

Q&A regarding 'The Global Minotaur'.(Correspondence)

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Al Goldberg, an MR reader, sent us five questions regarding our article, "The Global Minotaur" (MR July-August 2003). Answering them may help clarify a number of important issues brought to light by our article as well as issues which are always current in the wider debates within contemporary political economy. We answer his questions one by one but sometimes digress to cover other potentially interesting topics.

Q: What is "deflation"? How is "deflation" different from "recession" or "depression"?

A: The conventional definition of deflation refers to a situation of actually falling prices. Such periods were quite common in the earlier, competitive, phase of capitalism during the nineteenth century. The 1920s were also made famous by falling prices while Japan offers the latest such example. However, it must be said that conventionally defined deflation is quite a rare phenomenon under late capitalism. The main reason is the power of corporations to prevent prices from falling, or at least to ensure that they do not fall consistently and across the board.

Under the influence of corporate power (or monopoly capital), prices may fall in certain sectors where technological innovations are particularly rapid, but this process is kept in check and translates into a fall in average prices very, very rarely. The main mechanism by which corporations maintain prices, during periods of reduced demand, is through reductions of output. Hence instead of falling prices (i.e., price deflation) we observe what is called "real deflation"; that is, reductions mostly in output and employment. When such a state of affairs materializes the economy is said to be in a recession.

In the United States the economy is officially declared to be in a recession when output falls during two consecutive quarters. But this is a silly definition since it is quite clear that we are in the throes of recession even if, following one quarter of fallen output, output fails to pick up and instead remains fluctuating around that low level.

When recession proceeds for a while, with output falling in successive quarters, and then gets stuck at a low level without a visible tendency to rise again, we say that we are in a depression. This is usually associated with large loss of output, idle factories, a high bankruptcy rate, and also with a fall in prices. Although the most famous world depression occurred in the 1930s, the United States had already experienced two earlier depressions, one in the 1870s and one in the 1890s, which have received much attention from economic historians. It is indeed interesting to compare the depression of the 1870s with the Great Depression of the 1930s. While the former manifested itself in terms of falling prices, the latter was characterized by a catastrophic fall in output and employment. It is for this reason that many of us think of the Great Depression as the first significant crisis of the era of monopoly capital (recall how the latter manages to shield prices from falling while diverting the crisis onto output).

An excellent study undertaken by Congress in the late 1930s showed the extent of the catastrophe that was the Great Depression (U.S. National Resources Committee, *The Structure of the American Economy*, 1939). Prices in the most concentrated sectors fell only slightly, between 10 percent and 15 percent, while output collapsed by 60 percent to 75 percent, thereby making it nearly impossible for industry to continue producing at a profit. By contrast, in the less concentrated sectors (such as footwear and apparel), while output still fell by 25

percent to 30 percent, prices declined by an equally significant percentage. The depression of the 1930s also highlighted the crucial divide between raw materials and food producing areas and industrial centers. This divide operated both within the United States and globally. As the depression started to bite, American agricultural output was basically stable, even moderately expanding. However, prices fell by more than 50 percent generating widespread foreclosures and bankruptcies in the farming sector. Thus people were evicted from the land, because farm revenues were collapsing, while workers were losing their jobs, as factory production slowed.

The depression was transmitted to the underdeveloped countries through the catastrophic collapse of the demand for raw materials. In Latin America in general, and Brazil in particular, the crisis led to the inception of nationally based import substitution policies. After the Second World War the imperialist countries managed to keep price deflation in check, at least in the primary product sectors, by creating price support schemes and subsidies of all kinds. The latter benefited the multinationals producing fertilizers and new seeds.

Underdeveloped countries have never managed to overcome the systemic deflation in raw material and agricultural commodity prices. Thus their behavior is characterized by brief periods of boom and long periods of bust. During booms they attract capital, thereby becoming indebted to multinational banks and finance companies. However, when the bust comes, accompanied as it always is by severe devaluation of local currencies, they lose financial resources through the process of capital flight. Thus underdeveloped economies are plagued by systemic indebtedness, even if they often have surpluses in their balance of trade.

Q: How does the buying and selling of oil in U.S. dollars (petro-dollars) enable the United States to "continue its policy of world dominance through an unbounded balance of payments" (p. 66)?

