LI-Paper

A Forced Spend or a Spent Force?

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It may well be asked whether the damage inflicted by misguiding entrepreneurial activity by artificially lowering the loan rate would be greater if the crisis were permitted to run its course. Certainly many saved by the intervention would be sacrificed in the panic, but if such enterprises were permitted to fail, others would prosper. Still the total loss brought about by the boom (which the crisis did not produce, but only made evident) is largely due to the fact that factors of production were expended for fixed investments which, in the light of economic conditions, were not the most urgent. As a result, these factors of production are now lacking for more urgent uses. If intervention prevents the transfer of goods from the hands of imprudent entrepreneurs to those who would now take over because they have evidenced better foresight, this imbalance becomes neither less significant nor less perceptible.

Ludwig von Mises, 'Monetary Stabilization & Cyclical Policy' 1928

'Practical men of affairs' the world over are once again proving – by their renewed thralldom to his warmed-over Mercantilism - that Keynes was a far greater aphorist than ever he was an economist.

To widespread acclaim, Messiah- (sorry, President)-elect Obama has been promising a large dollop of fiscal 'stimulus' aimed at putting 2 ½ million people back to work over the next two years, while Chinese politicians up and down the whole Communist Party hierarchy are said to be eagerly scouring their shelves for previously rejected expansion plans to dust off and thrust before their anxious masters in Beijing.

As Doris Leuthard apes Chancellor Merkel, President Sarkozy, and their Latin counterparts in mulling over how best to support whichever failing business it is whose rescue will be most politically productive in their respective countries, UK Prime Minister Brown has abandoned all pretence that his heart does not beat to the strains of the Internationale by unveiling a massive unbalancing of the budget to be paid for five years hence – or so he pretends – by a nakedly demagogic assault on the bloated plutocrats who happen to 'trouser' more than £150,000 a year.

At the same time, ivory tower inflationists everywhere are all trying to outbid each other in promulgating mechanisms to undertake what is euphemistically called 'quantitative easing' - i.e., an unrestrained resort to the printing press. Ex-BOE committee member, Willem Buiter, has seemingly lost all patience with what he sees as his former colleagues' pusillanimity and has called for all the central banks to cede to the inevitable and to slash interest rates forthwith and across the globe to zero (something in which that Krishna of the Confederation's currency, Jean-Pierre Roth, has already obliged him).

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Pity the poor saver, the man of prudence or the thrifty housewife who has forgone the orgy of debt-fuelled self-immolation indulged in by his or her neighbours, but who will now be punished for their sins of omission by having their incremental income denied them. Such are the quasi-criminal 'rentiers' upon whom the Gespenst of Keynes would have us carry out a metaphorical genocide

Not to be outdone, top comedy double act, Hanky-Panky-Bernanke, have wowed audiences with yet another spectacular flip-flop, this time announcing a massive $20 billion injection into Citibank, together with a co-option of $306 billion of its less fragrant 'assets', in a copy of the Swiss Federation's CPR programme for UBS.

Neither content to rest on their laurels, the pair then ponied up another $800 billion with which to buy just about any species of unproductive debt you care to name – auto loans, mortgage-backeds, credit card receivables, and student loans – with the Fed printing up the money and the Treasury chipping in a $20 billion equity tranche. Straight man Ben has even talked openly about by-passing banks and primary dealers and of directly funding the US Treasury, a nakedly inflationary possibility to which we have long been drawing attention.

Condemned by its hopeless lack of understanding of the nature of capital and its ignorance of the processes of entrepreneurship, the mainstream seems to think that the provision of mere dollar bills can instantly revitalise the economy without a glimmer of comprehension for how difficult it is to restructure such a complex, interlocking metaorganism once it has become riddled with inconsistencies among the supply and demand of factors of production and weakened by the profound disharmonies between business perceptions and customer choices which are pursuant to a prolonged period of loose credit and manipulated exchange rates.

