Notes on Reaganomics' Fate

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On Feb. 19, 1980 Reagan presented his four-part program to fight inflation and get the economy moving again. "This plan," he said, "is aimed at reducing the growth in government spending and taxing, reforming and eliminating regulations which are unnecessary and unproductive or counter-productive, and encouraging a consistent monetary policy aimed at maintaining the value of the currency." Summing up near the end of his speech, he said, "For too long now, we've removed from our people the decision on how to dispose of what they created. We have strayed from first principles. We must alter our course."

This course altering is the pious wish to return from Keynesianism to the "first principles" of the good old days of laissez-faire capitalism — of free markets unfettered by government intervention. This has now been resurrected by the new administration in the catch-phrase of supply-side economics. Now their problem is to put it to work. There, as they say, is the rub. As we shall show, it is impossible to implement this return to the past.

Government Intervention to Stem Vulnerability to Collapse

The problem of making the free-market rhetoric jibe with reality has surfaced in a recent exchange of views between budget director Stockman and Treasury Secretary Regan. "The idea that's been established over the last ten years that almost every service that someone might need in life ought to be provided, financed by the government as a matter of basic right, is wrong," said Stockman on ABC's "Issues and Answers." The next day, Reagan begged to disagree. "I think Dave went a little too far in that statement," said he at a news conference. "When people are in need or unemployed, they can expect that government will help them." Contradicting supply side rhetoric, Reagan assured hard-hit savings banks and savings and loan associations that the government was standing by to help them "if the system needed to be stabilized."

Reagan's "correction" flows not from benevolence but necessity. Today more than ever the monopoly capitalist class is faced with a thoroughly stagnant economy threatening day by day to collapse. Any single collapse of a major corporation or bank could set off a chain reaction that would draw down others into an abyss from which none could escape. The U.S. economy is inflammable, volatile, fragile as never before.

The reason is that corporations, banks and consumers are in a financial crisis that dwarfs anything seen before, during or after the great crash of 1929. And rampant speculation on a scale never before seen in this country has pushed the vulnerability to collapse to an even higher level than the 1930s.

The collapse of the silver market last year and the role of billionaire speculators like the Hunt brothers is a case in point. The effects on the drop of silver prices, stemming from the inability of the Hunts to pay their margin calls, threatened to start a collapse of the major brokerage houses and banks that lent money based on silver..As silver prices fell, more margin calls would have been put out and led to more defaults. This would lead to a chain reaction collapse of brokerage houses and banks, dragging the rest of the economy with it. Reacting to this crisis, Federal Reserve Chairman Volcker was forced to arrange a loan of up to 800 million dollars to the Hunts by a group of the nation's largest banks — precisely to prevent the collapse. By comparison, the speculation which triggered the collapse of 1929 was relatively narrow. Now the threat comes not from one source, but many.[1]

Deregulation An Attempt to Stem The Tide of Collapse

The monopoly capitalists are not concerned with individuals of those like the Hunts. But businesses failing which bring banks down with them is something they must be concerned with. This is the sense in which market deregulation is taking place. Started by Carter, it is an attempt to stem the tide of collapse.

Since the Second World War large numbers of regulations have been added covering airlines, trucking, communications, oil, and so on. It has become a well-known joke that top corporate executives work for the government in the agencies that regulate their industry. The reason regulations have been introduced varies, but the reason they have been tolerated is that they tend to preserve the status quo — that is, the larger corporations can comply more easily than the smaller corporation.

The cry against market regulation traditionally springs from these smaller companies, from the self-made millionaires and from the sections of the country that are still growing, such as the Southwest. These are the ones that are trying to reinvest and grow today, unlike the monopolies. They are the ones who are always pressing for exemptions to the regulations and would like to see them done away with. These guys have been talking this way for years as they tried to cash in on the relatively long period of temporary stabilization and the profits to be made.

The change in attitude today comes from the biggest monopoly capitalists, who now push deregulation. And there is good reason.

The vulnerability is most clear in banking. Here, in an effort to make up for unprofitable investments such as long-term low interest mortgages, banks have extended themselves beyond normally safe levels. They have loaned out so much money taken in as deposits that they can quickly become insolvent if they can't collect on a big loan, or if a depositor pulls out a lot of money overnight. First Pennsylvania Bank needed 500 million dollars in government loans after writing off some Chrysler loans and losing money on mortgages. Even Manufacturers Hanover — a true giant — is worried about the Chrysler loans it holds.

