IMF chief economist’s revealing expression of theoretical bankruptcy

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Anyone still labouring under the illusion that those in charge of the global financial system have any analysis of the financial crisis of 2008, let alone know how to overcome its impact or prevent another disaster, should read an article by International Monetary Fund chief economist Olivier Blanchard published last month.

Appearing under the title “Where Danger Lurks” in the latest edition of the IMF’s quarterly publication, it is a clear admission of the utter bankruptcy of the would-be guardians of the stability of the global capitalist economy.

Blanchard begins by trying to explain how it was that the world’s supposed “leading economists” and financial authorities had no idea that a crisis on the scale of 2008 could develop.

The depth of the chasm between what passed for official theory and analysis and actual economic developments is best personified by the former chairman of the US Federal Reserve Board Ben Bernanke.

In February 2004, he delivered a speech on the topic of “The Great Moderation,” by which he meant the “remarkable decline” in both the variability of economic output and inflation over the preceding two decades compared to the turbulence of the 1960s and 1970s. Expressing his “optimism for the future,” Bernanke “forcefully” put the case that “monetary policy,” as carried out by himself, his predecessor Alan Greenspan and other central bankers, deserved “more credit than it has received in the literature” as the explanation for the “Great Moderation.”

Just over four years later, Bernanke was presiding over a financial meltdown which, as he recently explained in a court document, was the “worst … in global history, including the Great Depression” that could have seen 12 of the 13 most important US financial institutions at risk of failure “within a period of a week or two.”

What explanation does Blanchard offer for this extraordinary failure of insight, not to mention policy, of the entire financial establishment, with some of the brightest minds, continuous data streams and computing power at its disposal?

He maintains that the techniques used by so-called macroeconomics were based on a worldview which, while recognising economic fluctuations occurred, maintained that they were regular and essentially self-correcting. “The problem is that we came to believe that this was indeed the way the world worked,” he wrote.

According to Blanchard, this mode of thinking arose out of the so-called “rational expectations revolution of the 1970s” in which it was assumed that the behaviour of people depended not only on current economic conditions but what they expected in the future. Such expectations were in turn based on what had occurred in the past and the past demonstrated that, while the economy had been subject to different shocks and fluctuations, it “naturally” returned to its “steady state over time.”

Such explanations collapse immediately upon examination for they fail to account for the fact that the Great Depression of the 1930s likewise developed contrary to the prevailing economic wisdom of the day.

The real explanation of the utter bankruptcy of bourgeois economic theory goes far beyond the defects of its latest incarnation.

Long before the disaster of the 1930s and other ensuing crises, Karl Marx laid bare the unscientific foundation of all bourgeois economic analysis, where the latest “theory” is developed to try to provide some explanation for the failure of the previous one.

The bankruptcy of bourgeois economic thought is rooted in the very class interests it represents and defends. All its theoretical permutations and combinations are based on the unscientific conception that capitalism is not an historical mode of production but is the only rational and therefore historically viable form of socio-economic organisation.

Insofar as history is considered, it is only to demonstrate the fatal flaws in previous forms of socio-economic organisation which were finally overcome with the emergence of the capitalist mode of production based on the private ownership of the means of production and the “free market.” These are held to be the expression of something fundamental in the nature of mankind itself—the inherent tendency to “truck and barter” as Adam Smith put it.

Confronted with persistent crises in the world market, which point to the historically-limited character of capitalism and the contradictions lodged within it, Marx explained that its apologists, the bourgeois economists, “content themselves with denying the catastrophe itself” insisting that “if production were carried on according to the textbooks, crises would never occur.”

The high priests of bourgeois economic theory occupy a position in present day society somewhat akin to the heads of the church in feudal times who, endlessly quoting from scripture, sought to stamp out the explanations of Galileo and others that the earth moved around the sun, not the other way around.

And yet, as Galileo is reputed to have murmured when shown the instruments of torture, “it still moves.”

The source of motion in the capitalist mode of production, its booms, downswings and above all, crises, is the contradictions lodged within its very foundations. But for bourgeois economists any examination of these contradictions is excluded, for it would call into question the historical viability of the mode of production they all defend.

Crises exist because these contradictions exist, Marx wrote. “The desire to convince oneself of the non-existence of contradictions, is at the same time the expression of a pious wish that the contradictions, which are really present, *should not* exist” (*Theories of Surplus Value*, Karl Marx, Progress Publishers Moscow, 1968, p. 519).

The crisis of 2008 was clearly rooted in the US and global financial system, which provides the lifeblood of the entire capitalist economy. But Blanchard made no analysis of the contradictions within that system. Instead, he advanced the proposition that the reason the crisis was so completely unexpected was a failure of prevailing theory to take into account that the economy did not operate in a linear fashion and that small shocks, such as an across-the-board fall in American house prices, could have very large consequences.

"We all knew that there were 'dark corners'—situations in which the economy could badly malfunction. But we thought we were far away from those corners," he wrote.

On Wednesday *Australian Financial Review* columnist Maximilian Walsh drew a parallel between this explanation and the first efforts of cartographers.

"In the early days of cartography (circa 1500)," he wrote, "the problem of depicting the unknown on maps was addressed by leaving the space blank, except for the warning 'hic sunt dracones': here be dragons." Blanchard had come up with a "contemporary equivalent."

The contradictions which Blanchard chose not to examine, as he resorted to almost mystical "explanations" (at another point in the article he describes the present monetary policy of the central banks as a kind of "black magic"), are decisive because they are embodied within the very nature of capital itself.

Capital is not, as Marx ceaselessly explained, the physical means of production. They exist in every society. It is self-expanding value, a specific product of commodity-capitalist production—an *historical* product not a timeless entity—which grows through its constant circulation and changes of form.