The economic sphere of today is still, sadly over-populated with primitive mercantilists – people who are congenitally unable to avoid the crass confusion of money with wealth. These wisest of fools never stop to consider that the failure of a given business comes about for the rather basic reason that it is not able to satisfy consumer preferences either at all or at least at a price commensurate with its costs. Thus, to stuff that same consumer's purse with barely-dry dollar bills and exhort her blindly to "Spend!" is unlikely to offer a solution to this fundamental misalignment of intentions.

In the first instance, the consumer – once she becomes desirous of disembarrassing herself of some of her newly-swollen cash balance – will probably still choose another company's offering over that of the pitiful object of official support. In concrete terms, she may still not wish to buy a Chrysler rather than a Honda. Secondly, the influx of money may just as readily raise the sickening firm's costs as stabilize its prices, meaning that the medicine may have a very limited palliative – rather than an ultimately curative – effect.

A propos of this latter oversight, it excites even the cynic's incredulity to see the worst of all examples of monetary quackery currently being rehashed and served up by so-called experts, despite the clear verdict of both logic and history that it is doomed to failure.

This is the ludicrous idea that increasing wages will somehow boost employees' 'purchasing power' and so induce Lazarus to take up his bed and walk whereas the main impact will actually be to reduce a much more important species of 'purchasing power' altogether – viz., that exercised by producer-employers in buying the labour services of their workers.

At a time of falling sales – and, in some cases, of falling sales prices – the very last thing anyone should consider is a move to increase the input costs of business, much less dictate a hike in the most substantial cost of them all, the payroll.

Moreover, none of these Keynesian alchemists seems to be sensitive to the delicious irony that while they vociferously advocate such a boost in wages with scant regard to the basic arithmetic of the businesses this will afflict, they are simultaneously to be found demanding that, as part of its package of 'stimulus' measures, the central bank forthwith take steps to reduce the external value of the currency, blithely ignoring the fact that this is a sure way to reduce the purchasing power of everyone unfortunate enough to live within the same borders as these charlatans, worker or not.

Reaping a bitter harvest

But this is not a time for sober reflection, this is a time to utter fervent incantations and, above all, to take action – to be seen to be doing at a time of crisis is, after all, de rigueur, for the rulers of our great democracies.

Everywhere we hear variations of the same imposing refrain: 'we must bring spending forward' – as if the business of living for today and the hell with the morrow was not the root cause of our present woes. Nor does anyone stop to consider that, were they indeed to succeed in so 'advancing' outlays, when the day finally arrives whose spending such a scheme has already carried out, the exact same problem is likely to repeat itself. Thus, all we achieve is to trap ourselves in the same spiral of 'anticipation of revenue' that has committed many a regime – both ancien et moderne – to le déluge après nous.

After all, if I glut myself on this evening's dinner straight after breakfast, where am I likely to acquire either the means or the appetite to repeat the feat at its regularly appointed time?

To use a different metaphor, imagine a farmer who is lent money not just to buy seed, fertilizer, and farm equipment, but who also taps his line of credit to provide a car for his teenage son and a Jacuzzi for his wife.

If our hopeful's projections of a sufficiently good harvest to meet the payments turn out to be woefully wide of the mark – perhaps because he has spent too much time building the extension which will house the hot tub, or with his head stuck under the bonnet of the boy's new hot rod – trouble clearly lies in store.

Being unable to service or discharge his debts, his creditors – or, his banker's' depositors – will, in turn, find their own plans thrown seriously out of kilter. Furthermore, the combination of his lack of income, his impaired creditworthiness, and his suspect business acumen all imply no repeat business will be forthcoming not only for the car dealer and bathroom outfitters, but also for the farm supply shop and the tractor makers.

In a less Maynard-in-Wonderland world than the one in which we live, our man would then have to come to some arrangement with those to whom he is indebted, either selling up and dividing the receipts between them, or negotiating a breathing space before redoubling his efforts in the fields and living well within his means, in order to meet his rescheduled obligations at the newly agreed time and place.

