The Economic Crisis and the Ways to Get Out of It

by Arghiri Emmanuel

In the first part of this essay I shall try to define the origins and the specific features of the present crisis, as compared with the classical model of the cyclical crisis of the capitalist system. Then, in the second part, I shall undertake a critique of the various policies which have been applied up to now in order to cope with it.

I. The essential features of crisis in the capitalist mode of production.

Generally speaking, a system is in crisis when its own functioning engenders forces which destroy or injure it. In other words, crisis is nothing but a cumulative process in which an independent primary impulse, instead of giving rise to secondary effects which cancel it out, produces secondary effects which amplify it.

In the system of market economy, crisis takes the form of the existence side by side of overproduction in relation to effective demand and underproduction in relation to potential, the second of these phenomena being a consequence of the first. This "underproduction" constitutes, moreover, the sole dimension of the crisis, because it is the sole measure of the economic loss that results. That being so, it is clear that, without the "multiplication" referred to above, crisis could not occur, since one cannot imagine any primary impulse that would correspond to the order of magnitude of the real crises, those of 1929 and earlier, when the fall in production amounted to 25 or 30 % of the gross domestic product.

In this respect the capitalist system is the contrary of every other mode of production known or conceivable. In all the others one produces, in the first place, in accordance with the resources at one's disposal, and then consumes on the basis of the volume of actual production and in accordance with an established standard of distribution. The limiting factor thus being the resources available, under-employment of the means of production is inconceivable, while, on the other hand, a possible primary diminution of resources not only cannot provoke any secondary loss or any cumulative process, ~~for~~ but the system reacts in this case by intensifying its employment of the resources left to it, thereby reducing as far as possible the primary loss itself. All that can happen in this case is a crisis of shortage, but then the term "crisis" would be a misnomer. In the capitalist system, however, nobody can set himself to produce anything unless he can count on a previously-existing market, which means previously-existing purchasing power.

But since, in its turn, no purchasing-power can exist without a corresponding volume of previous production, the system finds itself fundamentally in contradiction with its own conditions of existence.

In all other systems consumption is an increasing function of production, while accumulation (and so investment) is a *decreasing* function of unproductive consumption. Far from blocking the mechanism of reproduction, inadequacy of effective demand would maximise the surplus and, therefore, the system's growth. In the capitalist system, investment, that is, productive consumption, is an *increasing* function of unproductive consumption. Now, these two consumptions, productive and unproductive, are the two components of a given aggregate – the global potential of production. As such, they are by their very nature inversely proportional to each other. It so happens that those who have the power to decide – the entrepreneurs – are incapable of treating them otherwise than as *directly* proportional.

How does it come about that, in spite of this fundamental contradiction, the system of market economy is not blocked completely and permanently ? This comes about because *actual* production constantly falls short of potential production, and thus can vary independently of the latter. It is these variations, this "cycle" between a *plus* and a *minus* in the underemployment of the potential, this mobilising and demobilising of the reserves, that make possible the simultaneous variation in the same direction of its two components, thus ensuring conjunctural equilibrium on the basis of structural disequilibrium.

It is nevertheless the case that investment is thwarted by a permanent contradiction between the encouragement it receives and the means available for it. When the former, which depends on the expansion of the market, is at its highest, the ~~second~~ latter, which depends on the rate of profit, are at their lowest, and vice versa. The system manages to overcome this contradiction only during the period of recovery, when mobilisation of the reserves of the factors makes possible a parallel increase of profits and of the mass of wages without a proportional increase in their rates. When full employment is attained, and given that the rate of accumulation of capital is higher than the rate of increase of the population, extensive expanded reproduction on the basis of unchanged distribution comes to an end.

The system ought, then, in order to emerge from this jam, either to maintain the increase in consumption without increasing employment, by modifying the rate of remuneration of the factors, or else go over to intensive expanded reproduction, by dissociating the department of means of production from that of consumer goods. As competition prevents the capitalists from doing either of these things — either increasing wages or continuing their expansion without increasing them —crisis breaks out.

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In all other systems, the remuneration of the direct producers constitutes an income and nothing but that. In the system of wage-labour, this remuneration, besides being an income for the wage-earners, is a cost for the employers, who happen also to be the only decision-makers where allocation of the factors is concerned. In order to maximise their profits, the employers have to minimise their costs, which means keeping wages at the lowest level possible. But profits are proportional to sales, and sales proportional to social incomes. Since wages are certainly a social income (and even the biggest) the *ex ante* efforts of the entrepreneurs to maximise their profits through reduction or stagnation of wages lead *ex post* to the minimising of both sales and profits.

Of course, consumer goods are not the exclusive objects of profitable sales. Means of production can play that role just as well. The problem is, and this crucial, that in the capitalist system sales of means of production cannot serve as a substitute for sales of consumer goods. They are an increasing function of the latter.

The co-ordinates of the present crisis

The contradiction which I have analysed above, the manifestation at the phenomenal level of the basic contradiction between social production and private appropriation, although it explains "crisis" in general, nevertheless fails to explain the onset of any particular crisis, and still less does it explain the onset of the present crisis, which is highly untypical.

1. First and foremost, this crisis has not come, in accordance with the classical pattern set out above, at the moment when the economy has touched the barrier of full employment, but after 30 years of non-crisis, during which the economy has been *sticking* more or less at that level, with uninterrupted growth at unprecedented

rates.

