



Jon Amsden

From subprime to slump?

This year the world has seen the power of money to socialise the costs of capitalist crisis, but are prices going to go on rising to Weimar-like levels? Jon Amsden explores the origins of the crisis and discerns something worse than inflation on the horizon.

In May of this year, Brian Marks made a valiant attempt to tie together inflation, the current crisis in financial markets, and struggles of the world working class. Marks wrote:

The food and energy crises are key ways capital is trying to displace the costs of devaluation onto the working class. (Foreclosures, the manipulation of interest rates, and the outright bailout of banks with public money are other important measures). The transfer of workers' wealth through energy and food costs to the energy sector is then conveyed in a concentrated form to save (by buying up) the banks in crisis. That is where primitive accumulation meets fictitious capital.¹

Marks argued that inflation is a special form of "looting" whereby the capitalist class attempts to appropriate "the wealth of the workers", for the purpose of "propping up fictitious capital". In a discussion on the Meltdown mailing list [Ben Seymour](#) queried Marks' logic on this point, noting that since inflation essentially devalues the workers' portion, at least in monetary terms, such would not be a particularly effective form of "looting".² For Seymour, the very thing that is supposed by Marks to constitute an accelerated "looting" of the working class, "an escalation of the ongoing compulsion of work" which presumably increases the rate of surplus value extraction, is at the same time undermining or cancelling out the value extracted. Thus, crisis can increase the economic pressure on the working class, but the actual rate of exploitation is offset by the devaluation of the currency which measures the product and price of their labour power. We will visit the "increased economic pressure" that inflation places on the working class a bit later on. In one respect, however, inflation can, in fact, be favorable to that part of the working class who may be net debtors. For example, Joe Sixpack has an outstanding credit card balance of \$9,000 US. As the real value of this figure is diminished by inflation, Joe will have to contribute less value to pay it back than he received (on credit) in the first place.

Both Marks and Seymour were writing in the attempt to make the current crisis understandable within the familiar paradigms of Marxist theory. There are potential problems here because, as I believe, Marxists do not exactly speak with one voice as to the ultimate causes of capitalist crisis. In his Penguin

edition of Marx's *Capital* Vols. I–III, for example, Ernest Mandel tells us that, "Marx did not have a theory of crisis." Currently, Marxists tend to argue vigorously over Marx's suggestion that the final cause of the cycle of boom and bust that has typified capitalist economies since the beginning is a tendency for the rate of profit to fall. This is another topic to which we shall return after setting the stage with the tragedy (and the folklore) of the current crisis. The first bit of stage setting has to do with the reality of the rate of change in prices (inflation or deflation).

When one attempts to make sense of the supposed causes of the current crisis, one finds that the rate of change in prices noted by Marks (Brian not Karl) makes up an important element in analysis of the ongoing collapse of financial markets and the underlying slowdown of the real economy. The focus on inflation is found in equal measure whether we read the financial press, scan the internet blog inferno, or simply talk among ourselves about what is going on in financial markets right now. The big question about the present chaos, both in financial markets and in the real economy, is whether or not it is the credit crisis which caused the slowdown in economic activity or conversely if it is the economic slowdown that has given rise to the credit crunch, to bank and corporate failures, to the disappearance of consumer confidence, to ever-increasing levels of unemployment and all the rest of it. The view that dominates the bourgeois media at the moment is that it is the collapse of the housing bubble and the attendant failure of financial institutions that has caused the "recession". In my view, the economic gurus of high finance, the government, and the media have got the whole thing back to front.

Since the main economic remedy initiated and celebrated both in academic and Wall Street circles is to pour more money on the problem, the role of inflation in the current mess becomes a central one. What most of us want to know now is whether or not the inflation that has marked the early moments of this crisis will be maintained throughout the coming collapse of capital markets. Why do we care? Let's pause a moment and look at what happens when inflation is rising. First, your life changes in a dramatic way. Americans who dearly love their oversized gas guzzling automobiles are learning to stay home more. Perhaps more important is that those who have any savings or hold any cash at all are watching it evaporate day by day. It wasn't that easy to earn it and now it is gracefully disappearing as the general price level keeps rising. Those lower down on the earning scale whether in the US, the UK, or elsewhere are learning to change their diets and to give up beer (even on weekends). What this all adds up to is a growing sense of insecurity and anger and (eventually) the search for a social scapegoat. German Nazism, for example, traced part of its heritage to the runaway inflation that plagued the Weimar Republic. On a less dramatic level, the way that inflation will affect your life is that you will discover a growing eagerness to spend the money you have on what you need or want before prices rise. It is possible that chronic inflation is one of the most serious economic phenomena that exists. But it is unclear whether inflation will continue to be the dominant form of the ongoing economic crisis.