In an article cheering the market deregulation of banks, *Business Week* writes, "The (financial) system features $100 billion banks and $100,000 credit unions, sometimes competing for the same customers. It is not only an inefficient system, but a dangerous one. It includes so many weak fish that a sustained and aggressive anti-inflationary policy by the Federal Reserve could bring hundreds of institutions to their knees." The weakest fish are dying. The Federal Savings and Loan Insurance Corporation (FSLIC) used 1.3 billion dollars of federal money to bail out 35 failing Savings and Loan banks in 1980 and merged 31 of them with other banks to create stronger institutions.[2]

Besides domestic troubles, American banks are vulnerable to events in the Eurodollar market. There, beyond the limits of U.S. regulation, dollars are loaned at rates which are often better than those of U.S. banks. Interest is higher on deposits, with even overnight deposits earning interest. These terms have attracted deposits away from domestic banks, and the estimates for the total market nearly doubled between 1975 and 1980. This market has been tolerated because it is making good profits for U.S. banks, but its sheer size and uncontrolled character makes many bankers worry it will generate a collapse as quickly as it has generated profits.

The third area of vulnerability is the system of government loans administered by the International Monetary Fund. These loans, largely Eurodollars, have expanded rapidly in the 1970s and have allowed the export of products and services to the third world countries — to countries too impoverished by imperialist plunder to pay for them. These loans are as a whole not temporary, but permanent, with banks lending money to pay off old loans and even more money to pay off the interest. Brazil is an example. The Brazilians borrowed heavily to build their industrial base and currently owe 60 billion dollars to the IMF and big banks. Now they are caught in a glut, unable to export enough products to pay even the interest. A number of countries — including Poland — are in the same predicament. What it means for the Western financial system, however, is that a default could bring down the whole system with it.[3]

The debts in the third world have been created by foreign aid and loans from the U.S. government, followed by IMF loans and World Bank loans. As the loans ballooned in the late 1970s, they were blamed on OPEC's fight with the U.S. and the industrialized countries around the price of oil. Recently, the IMF has tried to use OPEC money to cover these debts directly, through the sales of IMF bonds. But the bonds are as worthless as the situation is hopeless.

The Effects of Market Deregulation On U.S. Industry

The depths of the current crisis can be seen in the fact that the three pillars of the economy, the three industries that have been the leading and basic industries in the expansion of the economy in the 20th century — steel, auto and construction — are the industries dying today. Too far gone for deregulation to help, direct government intervention keeps them afloat. The Chrysler bail-out is one side of the coin. The other side is the protectionist measures in steel and soon auto, the opening shots in an ever-threatening trade war between the United States and the countries of Europe and Japan. Here free market rhetoric and government policy again collide.

But if Chrysler and Ford's recent record losses are symptomatic of the pillars of the economy, other companies are not far behind. Due to last year's recession and continued high interest rates, business bankruptcies are spreading through the nation's economy at a spectacular pace. In the first 10 weeks of this year, business bankruptcy filings soared to 2,933, a gain of 63 percent from the comparable perioId last year, and the highest number reported for the period since 1963. The gain early last year was already 53 percent above that for the similar period in 1979, according to data released last week by Dun and Bradstreet, Inc.[4] According to *Newsweek* "...corporations have loaded themselves with what many economists regard as a dangerously high level of short-term debt. Unless some of the burden can be transferred to long-term obligations, economic growth

"Market Deregulation is an attempt to stem the tide of collapse"

will suffer. Yet there is little prospect for immediate relief: yields on top-rated corporate bonds have already surpassed 14 percent, and (Salomon Brother economist) Kaufman predicts that they could rise to 16 percent or higher. Few corporations will be willing to pay those prices but unless they somehow manage to reduce their short-term debt obligations, banks will continue to add major borrowers to their lists of problem customers..."[5]

Because of the increasing vulnerability to the crisis, many companies are divesting themselves of unprofitable areas or selling off assets in an attempt to stay solvent and prevent a cash-flow collapse because of the high interest rates.