Everything, indeed, from the last war until 1974, proceeded as though the system had transcended the "cycle", as if something had rescued it from the dead-end of markets and profits in which it had been floundering. This something was evidently the fortunate conjunction of an effective trade-union struggle with the substantial contribution which the terms of trade guaranteed to the system, drawn from its periphery. The increases in real wages expanded the market, while the relative decrease in the prices of imported inputs, acting like an additional increase in physical productivity, kept up the rate of profit.

The Gordian knot — low wages restricting opportunities for investment, on the one hand, and, on the other, high wages curtailing profits — was cut by the inequality of external exchange, which made the poor pay for the high wages of the rich. The capitalists of the centre were able to increase the wages they paid without cutting down their rate of profit, simply because the former were national whereas the latter was international. This is the specific feature of the "consumer society", which no-one, to my knowledge, has bothered to define, and which, if it is something more than mere words, can only be the situation wherein good profits become compatible with flourishing markets.

It was after this long period of stable equilibrium, and not after a simple cyclical recovery, that the present crisis, unlike all previous crises, came upon us.

2. All previous crises were accompanied by a collapse of prices. In two years, between 1929 and 1931, the price-index which, by virtue of its universal character, is the most expressive, namely, the one that relates to international trade, fell by more than 25 %. The present crisis is accompanied, on the contrary, by a general increase in prices, and interest rates ~~that is~~ without precedent.

3. A third peculiarity of the present crisis is that all its predecessors began in a leader-country and then spread at a pace of maturation and in degrees of intensity which varied according to the level of industrialisation of each country. The present crisis, however, broke out everywhere practically at the same moment, and its uneven intensity as between one country and another is a function of trade balances rather than of level of economic development.

4. Finally, if what interests us is the real loss of social product and not the aesthetic of "major equilibria", and if, therefore, as has been said earlier, under-utilisation of productive potential, material and human, is the only relevant measure of the phenomenon, the present crisis is of a different order of magnitude from its predecessors. It is enough to recall that in 1933 the index of United States production had fallen to half what it was in 1929, and the index for France to 75 %; that unemployment stood at 45 % of the active population in Germany and 31 % in the United States; that the total profits of the 400 biggest American firms amounted in 1932 to only 6 % of their 1929 figures; that one-third of all American banks failed in 1931; that in 1932 the world's steel production had declined by 58 % from its 1929 level -- to appreciate that including the two situations in the general category of "crisis" may be regarded as a mere figure of rhetoric.

However, this quantitative difference being, at least in part, the direct consequence of the three qualitative differences previously mentioned, the latter are adequate to characterise the present crisis.

<u>The "oil" factor</u>

It is a fact that what has been called the "oil shock", besides having its deflationary effect -- the normal, <u>sine qua non</u> condition of every crisis of realisation of the product in market economies -- was also what generated the three Divergent syndromes of the present crisis:

(a) breach of the international "rules of the game" and sudden diminution of the one-sided transfer of resources from South to North;

(b) all-round increase in prices accompanying recession, which only the greater dearness of such a universal input as fuel can account for;

(c) simultaneity on the world-scale of the outbreak of a crisis, which points to the presence of a common external factor, such as oil, and modulation of its intensity in accordance with the trade deficit of each country, rather than with the level of accumulation of capital, which also squares with the effects of the increased bill for oil.

Nevertheless, as primary detonator of this crisis, apart from its specific features, it is not at all as a "bill" to be paid that the increase in the price of oil has operated, but, however paradoxical this may seem, through non-payment of this bill.

If oil were produced in countries such as Holland or the Scandinavian countries, the same increase in price would not have provoked in the consumer countries either a crisis or a major problem. There would, of course, have been a deduction of real value at the expense of those consumer countries, strictly equal to the price-increase. That deduction would have been perfectly bearable in itself, and would have had no secondary effects.

The increase in price of the oil imported by the O.E.C.D. countries amounted in 1974 to about 80 milliard dollars, for a total gross domestic product of 4,000 milliard, and when the second "shock" came in 1980, to about 140 milliard, for a gross domestic product of 7,600 milliard – that is, in both cases, to ~~more than~~ about 2 % of the gross domestic product. Since the reserves of unemployed factors, material and human, were larger than this percentage, even in the period before the first "shock", when 3 % of the active population were already unemployed, and, a fortiori, at the time of the second one, in 1980, when ~~more than~~ about 10 % of these countries' human potential and more than 20 % of their equipment were unemployed, production of the commodities to serve as counterpart to the extra bill for oil could have been managed at almost no social cost.

But it so happened that the suppliers of oil were not Holland or the Scandinavian countries, but underdeveloped countries whose internal incomes and, consequently, whose domestic market of ultimate consumption were insufficient to absorb the additional imports which would have constituted the counterpart of the payment for oil.

This deficiency would still not have been determining if these countries had been planned economies, capable, like any integrated economic community, of investing upstream independently of consumption downstream. On the contrary, their historical low level of ultimate consumption would have enabled them to accelerate the rate of accumulation upstream and, consequently, their pace of growth. The only change would have been in the composition of their imports in terms of use-values. But the bill for the oil they supplied would have been completely "covered" in real values, exactly as in the other hypothetical case, where the suppliers were countries with market economies, but ones as rich as Holland or the Scandinavian countries. The drama of the situation lay in the fact that the oil-supplying countries were both market-economies and poor countries — that is, they were market-economies without markets.

