of simply gaining and defending reforms - to a struggle for real political and economic power.** The programme of the liberal-left – the type of journalism which we see in the *Guardian* and *Independent* and Labour party publications – actually advocates reform of a system which is beyond reform. It should also be clearly understood that such reforms as advocated by most of the liberal-left such as public spending on work creation programmes, investment in green technology, a national investment bank **will only provide a temporary fix**, and may well have negative downsides, such as inflation.

Keynesian reform will not be a long-term solution, but it can alter the political balance of power and shift the argument in favour of the 99%. The politicisation of the mass of ordinary folk can begin with such an approach. Socialists, however, need to go much further than the type of Keynesian stimulus programme as advocated by Hutton, Krugman, Elliott, et al. Such a programme might consist of the following set of policies.

1. *Public works programmes to reduce unemployment. Or full maintenance for the unemployed.*

2. *Nationalization of all deposit taking institutions and the setting up of a national bank.*

3. *Strict rules on credit creation and the Shadow banking system.*

4. *More transparency and an end to over-the-counter (OTC) trading.*

5. *Closure of tax havens. Stop tax avoidance scams such as Transfer Pricing.*

6. *Withdrawal from overseas conflicts and NATO.*

7. *Harmonisation of corporate tax rates within the EU (to prevent a race to the bottom).*

8. *End of the global reserve status of the US dollar.*

9. *Indexation of wages, pensions, benefits, interest rates to inflation*

10. *A move away from indirect to direct taxation, and higher tax rates for the upper quintile of the population.*

These represent the economic demands. But capitalism also works at a political micro-level. The power relations in the workplace are such that employees and consumers have no say in how the business is run, by whom and for whom. Shareholder value is all that matters. This should be replaced by a stakeholder approach were all the interest groups have a say in the running of the organization.

Of course there is no possibility that such demands will be met, there is a war going on after all, and at the moment the class enemy have the power and the veto, notwithstanding the democratic will of the people. Moreover, some of these questions can only be raised at regional and/or global levels. This opens up several additional cans of worms. There is the seemingly intractable issue of Europe and the Euro. Reversion to national currencies (as advocated by the *Guardian*'s economics team) will only lead to devaluation and trade and currency wars. Then there are global currency and trade issues: What replaces the dollar as the basis for a global currency? Special Drawing Rights? A new gold standard? Or Keynes' idea of a global currency – Bancor – to replace national currencies? Then there is the massive question of climate change and the massive ecological damage and negative externalities which is the corollary of consumer capitalism.

The problem we face is that politics are national but capitalism and economics are global. But reforms of this type can obviously only be carried out at international level. Co-ordinated global action is not going to happen any time soon, but regional action, whether in Europe, North and Latin America as well as the ASEAN bloc is a possibility – in fact it is the only option for supra-national policy making at the present time.

The task seems truly Herculean, the point is however, that these issues **must** sooner or later (preferably sooner) be raised. They cannot be evaded. We do not choose history, history chooses us. And this is the labour of Hercules which history has bequeathed upon us.

An alternative (to capitalism – FL) will have to be found. And it is here that the emergence of a global co-revolutionary movement becomes critical not only to stemming the tide of selfdestructive capitalistic behaviour…but also to our re-organizing ourselves and beginning to build new collective organizational forms, knowledge banks and mental conceptions, new technologies and systems of production and consumption, all the while experimenting with new institutional arrangements, new forms of social and natural relations, and with the redesign of an increasingly urbanized daily life.

While capital has provided us with an abundant means with which to approach the task of anti-capitalist transition, the capitalists and their hangers on will do all in their power to prevent such a transition now matter how imperative the circumstances may be. But the task of transition lies with us, not the plutocrats. As Shakespeare once advised: 'The fault…is not in our stars, that in ourselves that we are underlings.'

> *Right now, as Warren Buffet (the famous American investor – FL) asserts his class is winning (the class war) our immediate task is to prove him wrong.*

(Harvey, op.cit.)

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