It was in the midst of this kind of snowballing vulnerability that Carter started the ball rolling on market deregulation of the airlines, trucking, communications and banking. In a sense, it was the start of the process of "pre-emptive collapse." As always occurs during capitalist crises, economic centralization occurs as the strongest swallow the weakest companies driven under by the crisis. Rather than wait for the business collapses to occur spontaneously and potentially bring down others with them, the government's market deregulation forced the issue and gave the strongest sharks the right to step up the centralization process. This, they hoped, will create stronger monopolies better able to withstand the crisis financially and eliminate potential weak spots.

Reagan's actions have extended this trend. By urging curbs on the antitrust powers of the Federal Trade Commission and the Interstate Commerce Commission, he has given the biggest monopolies — like IBM, the major oil companies, General Mills and AT&T, all under government antitrust suits — the green light to grab all they can. GM has announced that it will no longer worry about domination of the domestic market. In the past it gave federally mandated safety technology to American Motors to help them stay in business. Today it will take what it can get.

Reagan has also criticized the Federal Communications Commission and the Security and Exchange Commission for interfering with business and proposed cuts in their budgets. This opens the road for more centralization in the communications industry (such as the hotly contested cable TV market which has forced the biggest company, Teleprompter, into bankruptcy). More significantly, it will speed up the already furious merger motions taking place in many sectors.

Another move in this market deregulation scheme is Reagan's decontrol of old oil, completing Carter's deregulation of new oil. The immediate sharp rise in gas and heating oil prices has swelled the already bloated profits of the Exxons and Mobils at the expense of small refiners and consumers. The farce in this tragedy is that the supply-siders' predicted effect of getting the oil companies to put more of their new-found profits in drilling for new oil has failed to appear. Instead, the cash-rich oil companies kept their profits above ground and went after other major monopolies, particularly in minerals. The swallowing of Kennecott by SOHIO is only one in a string of acquisitions by oil companies. And through this all, of course, not a drop of new oil was ever produced, nor any new jobs created. In fact, jobs are usually lost in the centralization process as organization duplication is eliminated and the most unprofitable parts of the swallowed company are shut down. And as the economy becomes increasingly centralized, the tendency and ability of the monopolies to raise prices increases.

In summary, market deregulation is a defensive measure to stem the tide of collapse. It cannot by any means replace government intervention to shore up selected industries. It cannot address the fundamental cause of the crisis. It can only sharpen the fight between the bourgeoisie on an overcrowded liferaft in a stormy sea.

Can Tax Cuts Bring on New Economic Growth?

If the vulnerability to collapse brings about the necessity for an "impure mixture" of government intervention and market deregulation from the laissez-faire advocates, they want to get government off the backs of business through tax cuts. Supply side economists simplistically believe that tax cuts will spur people to save more and corporations to invest more, thus boosting renewed growth in the economy. This is a very big "if" complicated by the nature of the economic crisis today. First of all, the rich will get the biggest dollar cut in their income taxes. For most, the tax cut comes to only around 100-200 dollars this year — and this is for the median gross income in the United States, the income of the industrial worker and lower petty bourgeoisie. While it could spur the buying of new refrigerators or some new cars (which bourgeois economists fear could add to inflation as the capitalists try to recoup inflation losses by raising prices), there is very little chance of people putting it into savings given the fact that inflation is running their real incomes into the ground.

The supply-siders hope that the major effect will come from tax breaks to corporations. This comes in the form of allowing faster depreciation for tax purposes on capital goods such as machines, buildings. They hope that this will spur new investment, create new jobs and boost productivity in the economy. The response from the capitalists has been lukewarm at best. "I don't think the markets will ever take on good faith that the Reagan Administration proposals will work," says economist Sam Nakagawa of Kidder, Peabody and Company, a stock brokerage firm.

The crux of the problem is that there is no shortage of capital in the world. The world financial markets are literally awash in liquid investable capital and a capital shortage does not exist in the United States. *Business Week* says:

> The nation's biggest corporations are sitting atop a record $80 billion pile of ready cash that could finance a grand boom in capital spending....Instead the money is being fed out slowly, the pace of business investment remains sluggish, and top corporate executives, and a

good many economists concede that the measures aimed at generating more cash as a way to stimulate investment probably would not do the trick...(T)he relatively high rates of return available on cash invested in such short-term financial instruments as super-safe treasury bills, certificates of deposit, and commercial pater, coupled with all the uncertainties about investment in plant and equipment, make it all the more attractive to sit on money instead of spending it...When corporations do spend today, it is frequently to retire debt, buy back outstanding shares, or make acquisitions for cash.[6]

Because of the crisis of overproduction and the vulnerability to collapse, says the *Business Week* editorial in the same issue, "...instead, corporations are building up their bank accounts and short-term investments because they are afraid of what the future will bring and because they cannot find long-term investments that promise enough return to justify the risks involved."[7]

In a word, the tax cuts will only add to the capital glut while the economy continues to decline for lack of investment in basic industries.