The crucial fact is that in the dynamic of a planned economy it is tomorrow's consumption that determines today's investment, whereas in a market economy it is yesterday's ~~yesterday's~~ consumption that does the determining. The difference is that tomorrow's consumption can be planned ahead, whereas yesterday's has to have taken place already. And, in the given case, the "yesterday's consumption" was non-existent.

In short, everything happened as though the producer countries, after having been for a long time too poor to sell their oil at a remunerative price, when they became strong enough politically to impose an administered price, found themselves too poor to be able to pocket it. In 1974 and in 1980 they were able to "realise" only about half of the price of their oil, leaving the other half to be converted into financial claims on the purchasing countries.

Now, if the latter countries had themselves been planned economies, this partial non-payment, or postponement of payment, of the bill would not only not have bothered them, but would have been welcome, since it would have allowed them to avoid frictions and proceed to make the necessary readjustments by spreading out over a period their additional productive effort. But in the fundamentally contradictory dynamic of market economies such "saving" on the part of their suppliers, far from being a boon, is a calamity, because the trade-balance deficits which reflect it generate a deflationary disequilibrium in a system which already tends that way. When it gets beyond a critical threshold, this starts off the cumulative process of crisis.

The reaction of the oil-importing countries

The dirigisme that exists in the industrial countries --not enough to reverse the dynamic but enough to produce additional distortions -- has aggravated the process. Frightened by these deficits (which, moreover, they expected to be bigger than they actually have been), and with a view to passing them on, one to another, the governments of the oil-importing countries, operating in extended order, have taken a series of protectionist measures which have accelerated the chain-reaction of deflation in the region as a whole.

In short, what was needed at the beginning was to work a little more in order to pay a bill already reduced by half through the oil-producing countries' "saving". In 1974 that represented, say, the equivalent of two million man-years. The contradictions of capitalism have had the consequence that, instead of working more, the countries concerned have worked five times less: instead of two millions of their unemployed being set to work, ten million more workers have lost their jobs.

In value terms, the O.E.C.D. estimated, for 1980, the loss suffered as a result of the second "oil shock" at 7¾ % of the gross domestic product of all the industrial countries with market economies, which at that time amounted to 7,606 milliards. When this second "shock" occurred, the price had risen from an average of 15 to an average of 35, that is, the addition to the price was 20 dollars per barrel. The imports of the O.E.C.D. countries being 6.9 milliard barrels <u>per annum</u>, the extra price to be paid was thus 138 milliard dollars, half of this being realised in imports and the other half in financial claims. It follows that a series of measures taken to cope with an initial, independent deterioration in the variable price, of the order of 70 milliards, if we count only the part of the bill <u>really paid</u>, or 140 if we count the whole of it, resulted in an ultimate loss, according to the O.E.C.D.'s figures given above, of 590 milliards (7,606 x 0.0775 = 590).

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This "non-payment" of the oil bill turns out to be the determining factor not only in the initial outbreak of the crisis but also in its evolution. For there is not only the coincidence in time of this outbreak with the "shock" or "shocks", there have also been the ups and downs during the ten years that the crisis has gone on. If we trace the conjuncture curve in the O.E.C.D. countries, taken as a whole, over this period, we find that it sticks close to the curve, equally up-and-down, of the trade-balance surpluses resulting from "extra payments" for oil, themselves due, on the one hand, to fluctuations in prices (in fixed dollar terms) and, on the other, to the development of the power of absorption of imported commodities by the oil-producing countries.

Consequently, mere observation of the facts should have sufficed to gain acceptance — even if only until proof to the contrary was provided — of the causal link between the two phenomena, and the foregoing long theoretical analysis would have been redundant, if a curious conjunction of two intellectual inhibitions had not created a strong prejudice against explanation of the crisis by the oil factor.

First of all, there exists a sort of guilt-complex which creates among the "Third-World-ists" something like a need to ~~exonerate~~ exculpate themselves. Everything happens as though the periphery ~~is supposed to digest~~ were as unable to accommodate itself to its victory ~~as badly~~ as the centre is ~~digesting~~ indeed unable to accommodate itself to its defeat. (Perhaps there is in this something to give meaning to that much-chewed-over notion of "dependence", which without it would be meaningless. It is a question of ethical dependence. The periphery ~~is supposed not to have arrived at a situation where in it can truly take~~ allegedly could not succeed in making itself comfortable in taking up a position of strength, when it so happens that it is in fact in that position; while the ~~"autocentrism"~~ "self-reliance" of the developed countries is supposed to consist in setting themselves up as the measure of all things, making "the interests of the West" ~~a~~ the universal ~~reference point~~ gauge of good and evil — sometimes explicitly.)

The second factor is a sort of congenital panic suffered by Marxists in the presence of any hypothesis which seems to put aside or to depreciate the <u>endogenous</u> causes of capitalist crisis.

I hope that the formulation I have given is such as to reassure both groups. The first, because what is being blamed is not the excessiveness of the price demanded, but the incapacity of the sellers to appropriate it fully. The second, because one must really be very sick in oneself to feel ill merely on account of being excused from paying in full for the goods one needs.

All this does not mean that, but for the oil business, there would have been no crisis at all. Capitalism bears crisis within itself just as a cloud bears rain. But it would not be the same crisis, nor would it have come at the same moment.

II. Anti-crisis policies and the surprises of stagflation

After this analysis of the nature and course of the crisis it is already clear that the pivot of our problematic is the dialectic of inflation and deflation.

As we have just seen, the policies that were announced immediately in most of the countries concerned (though not always applied) were essentially inspired by the idea that the fight against inflation took priority over everything else.