Consequently, what people want to know at this point is whether or not the present positive rate of change in prices (inflation) will continue to accompany all of the ills of "recession" that we have come to know and fear. These include: losing our jobs, losing our savings (Indy Mac, Northern Rock), watching the value of houses and apartments plummet, the breakdown of international trade (the "stalled" Doha Round) and, in general, the social and economic turmoil that lies ahead. The answer proposed here is that, no, inflation as we know it will not continue to dominate the reality of and

discussions about the ongoing economic crisis. On the contrary, the current inflation (sometimes called "stagflation") will become deflation (the rate of change in prices goes negative) and, as past history shows, the deflationary crisis could be infinitely worse than what we are going through at the moment.

As a way of getting into the current discussion of these matters, let's take a look at the financial and international press on a particularly confusing and anxiety provoking weekend, 16 August, 2008. The eminently respectable *Financial Times* (FT) tells us in its front page headline that there is a "Surge for the Dollar as Global Fears Rise":

Against sterling, the US currency notched up its 11th consecutive day of gains — its longest uninterrupted rise in more than thirty-five years — as markets became increasingly convinced that the US was best placed to weather the global downturn.

The dollar's rise, according to the FT, was "triggered" by a sudden collapse of commodity prices. What the FT is trying to say, in simple language, is that when the commodity price bubble suddenly deflated, the dollar became *ipso facto* more valuable. What the FT then asserts, in a more or less imperious assumption, is that the sudden "surge" in the value of the dollar reflects a worldwide (and to my mind extremely unlikely) growth of confidence in the US economy.

"Confidence?" The US domestic and trade deficits are in the hundreds of billions for any foreseeable future, major banking and financial institutions are being handed billion dollar crutches by the Federal Reserve, the real economy is grinding to a halt, all the Buicks are now made in China, and the FT proclaims "confidence?" Please, somebody get me a glass of water, I have to sit down for a moment or two! Either that or hand me a copy of the weekend *International Herald Tribune* so that I can regain a sense of balance!

The "Weekend Business" section of the *International Herald Tribune* (IHT) for 16 August features one of the great economic naysayers on the "other side of the pond" who, under no less than four reiterated photographs of himself looking "worried", is headlined as follows: "The Seer Who Saw the Storm Coming: Professor Warned of Financial Crises One Year Before They Struck." The IHT, in the person of junior professor, Stephen Mihm, then has lunch with the famous/infamous Nouriel Roubini of New York University's Stern School of Business who is, well, "very worried".

Roubini is the sole proprietor of a website entitled "RGE Monitor"³, which regularly provides pessimistic arguments on the US economy to the following constituencies: bear market enthusiasts, students of the international economy and those members of the US Left (including me) who would only be too happy to see the whole overpaid, hyper-inflated, double-talk infected, economically exploitative, and (more or less) criminally inclined financial sector of the US (and global) economy fall flat on its face, never to rise again. Mihm says, in reverential tones, that, from the screens of the RGE Monitor, Roubini called the ongoing financial crisis of 2008 exactly one year before. Unfortunately, nobody listened.