The Budget Cuts: Can the Government Be Pulled Out of the Economy?

The supply-siders' corollary to getting the government off of the backs of business is getting the government out of the economy through budget cuts. The problem is that in the advanced capitalist countries like the United States, the domestic economies are literally structured around Keynesian economics. Programs like food stamps, for instance, are necessary to fight the serious and prolonged crisis of overproduction in the agricultural industry. CETA programs and housing grants and loan guarantees keep joblessness "down" and have kept the construction industry going for the last thirty years. To show how deeply the federal government's role is imbedded in the economy from another angle, the White House report in Reagan's economic program shows that in fiscal year 1981, federal budget outlays will come to 23 percent, or nearly a quarter of the gross national product of the entire economy this year.[8]

And for all the media hype of budget cutting to bring down government spending being the answer to inflation, the concrete facts of the Reagan budget show it will be even more inflationary. The massive budget cuts in social services and the projected tax cuts largely cancel out each other in terms of overall government spending. But with the sharp increase in military spending, the government deficit will be greater than ever. Overall, whatever Reagan's plan, there will be a total tax cut of around 53.9 billion dollars in 1981. Budget cuts are projected to be nearly 50 billion dollars this year. With military spending increasing over 30 billion dollars between 1981 and 1982, the government deficit stands at greater than 55 billion dollars this year — or nearly 25 billion dollars more than even Carter projected. Military production is inherently inflationary since no useful goods can be put on the market, yet money is put into circulation through buying means of production and paying people to produce. Moreover, the government can only make up the deficit through more taxes, borrowing from the capital market or printing money. Tax cuts shut off the first source. Borrowing drives up interest rates and weakens the ability of corporations to survive and exacerbates the vulnerability to collapse. Printing more money to cover the deficit will spur hyperinflation.

The futility of Reagan's attempt to control inflation through budget cutting can be seen in Eisenhower's first year as president when he tried to do the same thing. To make cuts comparable to the size Eisenhower made, Reagan would have to cut far more than he has proposed up to now. What happened after Eisenhower cut the budget is instructive. The inflation rate did go down a few points but only at the cost of a severe recession. And today, it is widely accepted by bourgeois economists that the "basic inflation rate" in the U.S. is around 10 percent per year.

Then the vicious cycle starts over again in a sharper way. More unemployment means lower tax revenue on the one side of the sheet and more dole, welfare, unemployment compensation on the other. This would mean more and more budget deficits, more borrowing to cover them and — inevitably — having to print money again to do it. They just can't stop the doles either. The "basic speech" says throw the bums off welfare, but Wall Street knows better. They can think far enough ahead to know what millions of starving workers would mean.

Monetarism — The Old Disease As New Cure

Faced with this hyperinflation/collapse scenario, it's interesting how the bourgeoisie's minds work. They used Keynesian deficit-financing and the resulting inflation to stave off increasingly deeper crises of overproduction. We can all see the result. Monetarist bourgeois economists are suddenly in vogue, decrying "the bankruptcy of Keynesian demand management." And they think that the crisis is mainly being caused by inflation. This gives rise to a paradox. Their old all-purpose cure has turned on them and become a disease. The monetarists now proudly hail the old disease as a new cure.

The theory and policy of monetarism — actually a reverse Keynesianism — is to clamp a fixed limit on the growth of the money supply and hang on for dear life — while unemployment and mass bankruptcies impoverish the people in wholesale batches. This they reckon will at last cure us of our "inflationary psychology" and restore capital investment in productive industries.