In the meantime, the businesses which he had been in the habit of patronizing would likewise have been forced to reassess their modi operandi, and some of these, too, would no doubt find a summary liquidation the only realistic response to a marketplace now lacking the wholly illusory revenue which had formerly originated solely in importunate old Farmer Giles' ill-advised access to credit.

But, alas, such a morality tale of the consequences of fecklessness is not part of the modern repertoire. Instead, what happens is that either our farmer or his bank goes bleating to the State about the hardships being caused to that great impersonal, the Economy, and our Practical Men and Women of Affairs start interfering straight away to forestall the necessary adjustments.

Buying the farmer's claims back from his bank at some wholly unrealistic price, the state first guarantees the 'liquidity' of the institution and thus conveys the false impression to its depositors that their saving has led to a fructification of wealth and that their funds can still be turned into real goods on advantageous terms.

Now holding his mark, the government reassures Giles that, far from foreclosing on him, it will offer him even easier terms on which to tide himself over. In its munificence, the State may even offer to pay more than the going rate for our man's inadequate crop, so he can meet those terms, without wondering whose money it is using (or grievously diluting) to do so; without stopping to ponder whether this arbitrary privilege will disadvantage the prudent and far more efficient farmer who lives a life of blameless self-reliance just down the valley.

But if the debtor and his bank are thereby spared the consequences of their errors, what are we to do about those for whom his custom played such an important role? What else, but more loans, more subventions – and further promises that the State will buy more of their goods, too? After all, tractors can always be converted to military use, or shipped abroad under the guise of 'aid', while the now-unwanted Jacuzzis can be fitted to bathrooms in the tax-funded quarters of deserving party loyalists.

There can surely be few who would deny that a society which finds itself in such a state is poorer than it thought it was. It should also be reasonably uncontroversial to argue that the State can only undertake these actions by commandeering resources for its political purposes which free individuals would have both valued differently and devoted to distinctly other ends (otherwise there would be no crisis) and hence that, while the macro-aggregates so beloved of the Collectivists may bear up better than they otherwise might have under such policies (at least for the short run), the majority of those individuals will be worse, not better, off.

That they will become progressively worse off – at least in terms of falling increasingly short of the highest attainable trend rate of increase of real income – is harder to prove (being by way of a counter-factual), but this will nonetheless be the inevitable consequence of preventing a re-allocation of capital means and a re-ordering of the productive structure away from that built on the shifting sands of easy credit and into one much more in tune with people's voluntarily expressed needs and – crucially – one more closely consonant with the resources and techniques with which they can pursue those same needs' fulfillment.

By their fruits shall ye know them

To change analogies somewhat, imagine that Robinson Crusoe has been sending Friday out every morning with an armful of cuttings from his precious stock of mature fruit trees, supposing that his companion will spend his days grafting these onto suitable rootstocks in the fertile grounds on the other side of their shared island.

Crusoe thereby intends that Friday should both feed himself (leaving more of the existing harvest available to his master) and imagines that he, Crusoe, can rely on his entitlement to a share of the other's crop to supplement his diet when his own trees age and their yields begin to decline.

Friday, however, finds the whole process too much of a labour. Once safely out of site, he braids the saplings into a sunshade and lies snoozing in the sun until it is time to go home and share in Crusoe's evening meal.

Finally, comes the awful day when Crusoe – perhaps following one of his wayward goats along the track which leads right into Friday's resting place – discovers the fraud. His fury at being so deceived will only be matched by his horrified realization that not only has his share of consumable fruit (his income) no prospect of being augmented, but that it will soon, in fact, begin to decline as the scarce capital goods which his cuttings represented have been misused to provide unproductive shelter services – being diverted from the agricultural to the leisure industry, if you will.

What do you think our hero – and his chastened servant – will henceforth do in their attempts to head off the impending threat of scurvy? Eat more fruit? Build more sunshades? Kill a few of their straggly flock of goats and cook up a celebration supper?

No. If they have any sense, they will try to eat less while lavishing their most tender care on their existing trees and striving might and main to make up for Friday's infantile dereliction of his duties before it is too late to repair the damage so caused.

