Boom or bust? Debate ignores real economy

by Chris White

A number of highly placed, even authoritative, so-called "experts" have warned of late of the looming dangers of a blow-out of U.S. equity markets. Such warnings are indicative that something is up. Nonetheless, they are all flawed in the same basic way, as regards their implicit assumptions about the relationship betwen the physical economy, and the monetary side of economic processes.

Chief among such evaluations issued has been that of Guido Carli, a former governor of Italy's central bank, the Banca d'Italia, and a member of David Rockefeller's anti-capitalist Trilateral Commission. Carli speaks for those higher circles of international finance, who decided at the last meeting of the Basel Switzerland-based Bank for International Settlements in early August, to begin to pull the plug on the international speculative financial bubble, which, they themselves decided to create in the first place.

The decision to so pull the plug was followed in short order by major shake-outs on the London Stock Exchange, and on the Bourse in Milan, Italy. In both these cases, the local central bank, acting to tighten the availability of credit, helped to trigger a stock liquidation in the order of more than 10% of the total of either market.

Those actions were the warning that the now five-year-old speculative bubble, centered on the so-called "creative," or "innovative" methods, of Wall Street, like securitization, off-balance-sheet financial operations, and the notorious junk bond sales, are slated to be wiped out, in a general, central bank-promoted deflation of speculative paper values.

Re-run of the John Law swindle

The central bankers' scheme is a rerun of one of the greatest documented swindles of all time, John Law's "South Sea Company" bubble of the early 18th century. Touted proceeds of the company's activities were used to suck in investment funds in a British version of the scam, and a French version. Realization that there would be no such proceeds forthcoming resulted in the wipe-out of the suckers who had put up their funds, while the financial powerbrokers who promoted Law and his schemes, were able to take over liquidated suckers, and national finances in the two countries alike.

So it is now. The liquidation in London and Milan is being pushed to fuel one more run-up in the New York markets, the better to pull in the suckers before the coming day of reckoning. Then, the scheming goes, discounted assets will be bought up cheap, and financial and thus political power concentrated in the hands of those interests for whom the cited Guido Carli talks.

The assumptions that such financial insider circles, including Carli, employ to arrive at their arguments in favor of a deflationary plug-pulling, ignore the real world of physical economy. They assume the immutability of "boom-bust" cycles in the creation and liquidation of the paper instruments which reflect physical-economic processes. Thus they essentially argue that the present "boom" phase of the cycle has turned into a speculative frenzy, which should be deflated via a bust, such that the appreciation of paper instruments can begin all over again.

To substantiate such assertions, it is argued that the growth of the face values of stocks and so on, combined with the increase in volume of markets, has outstripped the capacity of corporations to generate earnings to support such values. Thus, it is said, if face values and volumes are deflated, the underlying earnings would be reasserted under changed conditions, and the process could begin again.

In short, it is assumed by the "experts" that the financial side of economic processes can operate actually without respect to the performance of the physical economy as a whole. By the criteria thus put forward for the financial system, it is indeed possible to make a strong case that the stock market in the United States has been collapsing, even while the Dow Jones Index has risen from the 800 level of 1982 to 2700 of today, and while the volume of stocks traded has doubled and tripled.

Fraud of the bull market

The increase need simply be set against the more than comparable declines in earnings of major corporations quoted, such as the airlines, the oil companies, the aerospace sector, and so on. It does not take much effort to demonstrate that a dollar invested in 1982 is actually worth something less than an old-fashioned wooden nickel in the ripened "bull market" of the summer of 1987.

Thus it is relatively easy to imagine the power-hungry denizens of the top circles of international finance, eagerly contemplating their shopping lists of what purchases can be made of United States assets under nickel-on-the-dollar terms, or worse.

There are even circles in the United States who have done similar such calculations. Among them the *Wall Street Journal,* whose coverage of the Fifth Anniversary of the Great Bull Market, which began Aug. 13, 1982, drew the ire of Jude Wanniski and the other supply-side architects of the so-called Reagan revolution. From the standpoint of Carli and the *Wall Street Journal,* Wanniski and his friends, including the President, are out of the real world. From the standpoint of the real world, so too are Carli and the *Wall Street Journal.*

For example, "earnings" ought to be related to .the production of net profit, economically defined. The U.S. economy, contrary to the illusions of Carli and the *Wall Street Journal,* has been functioning below the breakeven level, that is, without net profit, since the interval 1979-82. Those were the years of Paul Volcker's high interest rate economic warfare against the United States. Of course, parallel with the bull market, the Great Recovery, the most sustained surge of economic growth since the end of World War II, also began in the year 1982-83. But the Great Recovery never actually happened.

There was no recovery of the U.S. economy from below breakeven conditions. There was no return to profitability for the United States in any economic terms. Some costs of economic functioning were shed, as the economy ratcheted downward, for example, machine tools or shipbuilding, other costs of economic functioning were turned into net liabilities through the increase in imports that partly disguised how bad things had become, while helping to support the tremendous increase in degraded coolie labor, service sector jobs that were created.

Without economic profitability, earnings that are reported as earnings, are as much of a fiction as any other paper claim to bull-market riches. That is to say that speculative paper gains, from real estate speculation, foreign exchange swindles and so forth have replaced economic profitability on the earnings side of the so-called price earnings ratio. Then the economy, as measured by its capacity to produce at levels of late 1960s market basket outputs for producers and consumers alike, spirals downward, while the speculative and usurious claims against the economy, spiral out of control, fed by the tripling of on- and off-balance-sheet debt of all borrowers, since 1982.

The bubble takes off, without reference to the constraints of physical economy that underlie the generation of paper values. The bubble is maintained by the inflow of foreign funds, legitimate and illegal at a level of $150-180 billion per annum. Remove the foreign funds and the bubble collapses. Collapse the bubble and underlying reality is reasserted, but it's not the reality of Guido Carli and his friends. They will not simply be able to buy up the United States cheap and divert the resultant earnings stream, in the form of interest, rent, and usury to their own account.

Without the generation of real profit in the economy, a deflation of paper values, will constrict credit throughout the economy, and send what is left of the wreckage of the once great U.S. economy into not simply a deflationary bust phase so-called, but into an economic breakdown crisis without parallel in human history, but comparable to the breakdown of Europe over the 50 years leading into the Black Death of 1348. Without reorganizing the bankrupt credit and financial system to permit wealth, and thus profit, to be produced, the capacity of the economy to bounce back from the kind of deflation the European insider circles plan on implementing is pretty much nonexistent.

It can therefore be confidently said that the proponents of deflating the great bubble of the 1980s are deluding themselves if they think they can survive what they seem to have decided to unleash. Financially, the crash cannot be directed toward the outcome they demand. Economically, with the virus AIDS loose, and with the Russians on the march, their plans have all the character of the tawdriest self-serving fantasies.

Yet the speculative bubble will come down, at some point, whether the financial insiders decide to help it on its way, or not. Simply because it cannot be supported, without destroying the host economy on which it rapaciously feeds.

Therefore it isn't good enough to simply say, bring the bubble down, and start again with a clean deck. There won't be a deck. Needed then are new policies, which will permit the reorganization of the bankrupt financial structures, while fostering the kind of economic revival on which real wealth generation depends. Clearly that is not something which central bankers, and their financial insider circle friends are capable of doing.