Correspondence on economic recession in the US

28 March 2001

To the *WSWS*,

What if lowering interest does not stop the recessionary slide? Could the US experience a Japan-like deflation?

SH

Dear SH,

The broad answer to your question is yes. But whether or not the US experiences a recession or undergoes a Japan-style deflation in the immediate period, the more important question is the longer-term historical issues raised by the present situation.

A decade ago the collapse of the Stalinist regimes in Eastern Europe and then the Soviet Union was proclaimed as the triumph of the market and the definitive victory of capitalism over socialism. In refuting these assertions the International Committee of the Fourth International (ICFI) made two decisive points: first, that the Stalinist regimes did not represent socialism in the first place and second, that their demise was the initial expression of the emergence of inherent contradictions in the world capitalist economy itself. Above all, we insisted, the collapse of the nationally based Stalinist regimes signified the predominance of the world economy over its national parts.

The free market euphoria, which accompanied the demise of the Stalinist regimes, seemed to be confirmed by the growth of the US economy during the 1990s. The rise of share values on Wall Street and the transformation of production resulting from the development of computer-based technologies was hailed as the arrival of a "new economy" in which the business cycle, not to speak of more deeply rooted problems, was a thing of the past.

But in the midst of this celebration the economy of Japan continued to stagnate. In the late 1980s, Japan had enjoyed a spectacular financial boom, with stocks and land prices rising to unprecedented heights. But with the collapse of this financial bubble all attempts to revive the Japanese economy—both through cuts in official interest rates to near zero and massive government spending programs—have failed.

While the US boom continued this was put down to the fact that Japanese capitalism did not adhere to the American "free market" model. But now concerns are being voiced in some sections of the financial media that the Japanese share market collapse and subsequent stagnation may have been the forerunner of processes now being seen in the US itself.

It has been noted that, unlike previous experiences, the present US slowdown has not been preceded by a tightening of interest rates, more fundamental factors are involved and therefore that recessionary tendencies may not be halted by cuts in rates—the situation which has prevailed in Japan.

For example, Morgan Stanley Dean Witter chief economist Stephen Roach pointed out that while most fund managers attending the firm's recent Asian investment conference believed that "at the end of the day, the Fed will win—it always does", he was "hard-pressed to generalise on the basis of Fed successes of the past."

"I continue to believe that this cycle is very different from those of the past 55 years: It is not about inflation—and the Fed's penchant to fight it. Instead, it is about a more lethal cycle from a more distant era, triggered by periodic asset bubbles and boom-bust cycles of capital accumulation."

Marxist political economy

The processes to which Roach and others, such as the former US treasury secretary Lawrence Summers, are pointing have long been identified by Marxist political economy.

They arise from irresolvable contradictions between the growth of the productive forces and the social relations of capitalism, based on the extraction of profit. The growth of the productive forces is manifested in the accumulation of capital but this very expansion inevitably leads to downward pressure on the rate of profit. This is because the surplus value extracted from the working class—the source of all profit—cannot keep pace with the expansion of capital.

The pressure on the rate of profit arising from the over-accumulation of capital relative to surplus value leads to an intensification of competition. This is the driving force behind deflation—falling prices and asset values—the downsizing by major companies as they seek to cut costs and so maintain their individual profit rates, and the merger movement which has seen the amalgamation and/or takeover of major corporations as they strive to rationalise their operations on a global scale.

At the same time, the over-accumulation of capital means that vast amounts of fictitious capital, that is, stocks, loans, etc., which, in the final analysis are claims on future surplus value, are suddenly found to be without any real backing. This is the source of the stock market slide. And there are concerns in financial circles that it may not be halted by cuts in interest rates.

An article published in the March 22 edition of the *Economist* noted that in the week before the latest interest rate cut by the Fed no fewer than 38 of the 40 stock markets tracked by the magazine fell and in the week of the cut 32 of them slid again.

"Some economists," it said, "think a new form of financial contagion is spreading, via stock markets, in a way similar (if slower) to that in which Asia's financial crisis in 1997-98 infected one economy after the other. If stock markets tumble in even healthy economies, then business confidence there can be hurt. Where American recessions used mainly to affect the rest of the world through trade, stock markets are now perhaps a more powerful channel."

The article went on to point out that stock market capitalisation amounts to a much larger proportion of gross domestic product than before and that the $10 trillion in paper wealth destroyed worldwide over the past year amounts to about 30 percent of global GDP. "Never has so much been lost in such a short time."

This brings me to the point that I raised at the start of this reply. The ICFI explained that the demise of the Stalinist regimes signified not the end of socialism, but rather the breakdown of the Cold War mechanisms through which the contradictions of global capitalism had been regulated in the post-war period.

It is therefore significant that in seeking to find explanations for the present situation economists are recalling the type of economic processes that erupted so explosively in the first part of the 20th century. It is a sure sign of things to some in the 21st.

Yours sincerely,
Nick Beams