A: Take a small country like Thailand. Why would anyone in the United States or China want to buy Thai bhat? The only possible reason is that either she wishes to travel to Thailand (in which case she will want to buy some local currency for day-to-day expenses while visiting) or she wants to import Thai goods or services into her own country. Thus, the demand for the bhat is related directly to the demand for Thai output. Similarly, Thais will wish to sell their currency in exchange for, say, euros if they want to buy something from Europe (or visit Athens, Paris, or Berlin). Thus, the value of Thailand's currency depends on the balance of trade between Thai exported output and the output of other countries imported into Thailand. It is in this sense that currencies like the bhat are said to be bounded by their economy's balance of payments.

Consider however a country whose currency is demanded independently of its output. Let's say that, for some unspecified reason, the Chinese were to demand bhat in order to purchase coal from Australia. Suddenly, the value of the bhat is liberated from the clasps of Thailand's balance of payments. For even if Thailand is running a balance of trade (or payments) deficit, as long as China is demanding increasing amounts of bhat to purchase coal from Australia, the demand for the bhat (and thus the value) will be more or less stable even if Thailand's balance of payments is deteriorating.

Of course for this to occur, Australia must have a reason to demand payment for its coal in bhat. In effect, this would only happen if the bhat were the currency in which coal is traded internationally. In conclusion, when a hugely significant energy source, like oil, is denominated in one currency only (the U.S. dollar), that currency is cushioned from fluctuations in the balance of payments of the country issuing it. This is why the U.S. dollar is not subject to the constraints facing other currencies. Saddam Hussein's decision to sell Iraqi oil in euros, as opposed to dollars, and the threat that Iran might follow suit, posed a direct and immediate

danger to the American economy's capacity to run a deficit without at the same time devaluing the dollar.

In the context of the U.S. dollar's global hegemony, the indebtedness of areas like Latin America (and the severe deflations and recessions in countries like Brazil, Argentina, and Mexico) have been an important element in validating the international position of the U.S. dollar despite the huge U.S. external deficits. Surely no challenge to the U.S. currency could come from those countries since their ruling classes permanently demand dollars in order to protect their wealth from their very own actions which lead to a persistent economic crisis in their backyards.

Moving further afield, the same applies to other dollarized areas such as Central Asia or Russia. The latter has a large balance of payments surplus originating in two related developments: First, domestic incomes (and thus demand) collapsed after the Soviet Union ceased to exist. Second, Russia is exporting huge quantities of oil and gas at a time of increasing energy prices. Now, because of the collapse of Russia's economy (outside the energy sector), the dollars thus obtained by the oligarchs (who control the energy sector) are not invested in the Russian economy. They are instead tied up in financial activities both legal and illegal, and mostly abroad. (Recently one of these Russian oligarchs caused a sensation in England by buying the Chelsea Football Club and spending fabulously to attract star players.) The crucial point here is that all of these activities are denominated in dollars.

Thus, given the present power and class structure in Russia, dollars will always be preferred to the domestic ruble and also to the euro. It is precisely the large outflows of money from the United States which make dollars so easy to acquire compared to euros. This suits the financial and speculative-cum-criminal needs of the Russian oligarchs. From the examples given above, notice how the deeper the state of crisis in any one country, the stronger is the position and the acceptability of the dollar and of the U.S. financial system regardless of the deficit in the American balance of payments.

Q: The U.S. runs a trade deficit, that is, it imports more from the world than it sells to the world. This excess of dollars by the importers is invested in U.S. treasuries. How does this excess of dollars place the rest of the world "in a state of permanent deflation" (p. 73)?

A: When it comes to the developed capitalist countries, representing the imperialist core of the world economy, the situation is rather different. These countries rely on their domestic currencies and would not want to depend permanently on the U.S. dollar. Currencies like the yen and, until recently, the deutschmark and the French franc, embody the strength and the international purchasing power of their underlying capitalist economies. After all, the merger of these currencies into the euro is nothing but a stage in a process aimed at the formation of a Europe-wide system of integrated monopoly capital. Thus for countries like those of the EU's eurozone, and also for Japan, the holding of dollar denominated assets is not a permanent compelling necessity but depends on the circumstances. One important element is the state of the economy.

Take for instance the clash between France and the United States in 1965, when President Charles de Gaulle wanted to change the dollar holdings of the Banque de France into gold (as was allowed by the Bretton Woods agreements). The French economy was then operating at near full capacity and full employment while exports to the rest of Europe, especially to the rest of the Common Market, were booming. The source of profit was the practice of setting prices which reflected good profit margins and selling more output. Thus the interests of the

corporations, especially in newly reconstructed European capitalism, lay in expanding real investment and real capital accumulation.