Let it be said straight away that, apart from any other consideration, such unconditional priority is ~~xxx~~ surprising in itself. Jean Denizet, in <u>Le Figaro</u> of 9 January 1977, wondered if it was not simply due to the fact that there are very few people alive today who in the 1930s were old enough to have personal experience of the Crisis — the real one, with a big C. In fact, as we have seen, the parameters of that crisis were so terrifying that it is hard to understand how the slightest risk can be taken in this direction.

An ~~xx~~ unemployed worker, by himself, represents a very definite and uncompensated loss for the community: one point more or less on the price-index signifies, after all, merely a transfer of wealth from one group of economic agents to another. However thorny the social and technical difficulties may be which are due to instability of prices as such, it is certainly not easier to solve them with a reduced global social product than with one of the volume of which has been maximised.

The ambiguities of "inflation"

Underlying the anti-inflationist philosophy is a fallacious identification of inflation with increase in prices. If we go back to the traditional definitions, inflation (without inverted commas round it) means an excess of nominal purchasing power (and will to purchase) in relation to the nominal value of global production, and so an excess of demand over supply, at a given price level. Raising this price level, far from being a factor causing disequilibrium, is a way of emerging from it.

Is this mere playing with words ? No! For, on the one hand, an increase in prices through the automatic reaction of the market which brings the nominal value of supply up to the level of demand is only one of the ways to restore equilibrium. There is another — acting so that supply equals demand, not by increasing its value (the physical volume remaining unchanged) but by increasing its volume (with prices remaining the same). On the other hand, because, even if we were to accept that all inflation tends to bring about an increase in prices, ~~the converse is to bring about an increase in prices,~~ the converse is not true. Every price-increase is not necessarily due to inflation. It may be due to a structural increase in costs, whether this results from modification in the technical conditions of production or from a variation in the rates of remuneration of the factors.

It is this last case which is called, improperly, "cost-inflation", in order to distinguish it from "demand-inflation." Improperly, because there are not two kinds of inflation but, on the one hand, inflation properly so called, and, on the other, increase in prices, which not only has nothing to do with inflation but -- and this is what is important - can perfectly well go along with its contrary, deflation. This is just what has happened with oil, which engenders, simultaneously, increased prices through its impact on production costs, and deflation through its action upon trade balances.

This is what gives meaning to the term "stagflation." As the first component of the term, stagnation, is undoubtedly synonymous with deflation, then, if one were to take the second component literally, there would result a simple contradiction in terms: inflation in spite of deflation ! But if one replaces the second component by "price-increase", something quite conceivable is obtained: a rise in prices despite deflation.

<u>The prices of the factors</u>

Is it the fact that the increase in the costs of the inputs -- oil and perhaps some other raw materials -- is the sole cause of the structural (not inflationary) increase in prices ? No ! There is also the possibility of an exogenous variation in the remunerations of certain factors, notably labour-power, within the setting of an inconvertible currency system.

Why this last-mentioned condition ? Because, if money is a commodity with an intrinsic value and burdened with its own costs of production, all prices are relative and an increase in the remuneration of one factor cannot in any way result in a rise in the general price-level -- a notion which, moreover, would in this case be meaningless. Such an increase is necessarily compensated by a corresponding diminution in the remuneration of one or more of the other factors.

Assuming the existence of a money-commodity and of perfect convertibility, Ricardo, Marx and all those who, explicitly or implicitly, have accepted the exogenous determination of wages, have shown that a general variation in wage-rates affects only relative prices. On the scale of society, it is counterbalanced by an inverse variation of the rate of profit.

Their proofs no longer hold, however, when the gold (or silver) standard is abolished and all prices, including the price of labour-power, are nominal, expressed in terms of absolutely inconvertible paper currency which floats without restraint in relation to other currencies: that is, when money becomes a mere unit of account.

In this case entrepreneurs can calmly incorporate wage-increases in their costs of production while maintaining their usual mark-up. The two variables -- wages and profits -- then both become independent.

The difference between the two cases can be illustrated by means of Sraffa's paradigm:

$$(A_a p_a + B_a p_b + \ldots + K_a p_k)(1+r) + L_a w = A.p_a$$

$$(A_b p_a + B_b p_b + \ldots + K_b p_k)(1+r) + L_b w = B.p_b$$

$$\vdots$$

$$(A_k p_a + B_k p_b + \ldots + K_k p_k)(1+r) + L_k w = K.p_k$$

If we adopt the hypothesis of the existence of a real standard and total convertibility, we shall have to take some commodity (k) as our money-commodity. We shall then have $p_k = 1$ and all we shall need to determine are $(k - 1)$ prices. In this case, all prices, "p", will be expressed in terms of k, which means that all prices are relative and a general "level" of prices is meaningless.

Our variables being the $(k - 1)$ price-relations, plus a single "w" and a single "r", we have only one degree of freedom, and as soon as "w" is given our system becomes perfectly determined. Given that "r" is then fixed endogenously, there is no possibility of a general increase in prices. Any variation of "w" would entail an inverse variation of "r".

Matters change radically if the monetary standard is "produced" externally and without any link with the costs of production of the k commodities of the system. Prices expressed in terms of such fiduciary currency become absolute prices and the notion of their general level acquires a quite definite meaning. We then have $(k+2)$ variables (k price plus one r and one w), which gives us two degrees of freedom. It is no longer only w but r as well that must be given us. This means, in everyday language, that in this case there is nothing to prevent entrepreneurs adding to their cost-price whatever mark-up they wish.