Just between us, the man who was christened "Dr. Doom" by the more lighthearted *New York Times* was not the *only* prophet of doom. There were several others who explained their position a bit more clearly than Dr. Doom,

but to make sense of it, a brief reminder is necessary. The financial community, as most people know, is divided between "bulls" (optimists) and "bears" (pessimists). However, what most people don't know is that the bulls and the bears speak for different financial constituencies that divide up rather neatly along the lines of how much money the folks concerned have to invest. The bulls commonly speak for (and to) investors in equities (i.e. shares) including small investors, those with their life savings marooned in pension plans, and (of course) widows and orphans. The bears, on the other hand, commonly speak to the investors who have serious money to place and who tend to prefer bonds of all kinds, but especially government bonds. What divides the "bulls" and the "bears" (sometimes called "the bond gods") is guess what... fear of inflation. Fixed income securities become less valuable in an inflationary scenario. The "bond gods" tend to equate inflationary pressures with a vibrant market for equities, so there is often more than a little *Schadenfreude* on display when equities take a hit and bonds are doing better. The professional bears tend to have more complex and powerful arguments about economic decline than does the NYU professor mentioned earlier.

Roubini has been concentrating on one single theme of the coming disaster, namely, the huge current account deficits typically run by the United States. The current account deficit measures what America *does not pay for* in exports in terms of what it cheerfully continues to consume in imports. For the last few years, the US current accounts deficit ran at about 1 billion dollars per day, but recently this has risen to much higher figures. By concentrating on this grim economic variable, Mihm asserts, Prof. Roubini could foresee:

... a bleak series of events: homeowners defaulting on mortgages, trillions of dollars of mortgage backed securities unraveling worldwide, and the global financial systems shuddering to a halt.

Quite how Roubini can get from a negative trade deficit to this varied and complex list of "worries" is not explained. It is, in fact, unlikely that anyone could deduce or predict all of the above troubles from the simple fact that the US is wildly overdrawn on its credit card. Never mind!

Roubini, because he is "worried", and because he wants to save the market capitalist economy from itself, has applauded the various actions of the Federal Reserve intended to stave off economic ruin. This is where the question of inflation, or "stagflation" (prices keep going up as the economy winds down) comes in. Why did Roubini applaud loudly when the US central bank ("the Fed") cut interest rates to save the US economy? The constant assumption here is that cheaper money will stimulate the capitalist production machine to go back to work. Roubini also endorsed the Fed's intervention to prevent the total collapse of Bear Stearns, investment banker, by (essentially) nationalising it with the help of J.P. Morgan. Now J.P. Morgan, the biggest, oldest, and richest investment bank in the US, is writing off billions of dollars — but not to worry! Both actions applauded by our "worried" professor put more "money" into the system at a time when the economy was slowing down. More money alongside fewer goods being produced usually spells inflation. This is, of course, precisely what happened and will probably continue to happen for a while. What *did not* happen, however, was that injections of cheap money restarted the economy. The reason is that, despite everything you have read, the sudden shortage of bank credit was not the *cause* of economic slowdown but, rather, its *effect*. It was the fact that people were losing their jobs and couldn't pay their mortgage payments due to the economic slowdown that

caused the housing crisis and not the other way round. Thus, the mortgage crisis happened (all over the world) because many mortgage holders could no longer make their mortgage payments. Why not? Because the working class were either losing their jobs, going on short time, or taking lower paid jobs just to get by. The question we now need to look at is why do economies slow down (or die altogether) and what happens to the rate of change in prices (inflation or deflation) when they do?

The classic Marxist position is that both an expansion and a contraction in capitalist economies are needed for the accumulation of capital. In the expansion phase, a new technology is adopted and the first comers make a lot of money, wages are bid up, and the prices of goods fall. In the US, a classic expansion of this nature took place, for example, after the Second World War. War production had decreed the introduction of new technology, workers had organised unions to demand higher wages and (briefly) to ascend to a middle class lifestyle. The jobs they held, by the way, had medical coverage, pensions plans, and secure employment until pensions kicked in. That world is now gone forever.

Going back a few years, again for the American case, the Great Depression (1929–1939) was a classic contraction. Banks failed by the thousands, industries closed, something like 25 percent of the workforce was without jobs, and (this is the interesting part) prices of everything fell through the floor. This was the classic deflationary crisis, i.e the sort of crisis that had characterised capitalist development from the beginning. In Marxist theory, the importance of deflationary crises is that fictitious capital (largely overbid stock prices) is destroyed, larger and more efficient capitalists gobble up the little ones thus laying the ground for the introduction of new technology, and (most important) the working class is disciplined for the next round of production.