Now, let us bring into the picture the incipient balance of payments deficit of the United States. The deficit, due mostly to American spending abroad for imperial purposes (e.g., the Vietnam War), was actually good for the European economies. It allowed them to build up reserves so that they could buy raw materials, such as oil. But, at the same time, a glut of dollars meant a persistent U.S. deficit which was in turn thought to unsettle the international payments regime, by putting pressure on exchange and interest rates. Liquid dollar holdings in Europe created the Eurodollar market which tended to be short-term and speculative in nature thereby clashing with the longer term plans both of corporations and the state.

Furthermore, as was pointed out by the MR editors at the time, the outflow of dollars to Europe put U.S. corporations in a good position to undertake mergers and acquisitions. Again this clashed with the French (but also with the German and Italian) objectives of strengthening their own capitalist groups. Last, but not least, with inflation accelerating in the United States due to the Vietnam War and the military spending boom, European financial capitalists were holding a currency that was depreciating in terms of its purchasing power in the United States. Thus France wanted to get rid of the unwanted dollars by exchanging them for gold.

Notice though that de Gaulle could only take such a step because: (a) France was a developed capitalist country; (b) the French economy was booming and its import dependency upon the United States was being reduced effectively; and (c) French international trade was being redirected increasingly towards Europe (mostly thanks to the European Common Market formed under U.S. auspices in 1957). Eventually France relented because of the enormous political pressures exerted directly by President Lyndon Johnson and indirectly via the West German government. But the dollar bluff was called and confidence in the Bretton Woods agreement began to wane rapidly.

Let us now take another example related to today's situation. U.S. deficits are much larger now, as a proportion of gross domestic product (GDP), than in the mid-1960s. Throughout the 1980s, and especially the 1990s, net exports to the United States were the only dynamic component in otherwise stagnant European economies. This is particularly true for the countries that now form the eurozone. Exports to the United States were very important also in the stimulation of domestic investment. Yet U.S. external deficits were not being questioned at all. In part this can be explained by the speculative bubble which drew money from Europe to Wall Street. Yet, when the dollar began to devalue after the bubble burst in 2000, the Europeans, after boasting briefly about the international strength of the euro, began to panic and started to buy dollars to shore up its value with the purpose of enhancing their exports to the United States.

Why were they so obsessed with exports to the United States that they would accept any dollar payment? Because their own markets in Europe were stagnant and incapable of absorbing their output. Thus, Latin America's and Russia's dependence upon the dollar is predicated upon the implosion of their respective economies, while Europe's and Japan's willingness to accept dollars and recycle them into the U.S. financial system is explained by their stagnation which compels them to seek export outlets.

So it seems to us that, on the whole, "excess dollars" are an acceptable global form of payment not because of the strength of the U.S. economy but because of (a) the crisis and stagnation buffeting the rest of the world, and (b) the ability of the United States to impose the dollar as an international means of payments (e.g., in the energy industry). The latter is crucial, for it is the

essential mechanism which creates a demand for dollars not tied to the specific requirements of the U.S. economy. Oil, being the prime energy source worldwide, fulfils this purpose admirably.

Q: Wouldn't the stagnation of Europe's and Japan's economies be caused by "global excess capacity and a problem of markets" and not by a capital drain (p. 66)?

A: It is of course possible to imagine a nightmare scenario in which all economies suffer excess capacity, deficient aggregate demand, and, therefore, the whole world is in a state of generalized depression. This is indeed, more or less, what happened in the 1930s. However, what we have seen in recent years is a situation in which the United States has been growing relatively rapidly for an unprecedentedly long period (one that, even when it stopped, did not give its place to a serious recession) while Europe and Japan are stagnant. Instead, however, of capital moving from the booming to the stagnating parts of global capitalism, we observe that the U.S. boom was being financed by burgeoning debt, which was in turn supported by capital transfers from the stagnant economies of Europe and Japan. Thus, we argue, there is a strong causal link between Europe's and Japan's stagnation, on the one hand, and the flight of capital from those countries toward the U.S. economy on the other.

Q: And wouldn't the U.S. "boom" be caused by ever increasing debt financed by the foreign purchase of U.S. treasuries?

A: Of course. But the interesting question is: Why would non-Americans continue to fuel that boom by purchasing U.S. treasuries at a time of increasing U.S. deficits, indebtedness, and a catastrophic balance of payments? We hope to have answered this burning question above.

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