In other words, in the present monetary system, as this has developed after the transformation of the international gold standard into a more or less pure dollar standard, employers can recover through prices, and thus annul ex-post in real terms, the wage increases they have been obliged to grant ex-ante in nominal terms. It is in this sense that wages can nowadays be considered an independent factor in "inflation", or, to speak more correctly, of general increase in prices.

We can express the same thing in a different way. An increase in the absolute value of goods can have no meaning other than a fall in the relative value of one among them, namely, money. When money is a real "good" (for example: gold), for such a fall to take place (following a general increase in the quantity of <u>money</u> distributed to the workers) it would be necessary for the organic composition of capital in the gold-mines to be higher than the average of the other branches, and for this superiority to be proportional to the increase in the rate of wages. There is no reason to expect such a singular combination of circumstances. It follows that the capitalists have, in this case, no way of taking back from their wage-workers in real terms what they have given them in nominal terms. But when the wage-earners receive paper dollars or francs, there is no pre-determined proportion linking these things with the contents of the housewife's shopping-basket. The capitalists therefore possess, at any rate under some socio-political conditions, the possibility of fixing this proportion themselves, by manipulating their selling-prices.

In the case we are looking at, the wage-earners, as might have been expected, have resisted the attempt to make them pay the oil bill. Squeezed between the decline in profitability and the rigidity of nominal wages, the system has slipped out of the <u>impasse</u> by the ramp of an increase in prices. It has thus preserved profitability, relatively, by disconnecting real wages from nominal wages. What has opened the door for it to do this is a <u>floating</u> currency.

Besides wages, all the other factors whose prices are fixed exogenously —rents, interest-payments, taxes, etc. ---are capable, in the context of an inconvertible monetary system, of engendering a general increase in prices. As in the case of wages, this price-increase, improperly called "inflation", has nothing to do with inflation in the strict sense, and can quite well be compatible and co-exist with its contrary. It is this combination with its contrary which is what constitutes "stagflation".

As against this, "true inflation" (Keynes), or inflation caused by demand, not only cannot, by definition, exist under conditions of under-employment such as prevail today, but is an extremely rare phenomenon in the capitalist mode of production, which, except in very exceptional circumstances — war, blockade, etc. — is endemically deflationary.

<u>The contradictions of "austerity"</u>

We thus perceive directly the danger represented by measures restricting demand at a moment when, despite the increase in prices, effective demand is not only not excessive but is particularly deficient, owing to the recession.

In their own way, austerity plans strive to cure both of the two components of "stagflation". "Inflation" — assumed to be due to demand — is to be reduced by restricting the consumable part of income, while investment is to be stimulated by means of encouragements both direct and ~~indirect~~ unsystematic, so as to prevent depression.

The logic of this is Cartesian. The less we consume, the more we save and invest. Investment and Consumption are the two competing uses of a given aggregate: <u>the social product</u>. The trouble is that the system is anything but Cartesian. It suffers from a fundamental contradiction between the power to invest and the will to invest. While the former does indeed vary inversely with ultimate consumption, the latter is co-extensive with it. Under these conditions, to try and stimulate investment, or merely to maintain it at the same pace, at a time when ultimate consumption is falling, or merely stagnating, is, whatever the direct means of encouragement employed, no less utopian than trying to square the circle. That is, incidentally, the unachieved age-long dream of capitalism: to maximise accumulation without increasing wages.

But there is another interesting connexion between the two components of stagflation. The mere existence of the second of these — "inflation", or increase in prices (without inverted commas) — prevents the first — stagnation — from evolving into depression and crisis.

The ~~xxx~~ reason for this is that, despite the stagnation of sales, expectation of a coming increase ~~i~~ in prices encourages entrepreneurs to dis-save and invest, for fear of losing more by holding on to their monetary assets than by keeping up their productive activity.

This is a very important point. If we analyse the present minor recession, we cannot find any very precise peculiarity in it which guarantees that it will not degenerate into one of those cyclical hurricanes of the pre-war period — except this: that, contrary to what happened in the past, today, when all other encouragements to buy have disappeared, one still remains, namely, fear that the longer you put off a purchase, the higher the price will rise.

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The priority accorded to the fight against increased prices over the fight for full employment is thus unacceptable both on the social plane and on that of the output of the economic machine. But this is not all. It is absurd even in terms of its own logic.

What is implied in the distinction between "inflation" of costs and inflation (without inverted commas) of demand goes further than the fight against increased prices. It touches on the question whether the ultimate determinant of equilibrium prices is the market or production. Whatever the answer to this question may be when what is involved is a <u>pure</u> model of market economy, the social reality of today has in any case deprived the market of that role, if only because the price of the most important factor of production, labour-power, is no longer included in its agenda. Furthermore, the actual instruments of any austerity plan — restrictions on credit, taxes, etc. — also deprive the market of any determining power in relation to the other factors.

Now, quite apart from any doctrine, the state of demand could affect the equilibrium prices of ultimate goods only if the latter could, in their turn, affect the prices of their factors. It is therefore utterly absurd to try to modify the level of demand, with a view to modifying the prices of ultimate goods, when our own deliberate action consists in fixing the prices of the factors before those of the ultimate goods.

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If, as my analysis tends to show, the increase in prices is structural, due to the conditions of production (these including the remunerations of the factors), the illogicality of deflationary measures is at once apparent. Not only are they naturally ineffective in that they aim at correcting a disequilibrium which does not exist, they are also liable to have effects which run counter to their purpose. Some of them, aimed at restricting demand, such as increases in taxes and rates of interest, have the (unintended) effect of increasing costs and, consequently, selling prices.