So why is it that our Lords and Masters seem to think that when half a globe's worth of Fridays turn out to have wasted the capital extended them by a few hundred million Crusoes, they should move heaven and earth in order to encourage yet more wasteful spending, whether undertaken by already hollowed-out householders or, notionally, on their behalf by eager politicos?

Having allowed – and, in some cases, actively inveigled – its citizens to be caught short of fruit, the State's remedy is not only to order in an extra 100kgs of jam, but to burn down the whole damn orchard in order to cook it!

As Ronald Reagan once wisecracked, the most terrifying thing anyone can say is: "I'm from the government and I'm here to help". Nonetheless, so terrified have the opinion makers become by the bogeyman of deflation that they are almost unanimous in their demands that even more trillions be disbursed as rapidly as possible in order to combat the slowdown (i.e., to stultify re-adjustment).

The poisoned chalice from which they are so avidly supping is that such 'help' can only result in a gross expansion of the Versorgungsstaat and so hinder the swiftest return to genuine free enterprise (that is, one not reliant on the subtle corruption of state-supported fractional reserve banking) and to that efficient allocation of private capital in the service of human needs which is our only hope for true material progress.

The blunt truth is that credit bubble – which was really the culmination of 25 years of increasing excess – has led to an enormous amount of hard-won physical capital being misallocated – whether holiday apartments in Spain, toy factories in Guangdong, container ships being laid down in Korea, dockside restaurants in the UK, or corn ethanol refineries in the American Midwest. Too much debt has been built up on the basis of real assets which were never going to throw off sufficient income to service and discharge it all.

Misplaced Keynesian attempts to 'replace' the unsustainable levels of spending which have been previously allowed to build up cannot repair such a loss, not least because the capital swords involved are far too specific to be easily beaten into ploughshares. All that can be done is to change the distribution of the loss already made, altering those on whom it falls, and changing the period over which it is recognised by an inherently arbitrary, thoroughly iniquitous method.

Sadly, such a warning will be lost on a mainstream which adheres to an utterly vacuous inversion of Say's Law – what we might call the "You Don't Say's" Law – that demand can somehow create its own supply, a typically infantile creed for the nihilist modern world of Cultural Marxism, one which degrades economic analysis to the level of over-indulgent parents showering sweets on a spoilt five-year old the minute the brat threatens to throw one of his many tantrums.

Instead, by attempting to ensure that no-one fails, the politicians and bureaucrats (especially the central bankers) may well end up ensuring that everyone fails as productivity falls, profits dry up, protectionism and mutual animosity increase to the point that the new debts become unpayable in their turn.

Moreover, with governments taking the lead role in this economic trench warfare, we can expect inefficiencies will abound and that court influence will come to count for more than cool entrepreneurship. Spending will be largely concentrated on goods, not assets and undertaken largely for its make-work possibilities - and not with an eye to earning a meaningful return on capital invested.

This means that far too many of these goods will be wastefully used or simply given away to favoured interests far below cost, as an electoral bribe. This, in turn, implies that the steep inflationary slopes which flank the far side of our present deep valley will be focused much more on things material and not on those financial, as was the case in the recent past. Commodities will not languish long at these depressed levels once this becomes more widely appreciated.

While equities, too, will initially enjoy a significant rise (at least in nominal terms) once the re-inflation makes its effects felt and optimism is rediscovered, a sober realism will quickly need to reassert itself since this will be an environment in which too many business men will henceforth not really be owners but merely outsourced state apparatchiks.

On top of this, the whole nightmare of policy inconsistency, of a contempt for profit, and of a morbid confusion of directives and programmes which made the upswing from 1933 so sickly in Roosevelt’s America could be repeated on a grand scale. President-elect Obama’s appointment of a rather incompatible mix of big-name ‘experts’ and fixers, each clamouring to have his or her own solutions to the crisis adopted, smacks worryingly of the infamous and thoroughly counter-productive ‘Brain Trust’ of his illustrious predecessor.

It will be a long time, indeed, until we learn that there is no remedy for current ills in the repetition of old mistakes.

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