It starts its life as money. This money is then used to purchase the means of production (raw materials, machinery etc.) as well as the labour power of the working class. All this takes place in the sphere of the market where freedom and equality reign. But then capital leaves this sphere and the process of production begins. New commodities are produced which embody the value of the means of production purchased together with the value of the labour power purchased from the worker plus additional, or surplus, value extracted from the labour force.

The source of this surplus value is the difference between the value of the commodity which the worker sells to the capitalist (labour power), which is paid for in the form of wages, and the additional value embodied in the commodities produced by the worker, which is not paid for. The value of the labour power of the worker and the value embodied in the commodities resulting from the use of that labour power in the production process are two entirely different quantities.

The new commodities are then sold and the value embodied in them again assumes the form of money, ready to resume the endless circuit of capital. The money which emerges at the end of the process is greater than that at the beginning because it is the expression not only of the value which started the circuit (comprising the money laid out on raw materials, means of production and labour power) but the additional value that has been *added* by workers in production.

The entire process can be summarised as M … M', where M is the initial money-form of capital and M' the greater quantity of money, expressing expanded value, which emerges at the end, ready to undergo further self-expansion in the next circuit.

As Marx explained: "It is precisely because the money form of value is its independent and palpable form of appearance that the circulation form M … M', which starts and finishes with actual money, expresses money-making, the driving motive of capitalist production, most palpably. The production process appears simply as an unavoidable middle term, a necessary evil for the purpose of money-making" (*Capital* , *Volume II*, Penguin edition 1992, p. 137).

In preparing Marx's manuscripts for publication, his life-long collaborator Frederick Engels made an important addition. It was for this reason, he wrote, that "all nations characterised by the capitalist mode of production are periodically seized by fits of giddiness in which they try to accomplish the money-making without the mediation of the production process" (ibid).

What Engels called a "fit of giddiness" has now become a permanent feature of capitalist accumulation. One measure of this process is the fact that in the US whereas financial profits were less than 10 percent of total corporate profits in 1980, by 2007 they amounted to 40 percent. Financial assets, which were roughly equivalent to global gross domestic production 30 years ago, had risen to 350 percent of GDP by 2007.

Marx's analysis of the circuit of capital points to an inherent contradiction in the nature of capital itself. On the one hand its self-expansion is grounded on the surplus value extracted from the working class in the production process. There is no other source of additional value. But on the other, capital strives to break free from production, this "necessary evil for the purpose of money-making" and simply transform money into ever greater quantities of money in the sphere of finance.

This contradiction, lodged within the nature of capital itself, is at the root of the financial crisis that exploded in 2008. However much each individual section of capital may benefit from parasitism and speculation, capital as a whole is nonetheless tied to the extraction of surplus value from the working class.

Financial assets represent, in the final analysis, claims by a section of capital on that pool of surplus value. But when the rate of growth of finance capital races ahead of the growth of production, as has taken place over the past three decades, these assets become "toxic," that is, their paper value vastly outstrips the surplus value that is available and, as Bernanke's recent testimony has made clear, the entire financial system is driven to the point of collapse.

Capital, acting through its representatives in governments and financial authorities, above all the central banks, has brought forward two responses to this crisis.

On the one hand it has demanded, and received, an endless supply of ultra-cheap cash to the money markets to try to put off the day of reckoning, and the social explosions it will produce. This is what has led to the boosting of share values to their highest-ever levels despite continuing stagnation in the real economy.

On the other, it has imposed a sweeping austerity agenda aimed at the lowering of wages and the destruction of social services in order to impoverish the working class and increase the extraction of surplus value.

There is no economic solution to this crisis within the framework of the capitalist mode of production.

Either the capitalist class returns the working class to the conditions of the 1930s and worse, imposes a police-military regime to enforce its demands, and plunges the world into another war as each section of the bourgeoisie strives to meet its needs by military means aimed at its rivals, or the international working class takes political power and overthrows the dictatorship of capital by means of socialist revolution.

Those who continue to believe that the bourgeoisie and its economists have some other solution hidden up their sleeve, which they will eventually produce if only they are given enough time to discover it, need only consult Blanchard's article to be disabused of that conception.

According to Blanchard, the main lesson of the crisis is that "we were much closer to those dark corners than we thought—and the corners were even darker than we thought too" as economists, financial institutions and regulators were "fooled" by the Great Moderation.

One lesson of the crisis, writes Blanchard, is that policymakers should resolve to "stay away from dark corners." But in the very next sentence, he acknowledges that we are "still too close" to them. "The crisis itself has led to large accumulations of debt, both public and private" and while "for the time being, the diabolical loops [in which a crisis in one area provokes one in another, which then exacerbates the original problem] have receded" it "would not take much of an adverse shock for them to reappear."

Perhaps increased regulation is the answer. But even Blanchard discounts that. "The reality of financial regulation," he writes, "is that new rules open up new avenues for regulatory arbitrage, as institutions find loopholes in regulations."

So what is the answer? Develop a new series of economic and financial policies that keeps the system “a healthy distance from dark corners.” In that case the economic and financial models for normal times might be appropriate—and once again all will be for the best in the best of all possible worlds.

But the global capitalist system is no longer in “normal times.” It is wracked by a breakdown that cannot simply be assumed away. If the so-called wisdom of bourgeois economists were to have any validity, they would have developed a “model” which could lead the way out of the “dark corners” back to “normal times.” But as Blanchard admits this is mission impossible.

“Trying to create a model that integrates normal times and systemic risks may be beyond the professional’s conceptual and technical reach at this stage,” he writes.