This is why the distinction between true inflation and mere price-increase, which I have emphasised so strongly, is no theoretical subtlety but a matter of substance.

It is not a question of distinguishing, as is usually said, between two parallel causes of the same phenomenon, namely, the demand-factors and the cost-factors of inflation. We need to take account of the fact that, in a situation in which there is absolutely no excess demand, but rather a shortage thereof (as is indicated by the first part of the word "stagflation"), combating *imaginary* demand-factors often results in *real* effects which are disastrous in relation to costs and, ultimately, to prices.

Non-proportional costs.

What prevents people from seeing these "perverse" effects of deflationary measures is the assumption of increasing costs, which, in the neo-classical camp, wins the support of all, both monetarists and others. It is thus imagined that we have a positive ambivalence. If austerity does not manage to reduce prices by restricting demand, it will bring them down by reducing the volume of production and, consequently, of unit costs.

On this point three different levels are confused: the level of quantitative variations in a branch of industry as a whole, the level of economies of scale, and the level of internal under-employment within enterprises.

Here we are concerned with the third level. Whatever the meaning of non-proportionality of costs at the level of an entire branch of production, and leaving aside economies of scale (that is, accepting that all the enterprises are of optimum dimensions, so that any enlargement of the installations would engender increasing unit costs), it nevertheless remains the case that, from the moment when *already-installed* equipment is under-employed, unit costs unquestionably *decrease*.

The idea of a fixed capital *engaged* in a production-unit, the marginal cost of the use of which would be nil, or almost nil, and in any case lower than the average cost, and this not only for society but for the entrepreneur himself, is for the neo-classical school an impossible idea. They, in fact, reason on the basis of a sort of universal "leasing." It is as though, the factors being infinitely divisible, the entrepreneur ~~uses~~ buys, every morning, just the quantity he needs for the production he plans for that day: a certain number of man-days, a quantity of hours of work by a temporary secretary, fractions of a building, of manhines and of vehicles, or the use of all those — so that, when the evening comes, he is left with nothing but a stock of commodities, which he sells so as to start the operation all over again next morning, on a scale that varies in accordance with the conjuncture of the moment. If these conditions applied, obviously the neo-classicists would be right. The greater the sales, the greater the quantities of factors demanded and bought by the entrepreneurs, and consequently, at the margin, the lower their quality and the higher their price. And vice versa.

In reality, though, things do not happen in that way. The means of production may well be divisible and mobile before they are acquired, but once most of them (especially fixed capital) are embodied in an enterprise, they are immobilised. Their financial cost is then indivisible and independent of the use made of them. If we add to this the increased proportion, in modern economies, of "white-collar" workers who are more ~~more~~ or less immovable, and the rigidity of certain other expenses, we arrive at a "standstill point" which is so high that the slightest fall in production brings about a serious increase in unit costs.

<u>The internal inadequacy of deflationary measures</u>

But let us take this matter further. Let us accept for a moment that the increase in prices is inflationary. The various austerity plans, based on the traditional quantitative precepts, would nonetheless fail in their purpose, in a world which is no longer traditional.

The principal distortion results from the dole payments which enable the unemployed to keep up their standard of consumption without producing. Moreover, when the standard of living is as high as it is in modern industrialised countries, the elasticity of household consumption, in relation to the fluctuation in employment, is low. The owners of the factors cling to their habitual way of life. They try to make up for the lack of remuneration, or the difference between this remuneration and the dole, by ceasing to save and/or by borrowing.

We ought to be glad of that. For this relative rigidity of consumption is, in modern capitalist economies, one of the strongest antidotes to the chain-reaction which, formerly. led straight to major crises. Today, a man made redundant is a man made redundant. It is less likely than in earlier times that, by withdrawing from the market, he will make another worker redundant. As against that, a large part of possible additional production can be carried on without proportional creation of new purchasing-power. The Phillips relation is reversed. Far from increasing inflation, the recovery of employment makes up for the excess demand, and, far from reducing monetary surpluses, unemployment tends to increase them. For the supply of commodities is reduced by the total of added value which is not produced, while demand is reduced only by the difference between wages and dole.

There are, of course, thresholds of discontinuity. Beyond a certain point, the internal contradiction of the process explodes. Neither dole payments nor dis-saving nor borrowing could finance unemployment if it were to increase indefinitely. But this is just where the danger of the operation lies: even if demand has nothing to do with the increase in prices, one can still bring prices right down by restricting demand continuously. It would be enough to go a certain distance in that direction to provoke bankruptcies. A major crisis thus always lies in wait at the end of the process.

During the first stages of an austerity plan, when the results are contrary to expectations, that is, when "inflation" gets worse instead of settling down, there are two possible reactions:

(1) to recognise the inadequacy of this policy and end it, and

(2) to conclude that the restrictions so far applied have not gone far enough, and to reinforce them.

For all sorts of reasons, essentially bound up with political credibility, governments broadly prefer, all things being equal, to take the second of these lines. Then, the lack of growth being in itself -- owing to the decreasing costs -- a source of "inflation", the deflationary measures become, as it were, a self-justifying process, WHIch produces the very situation ~~which~~ that makes it necessary.

