Fed Chair Yellen speaks in Boston: An admission of perplexity and impotence

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A conference convened by the Federal Reserve Bank of Boston on Friday to discuss what it called the "elusive 'great recovery'" brought forward a highly significant admission from Federal Reserve Chairwoman Janet Yellen. Her keynote speech made clear that neither members of the Fed nor bourgeois economists more broadly have any real idea of the causes of the low level of growth, productivity and investment in the US and global economy, much less what to do about it.

In her opening remarks, Yellen noted: "Extreme economic events have often challenged existing views of how the economy works and exposed shortcomings in the collective knowledge of economists." She said this had led to "new ways of thinking."

She cited as two examples the Great Depression of the 1930s and the stagflation, marked by high unemployment and high inflation, at the end of the 1970s. "More recently, the financial crisis and its aftermath might well prove to be a similar sort of turning point," she said.

"Today," she continued, "I would like to reflect on some ways in which the events of the past few years have revealed the limits in economists' understanding of the economy and suggest important questions I hope the profession will try to answer."

Her comments brought to mind the famous "Queen's question" directed to economists at the London School of Economics in November 2008 in the wake of the meltdown of the global financial system, when the British monarch pointedly asked: "Why did nobody notice it?"

The passing of eight years has not brought an answer to that question. Nor to the even more important one as to why all the major advanced economies and the world economy as a whole remain enmeshed in what has been called a "low-growth trap," or "secular stagnation."

Yellen's analysis, such as it was, centred on the question of the impact of lower effective demand on the supply side—the amount of goods and services the economy is able to deliver—in opposition to what she said was the traditional view that supply and demand are independent.

She pointed to what is known as hysteresis, when persistent low demand in the market begins to hit the production process (the supply side), damaging labour markets, productivity and business models—meaning the economy may be permanently damaged and unable to return to the pre-crisis growth trend.

She noted that one model of the US experience had calculated that the present level of output was 7 percent below where it would have been had the pre-crisis trajectory been maintained.

Yellen's focus on falling demand and its undoubted impact on the supply side of the economy, however, explained nothing. The key question is why investment demand—expenditure on new capital equipment and the increased hiring of workers—which plays the central role in fostering economic growth in the economy as a whole, has remained persistently below its pre-crisis level. Yellen pointed to this tendency, noting "the unusual low pace of capital accumulation," resulting in a "marked slowdown" in the growth trend of labour productivity, but she offered no explanation.

The reason she went no further is because to do so would raise more fundamental issues about the nature of the capitalist economy itself.

Under private ownership, the development of the productive forces, which takes place through new investment, is not determined by efforts to lift economic growth as such, much less to meet social needs, but by the drive for profit. If the rate of profit falls and remains low, new investment will not be undertaken and economic growth will stagnate or even decline.

Bourgeois economists, as Marx noted more than 150 years ago, are always reluctant to probe too deeply into this question, which fills them with "horror," because it

begins to call into question the historical viability of the capitalist mode of production as a means of developing the productive forces.

So they offer up alternative explanations based on market relations—supply and demand—or changes in demographic factors, in an attempt to cover over the fundamental causes rooted in the very nature of the capitalist economy itself.

It is the downward pressure on profit rates that explains, in the final analysis, the fall in investment and the consequent economic stagnation. This is why, despite the setting of interest rates at historic lows, investment has failed to respond, and the trillions of dollars made available through the monetary policies of the Fed and other central banks have not been used for productive purposes, but devoted almost entirely to speculation in financial markets.

In her speech, Yellen offered no alternative agenda, simply more of the same, and possibly even a further increase in monetary "easing." She noted that the presence of hysteresis after a deep recession raised the question of whether it might be possible to reverse supply-side effects by running a "high pressure" economy, and suggested that policymakers "might want to be more accommodative during recoveries than would be called for under the traditional view that supply is largely independent of demand."

Financial markets gleefully interpreted this as meaning that, despite pressure within the Fed's Open Market Committee for a rate rise—the last meeting of the Fed's policy-making body saw a 7–3 split vote to keep rates on hold—and the expectation of a 0.25 percentage point rise when the Fed meets in December, Yellen is the chief advocate of keeping rates lower for longer. Consequently, the markets rose on reports of her speech.

Yellen's speech was only one graphic expression of the growing sense of perplexity and bewilderment in the circles of bourgeois economy, as all of their economic "models" crumble under the impact of objective events. In opening Friday's conference, Boston Federal Reserve President Eric Rosengren, one of the members of the Open Market Committee in favour of a rate rise, pointed to what he called the "nonconformist" behaviour of the US economy over the past seven years.

He said that in the seven years since the Great Recession had officially ended, economists were still trying to determine whether slow growth in productivity was transitory or permanent. He noted that the yield on US 10-year Treasury bonds, now at or below zero on an inflation-adjusted basis, "suggests a lack of confidence in the US and global prospects, and the ability of policy authorities to offset weak growth."

A research paper prepared by three Federal Reserve economists released earlier this month advanced the claim that "demographic factors" might "offer an explanation for puzzlingly weak investment in the wake of the Great Recession."

While this was another clear example of the avoidance of the central problem, the paper went on to state that its findings "suggest that real GDP growth and interest rates will remain low in the coming decades, consistent with the US economy having reached a 'new normal.'"

The social and political implications of these warnings emerge from Yellen's opening remarks comparing the present period to that of the Great Depression and the stagflation of four decades ago. These events did not give rise to "new ways of thinking," as she claimed had developed in the past and could emerge in the present period.

The Great Depression was not ended by the adoption of Keynesian measures based on increased government spending. President's Roosevelt's experiments in that direction ended in failure, with a plunge in the US economy in 1937 even more rapid than in 1932. Instead, it led to the eruption of world war. Only after the mass slaughter of World War II and a vast destruction of productive forces was capitalism "restabilised" on the blood and bones of millions.

The response to the stagflation of the late 1970s was not "new ways of thinking" that somehow overcame the contradictions of the capitalist profit system. Rather, it resulted in a restructuring of the economy in which the globalisation of production—an inherently progressive development—was used as a battering ram against wages and conditions in the drive for profit.

Today both these trends—the drive to war and an unending onslaught against the social position of the working class—are becoming ever more apparent amid the deepening breakdown of the capitalist economy set off by the global financial crisis of 2008.