At bottom, the crisis of the economy is a permanent crisis of overproduction caused by the deepening impoverishment of the people. This in the final analysis prevents the capitalist from investing in productive industries. Rampant inflation does compound the investment problem. As long as the outlook is for out-of-control inflation, more and more capital will leave productive industry for the greener pastures of speculation in money markets, gold, Treasury notes, and so on. This has the effect of driving the crisis even deeper, faster.

That's why the thrust of Reagan's monetary policies is to try to convince the jittery individual capitalists that inflation will stabilize at a certain rate — even at 15 to 20 percent. Only when this happens will some even consider stopping their withdrawal of capital from productive industry.

Another part of monetary policy and another reason for the capitalists' nervousness are unstable interest rates caused by fluctuating short-term monetary policy by the government. The prime rate — the interest on loans banks charge to their best corporate customers — used to change about four times a year. Now it changes about four times a month. Moreover, the Federal Reserve Bank's discount rate — the interest rate the Federal Reserve charges to its member banks for loans, which is more indicative of the overall trends in interest rates — is much more volatile now than previously. Because of these fluctuations, corporation have a hard time determining financial strategy, compounding the problems of future uncertainty about investment.

Both the question of the inflation outlook and the interest rate outlook means the government has to try to keep the money supply growing at a steady pace — come hell or high water — and let the investors know months ahead of time what that pace will be. This is the linchpin of Thatcherism and now of Reagan's economic program. And this seems to be the policy now being followed by Federal Reserve head Volcker — at least for the time being.

But the short-term effects of the monetarist "cold-turkey" cure for inflation can be observed now in Great Britain, where the Thatcher government is in its second

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year of therapy. Inflation has been reduced from around 16 to around 14 percent. (All of that!) Meanwhile bankruptcies threaten even the biggest monopolies. Unemployment is skyrocketing. From an official rate of 9.2 percent now, it is projected by one source to reach 18 percent by the end of the year.

The bourgeoisie is attracted to this policy by its simplicity and even by its logic. There is truth in Friedman's formula that "inflation is the money-supply and the money-supply is inflation." But this discovery (explained fully by Marx in 1865) is too late dawning on Friedman. As we have shown, the world capitalist economy is incurably addicted to inflation and deficit-financing. The withdrawal symptoms would economically cause a severe deepening of the crisis.

Moreover, the monetarist policy of the U.S. has implications far beyond its own shores. Leonard Silk, economic columnist of the New York Times, wrote on this problem:

> Danger of a world depression. What Chancellor Schmidt is worrying about is that the United States, by relying so heavily on control of the money supply to curb inflation and by allowing interest rates to soar, is worsening Europe's problems of stagnant economic growth and high inflation.
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> High interest rates here cause the dollar to strengthen and European currencies to weaken, forcing costs of imports to Europe upward. To defend their currencies, the Europeans push their own interest rates up, threatening their economics with worse unemployment. But the Reagan Administration cleaves to its hands-off policy on both interest rates and foreign-exchange rates. A worsening European slump could damage the market for American exports and exacerbate pressures for protectionism.
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> Danger to the world economy: real. Needed: a better coordinated Western approach to fiscal, monetary and interest rate policy. This should be high on the agenda at the summit-meeting of Western leaders in Ottawa in July.[9]

Given the record of recent past summits of this kind, we are not holding our breath in waiting on this solution.

The Fate of Reaganomics

Every time the government comes out with its monthly inflation figures showing a slight drop, the bourgeoisie hails it as a sign of Reaganomics success. But even as they admit, the drop in inflation is today accompanied by growing signs of a renewed recession, as unemployment rates rise from 7.3 percent to 7.6 percent in May 1981. And this barely a year from the last recession.

Far from showing Reaganomic's cure, what is showing is the depth of the problem. Given the slight decreases in inflation during a period bordering on recession, what will inflation look like when the economy starts to temporarily "pick up" again?

There are thus fewer and fewer economic fixes left for the capitalists in this crisis. And the powerful lever of the economic crisis is driving the masses to politics and political solutions as never before. The scene is set for a massive class struggle in the battleground of the 80s. And more than ever, what we do and how we prepare for socialist revolution today will influence the final outcome. For all classes, the countdown has started. ☐

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Study Questions

1. *What is the purpose of the policy of market deregulation for the bourgeoisie? What is forcing them to do this?*

2. *Why are tax cuts not likely to increase significant investment in productive industries? Explain in terms of the fundamental problems of the U.S. capitaist economy.*