Domestic prices and trade balance

The need to have a trade balance which is in surplus or in equilibrium is a last-resort argument used by the advocates of austerity plans. According to this argument, an artificial boosting of consumption would cause a deficit in a country's external accounts without increasing domestic production: (a) through prices and (b) through an excessive marginal propensity to consume foreign-made goods.

(a) Price-elasticities of demand

The price argument is based, in its turn, on two assumptions: (1) that a boost to consumption would cause a worsening of "inflation", and (2), that, not only in volume, but also in value, a country's exports are a decreasing function, and its imports an increasing function, of the domestic price level. I think I have shown the baselessness of the first assumption. If my analysis is correct, the second assumption is pointless. But even if we accept that, contrary to what I believe, the boost would indeed provoke an increase in domestic prices, it still needs to be the case, if this is to result in a deficit in external trade, that the second assumption also be well-founded, that is, that the price-elasticity of demand be higher than unity.

This is one of the most firmly rooted of the accepted ideas of political economy. And there is good reason for that. It is one of the three pillars without which the entire edifice of neo-classicism would collapse, the other two being increasing costs (which I have discussed <u>supra</u>)and the absence of "externalities" (external economies and dis-economies).

No systematic statistical study has ever provided support to this assumption. Even such well-standardised goods as raw materials show price-elasticities which are markedly <u>less</u> than unity[1] This is, <u>a fortiori</u>, the case with the sophisticated products of the advanced industrial countries, whose specificity is, moreover, considerably reinforced by advertising. What is more, if we take the imported inputs into account, among those which are embodied in our exported products the "standstill point" is itself raised higher than unity. It follows that with an elasticity slightly higher than unity, so long as this does not exceed the threshold determined by our taking account of the inputs, our trade balance, far from worsening as the result of a recovery in prices, would actually improve. If these phenomena are not mere erratic "perversities", as one is sometimes tempted to suppose, but are the result of structural features of present-day market economies, which are imperfectly competitive, then it will be obvious that certain policies recently applied in the O.E.C.D. countries, with a view to gaining competitiveness on the international market, are quite wide of their mark.

Were we to reduce the national differentials of "inflation" to a common denominator, taking account of the devaluations and/or revaluations of the respective national currencies, we should find that the countries with a surplus — Germany, Japan, Switzerland -- are the ones whose prices, with currency variations thus corrected, have increased the most during the last decade, whereas the countries with a deficit, such as France and Italy, are precisely the ones where prices, expressed according to the same standard, have risen least.

This is what Jean Gabriel Thomas calls a worrying paradox: "The countries which seek and obtain a price-advantage in international competition do not gain any benefit from this where their trade balance is concerned, and the countries which suffer a price-disadvantage are not in the least affected as regards their competitive position."[2]

Many examples can be given. The rise in sterling by ~~more than~~ about 20 %, against the franc, between 1979 and 1980, while British domestic prices, expressed in sterling, increased by 18 % whereas French prices (in francs) increased by only 13.5 %, does not seem to have harmed Britain's exports of manufactured goods, which even increased slightly.

Furthermore, although the dollar appreciated by 23 % between 1980 and 1981, the global trade deficit of the U.S.A. (changes in price cancelling out changes in volume) was hardly affected.

(b) <u>The propensity to import</u>

It is on this point that the most groundless assertions are made. To listen to the opponents of boosting, one would suppose that a country's production, regardless of prices and for reasons that are, so to speak, technical, cannot benefit from any additional purchasing-power distributed, because this will be spent wholly, or almost wholly, on additional imports.

How and why it is that industries whose capacity is in excess of ~~this~~ their order-books, and wholesalers and retailers burdened with surplus stocks owing to reduced sales, should be incapable of satisfying the additional demand created by the boost just as easily and promptly as their counterparts abroad, is a question to which the writer of this paper has never had the opportunity of hearing an answer in discourses on the matter.

It might be all right if one were considering the special case of a particular country. But the same argument is used in all countries at the same time. Thus, according to this logic, the Régie Renault, which is said to be incapable of meeting France's additional demand if consumption were to be boosted in this country, would be quite capable of meeting Germany's additional demand, if the boost took place in Germany: whereas Volkswagen would, at the same time, succeed in winning new customers in France, and yet fail to serve their own compatriots, if, by extraordinary hhance, the economy ~~was~~ were to be boosted in Germany instead of in France.

All this seems to me to transcend common understanding. On the supply side, a certain selling effort is put forth on the same market by the two categories of suppliers, native and foreign. It is not apparent why the native suppliers, who possessed a definite share of the market in the days of full employment and easy sales, should relax their effort and allow this share to decrease in a period of under-employment and poor sales.

On the demand side, there is in every country an average propensity to consume foreign products. All things being equal, it is of the same order of magnitude as the ratio between imports and gross domestic product. To be concrete, let us say that in France, for example, in every basket of goods, whether this be the housewife's basket or that of the "intermediate consumption" of a factory, there will be found 77 % of French products and 23 % of foreign products. I am willing to accept that, despite the excess capacity of our factories, these baskets will continue, after the boost, to contain the same proportion of foreign goods. But why should the baskets of the boost-period contain <u>more</u> foreign products than those of the period of stagnation ? I see no reason why they should, and a thousand reasons why they should contain <u>less</u>. The marginal propensity to consume foreign goods cannot, <u>at the most</u>, exceed the average propensity.

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This marginal propensity to import does, of course, remain positive, and even if, contrary to the thesis I am opposing, the boost did indeed mainly benefit domestic production, it would nevertheless remain the case that <u>a part</u> of it, however small this might be, would make its way across the frontiers, engendering a deficit in the trade balance. The settlement of this deficit does, therefore, present a problem.