Both the expansion and the contraction phase are necessary for more and more capital to be accumulated, so Marxists call this process the "cycle of capital accumulation". In the classic Marxian doctrine, the downturns are caused in two ways. The small ones are caused by marked instability between the industries that produce consumer goods and those that produce capital goods (*Capital* Vol.II). The big ones are caused by a long run tendency of the rate of profit of capitalist enterprise to fall.

The rate of profit falls as technological innovations spread throughout industry. The first comers have already become rich, but when the whole sector adopts a new technology (say, steam power to replace water power), profits are eventually competed away. This is at the macro level. At the level of the firm, Marx argued (*Capital* Vol.III), the change in the labour to capital ratio in favour of capital diminishes the amount of living labour time that the capitalist accumulates. Then, since living labour is the source of all economic value, the rate of profit tends to fall.

The picture presented by Marx may seem counter-intuitive, but if you look at the world today you will see the results of this process that are, once again, manifesting themselves. Now capital has fled the highly industrialised regions of Europe and North America to be applied in China, Vietnam, and other relatively backward economies. Why? Because, of course, this is where the capitalist gets to accumulate most prodigiously the source of all surplus value which is human labour time.

How, then, did the present US and world crisis begin this time around, and will it continue in an inflationary or deflationary context? Let's close with this. As the rate of profit declines in the older sectors of capitalist enterprise, the so-called "financialisation" of the economy begins. The older metropolitan regions no longer export goods to the rest of the world. They now export capital. Lenin first noticed this process as the European countries began to export capital to other regions towards the end of the 19th century. Great Britain, for example, built power plants and street railway systems all over the world in this period. A similar process is taking place today, but the result now seems to be that the productive sectors of the mature economies are running down just as the financial sectors are becoming wealthier than ever. The result is "funny money games" in financial markets, including the creation of useless economic derivatives, the "lending" of capital to developing nations and the hectoring of less developed nations by the IMF to make them pay their "debts".

This is pretty funny. The US is the largest debtor nation on the planet as we speak, but its financial geniuses (until lately) have been "lending" through the World Bank and the International Monetary Fund. How do they do this? Well, it can only happen in a world in which the international reserve currency (currently the US dollar) is created by simply saying that it exists. This bit of magic has allowed the US to "live beyond its means" for some time now. It has also put the Chinese and the Indians in the grotesque position of financing the US wars for petroleum along with an out-of-control lifestyle obtained on credit. As a system, what could be called "dollar imperialism" is entering the disaster stage, both with respect to the costs and risks of war and with respect to the collapse of the real economy in the UK, the EU, and the good old USA.

Given these realities, will the present inflationary moment continue until we reach the point of total collapse? I happen to think not, though others whose views I respect point to the dangers of runaway inflation which are far more socially disruptive (think Weimar and the growth of Nazism). In my view, what will happen next is that, when the US economy completely collapses in both the financial and real sectors, the total collapse of the banks will follow with widespread corporate failure and the increase of unemployment to unbelievable levels. Under these circumstances demand will fail (as in the last great deflationary crisis of 1929–39) and prices will fall through the floor. There is another scenario, however, namely that of runaway inflation. Explaining this would require an extensive discussion of the role of the dollar as the international reserve currency. Briefly, the collapse of the dollar internationally could lead to runaway inflation in the whole global economy, with awful social and political consequences. One would have to take a more careful look at one of the central concerns of Professor Roubini, namely, his obsession with the American tendency to run a current account deficit worth \$2 billion a day(!), but this is a topic better left for another time.

-
- ¹ Brian Marks, "Living in a Whirlwind, or the Food/Energy/Work Crisis", <http://inthemiddleofthewhirlwind.wordpress.com/living-in-a-whirlwind-or-the-foodenergywork-crisis/>
- ² See: Ben Seymour and Jon Amsden: "Living in a Whirlwind, or the Food/Energy/Work Crisis — and some criticisms"
- ³ <http://www.rgemonitor.com/blog/roubini/>

Published 2008–11–18
 Original in English
 Contribution by Mute
 First published in *Mute* 10 (2008)

