Why Socialists Should be Deficit Hawks

written by Barry Finger | October 24, 2010

Christina Romer, the former chair of the President's Council of Economic Advisors, argues in today's (October 24) *New York Times* that "Now Isn't the Time to Cut the Deficit." Her argument, which is unexceptional among liberal economists, is simply that "tax cuts and spending increases stimulate demand and raise output and employment; tax increases and spending cuts have the opposite effect." This, she reassures her readership, is a "basic message of macroeconomics."

This reasoning arises from an analysis of the economic crisis that is based on a shortage of aggregate demand, specifically that component of aggregate demand emanating from the business class. They are not investing nor are they consuming in sufficient volume to lift the rate of economic activity. On the other hand it is equally clear that the business community has no faith in an economy that is stabilized by the growth of the public sector at the expense of the private sector, which is what Romer's prescription would bring about and what the President's stimulus package has already resulted in. Insofar as political disruption by a renewed left is not an immediate issue, capitalism only has faith in that recovery, and that recovery alone, which arises from the restoration of profitability where the expansion of demand is driven not by state purchases, but by the process of renewed capital formation. That is, capitalism has faith only in an economy that has been adequately restructured through the devaluation of surplus capital, by downward pressure on wages and by the minimization of government overhead costs. It looks forward to a revival of economic activity based solely on a firm capitalist footing — not one limping along on government crutches.

Deficit hawks argue, as they have in Europe, that there is a structural component to the addiction to the need for chronic borrowing which threatens the long term viability of capitalism. They believe that a burgeoning state demand will ultimately crowd out private investment, raising interest rates and choking off economic growth. But the immediate problem is a cyclical problem and the structural problem lies not with state demand, but the hypertrophic growth of the financial sector. And this is where capitalism's ideologues have turned a blind eye.

The left, I would argue, should demand that the state sector grow by becoming the employer of the last resort, independent of its effects on profitability or on the relative growth of the state. However, there is no reason to buy into Romer's argument that the deficit needs to be temporarily enlarged for that purpose. What advantage is there for the state to borrow from the wealthy? To do so would mean creating assets in the form of public debt held by a class that has will not relinquish its unused liquidity. It will simply borrow the money from the Feds at a virtual zero interest rate and sit back and collect a future windfall, that the working class will in part be taxed to honor.

The flaw in Romer's analysis is this. She assumes quite reasonably that taxing the public to finance state demand simply reduces private demand and therefore is not, on balance, expansionary. One effect simply neutralizes the other. And if her description of the spending behavior of the wealthy were accurate, her analysis would be convincing. But the wealthy are not spending their income. Their demand is a potential demand, not an actual demand. The wealthy are waiting the recession out and therefore contributing to its duration.

They should therefore be taxed. Taxing the wealthy under these circumstances would be expansionary precisely because it would entail injecting unused cash into the economy to expand government purchases. The state would be doing what the wealthy are not — transforming their potential demand into actual demand. And this would not come at the future cost of increased taxes.

This is how socialists might address Tea Party concerns that are seducing so many of the white working class. It clearly identifies one of the levels in which the behavior of the wealthy contributes to the economic distress of working people.

The other long term issue is that of the structural deformity of capitalism. And this too speaks to the worries of those who so resent the Wall Street bailout. It is, of course true, that revenues taxed to support state purchases are lost to the accumulation process.

But there is something far more threatening to capitalist expansion which is festering within the very anatomy of the private sector. The financialization of capitalism — at least in the US, Britain and much of Western Europe — arises out of capital's drive to free itself from the perils of productive investment. But its implications are structurally disruptive. Instead of recyling idle balances of profit back into the real economy, this new financial system increasingly neutralized these balances by transforming them into ever new financial instruments of risk aversion. It securitized mortgages; it created new forms of risk hedging, it created new financial insurance policies, etc. This internal recycling of funds within the financial sector — first skimmed from the productive sector — permitted a growth in asset values not justified by a parallel increase in surplus value.

Capitalism had—in other words — massively overissued claims on future profits that were unsustaninable in light of the flagging rate of accumulation, which the financialization of the economy itself massively contributed to. The financialization of the economy transformed the relationship of Wall Street to the productive sector from symbiotic to parasitic and its continuance in this form is an ongoing permanent threat to the resumption of anything resembling long-term business expansion. Rather than addressing this, the business class would prefer to dismantle working class gains in what is left of the welfare state.

The shredding of the safety net, however, will leave the real structural vulnerability of capitalism largely unaddressed.