This is, indeed, the sole grain of truth contained in the thesis in question. But it is here, too, that there bursts forth for all to see the fundamental contradiction of the economic system under which we live. In order not to allow some 25 %, of

23 %, or 8 % (depending on whether we are in Germany, France or the U.S.A.) of the additional purchasing power which could be distributed through a boost to escape abroad, domestic industry is denied the opportunity to produce, using unemployed factors (that is, at zero or almost zero social cost), wealth equivalent to 75, 77 or 92 % of this same purchasing power, and this without even considering the multiplication effects on economic activity.

Naturally, the percentage of this "outflow" abroad depends on the size of each entity and, consequently, its degree of "openness" to the outside world. On the scale of the O.E.C.D. countries as a whole, this does not exceed 5 per cent. For a concerted boost on the O.E.C.D. scale the risk of external disequilibrium would thus be negligible. Nevertheless, opposition from vested interests has so far prevented such concerted action.

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Could one country taken separately go ahead along that road, independently of the rest ? I think that it could, given two conditions: (a) negotiating its boost with its partners, with a view to keeping external exchanges as they were before, and (b) being prepared to sacrifice part of its currency reserves and/or to incur debts in order to cover, for as long as necessary, a possible residual deficit in its trade balance.

This would mean, in simple language, that the country in question would put the market into the hands of ~~t~~ its partners. Either they would follow it along the road of boosting or else the country would take steps to prevent its boost from profiting others. Would that be a violation of free trade ? I do not think so. It is universally agreed that measures to protect one's national market are legitimate when they are taken in response to unfair competition or social dumping. It is not apparent how introducing or maintaining austerity while another country boosts its economy differs from introducing a tax on imports, or subsidising exports. The very fact that the country in question is only trying to maintain the status quo is enough to show the defensive nature of its measures of intervention.

As for the small residual deficit that there may be after such an operation, it is really not clear what "reserves" are for if not precisely to cope with such a situation.

On the other hand, if it is decided to cover the deficit, in whole or in part, by incurring debts, the suppliers' consent is not even necessary, since, materially, there is no way in which one can sell to somebody else more than one buys from him without, *ipso facto*, accepting his credit-money.

III. Formal Boosts and Unadmitted Boosts

A strange consensus has recently appeared, uniting left-wing economists, on the matter of the alleged failures of Keynesianism. I cannot see what these failures are.

Two countries, Austria and Sweden, have applied Keynesian policies in a systematic and deliberate way. Sweden has not hesitated to undertake the most extreme and risky of measures to sustain growth, namely, financing the stocks of enterprises. The result has been that the rates of unemployment in these two countries are among the lowest anywhere.(3)

Another country where a Keynesian policy has been applied on a large scale - in this case, perhaps, more accidentally than on purpose — is, however paradoxical this may seem, the U.S.A. under Ronald Reagan.

If we follow the ups and downs of the budgetary deficit in that country, we observe that the deficit was reduced in 1979, increased in 1980 and reduced again in 1981, to resume its rise in 1982 at a pace much faster than before and attain today the phenomenal figure of 200 milliard dollars. Economic activity in the U.S.A. responded to these variations with clockwork precision, in the words of Anatole Kaletsky. The gross domestic product fell in 1980, rose in 1981, fell again in 1982 and then, in 1983, began its present vigorous recovery, during which more than four million new jobs have been created and, if we take account of the lengthening of the working week, the volume of productive labour applied, and so the volume of wealth produced, has increased by over 7 per cent.

At the same time -- a supreme refutation of monetarism — "inflation", which had reached ~~10%~~ 10½% in 1980, fell in 1983 to 4¼ %.

May 1984

<u>Notes</u>

1. UNCTAD II listed an elasticity of less than 0.5 for coffee, sugar, cacao, lead, hard fibres, manganese ore and black pepper, and between 0.5 and 1 for natural rubber, copper and vegetable oils with a lauric-acid base.

2. <u>Le Figaro</u>, 11-12 September 1976.

3. Already during the crisis of the 1930's the Swedish Social-Democratic government of the time managed to overcome it by a policy of boosting the domestic market.

19 January 1985

~~MARGARET~~/BRIAN PEARCE
42 VICTORIA ROAD
NEW BARNET
HERTS. EN4 9PF
Telephone (01) 449 6940

Dear Mr Laursen/ Arghiri Emmanuel has sent me his corrections to my translation of his article "The Economic Crisis ..."

Here they are:

<u>Page 7, line 3 from the bottom</u>: Delete "in extended order", and substitute "individually and independently".

<u>Page 8, line 15</u>: ~~Delt~~ For "variable price" substitute "price-variable".

<u>Page 8, line 25</u>: Delete "trade-balance surpluses resulting from the 'extra payments' for oil", and substitute: "trade surpluses of oil-producing countries".

<u>Page 8, line 26</u>: For "fixed" substitute "constant".

<u>Page 8, line 27</u>: Delete "by the oil-producing", and substitute "in these same".

<u>Page 9, line 9</u>: For "self-determined development" substitute "self-reliance" — and append a <u>footnote</u>: "'Self-reliance' is a frequent translation of the French 'autocentrisme' or 'développement autocentré', although the French expressions refer rather to a self-sustained, self-propelled, autonomous development."

<u>Page 10, line 4</u>: For "risk" substitute "chance".

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