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Capitalism: Sovereign Debt, Quantitative Easing (QE) and the Vortex Economy

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Bill Geddes
27th June 2012 (updated 29th Sept. 2012)

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Where Has All the Money Gone? 🐻

Winter has come; the last leaves have blown from the deciduous trees; their bare branches are silhouetted against a threatening, grey sky. There is a chill wind blowing squalls across the property. The chores are done, it's time to go inside, stoke up the fire and... ?

So here I am, sitting at my desk, trying to find a reason not to succumb to the common early winter depression to which human beings so easily fall prey. And this year that is not as easy as usual.

About Predators, Predictions and Vultures 🐻

Bloomberg is providing a background irritant to my thoughts (what a depressing view of the world they paint!). Apparently George Soros and one of his former advisors are predicting that Japan will soon default on its obligations. Its sovereign debt will soon reach 215% of GDP. Why isn't it panicking?¹

Perhaps George is hoping for another roller-coaster ride as markets overreact and the Japanese yen finds itself under attack. I hope not². I had thought that he'd grown a conscience since the 1980s!

Perhaps I'm being overly suspicious of his motives (and perhaps leopards really can change their spots!). Does he really think that the Euro is under such dire threat that he also needs to issue a warning about its future? Why does all this remind me of the dangers of predators' predictions?

Thomas More (1516), in his book *Utopia*, expressed his opinion of this kind of predatory behaviour:

...the nobility and gentry, and even those holy men the abbots, not ...thinking it enough that they, living at their ease, do no

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good to the public, resolve to do it hurt instead of good.³

The vultures are circling in the skies above Burma – or is it Myanmar? There's money to be made if and when they open their borders to international capitalist exploitation.

When the resources have been exploited and the generated wealth syphoned into the global fund management pool; will it be just another carcass, picked clean and left to be reclaimed by the jungle?⁴

Will its people join the millions in the region already providing cheap labor for capitalist enterprise?

As that ruthlessly unscrupulous entrepreneur and wheeler-dealer Cecil Rhodes⁵ put it in the 1890s:

We must find new lands from which we can easily obtain raw materials and at the same time exploit the cheap slave labor that is available from the natives...

(see [Capitalism and its Colonies](#)).

As has been said before: the more things change, the more they stay the same!

Tautologies, Printing Money and Simplistic Models

Pleonasm

So, in the US, 'The Fed' has decided not to indulge in 'QE' this time round⁶ (how easily the acronym rolls off the tongue now). At least 'Chairman' Alan Greenspan calls it for what it really is – 'printing money'!

How deferential the interviewer is: treating him like a member of US royalty. And he was in charge, or asleep at the wheel, when we all drifted into the current mess. But, of course, that was no great surprise! He has, for many years, been an Ayn Rand acolyte – a master of tautology! As Rand (1971) expounded in this delightful pleonasm:

I am not primarily an advocate of capitalism, but of egoism; and I am not primarily an advocate of egoism, but of reason. If one recognizes the supremacy of reason and applies it consistently, all the rest follows.⁷

Even now Greenspan can't bring himself to admit that the US 'New Deal' Glass-Steagall Act of 1933 had any merit (see [Protectionism](#) for more on this)! No wonder the FDIC was impotent during his reign.

Printing Money

But he is right about one thing – printing money won't solve the current sovereign debt crises around the world! An editorial in *The New York Times* entitled 'Quantitative Easing' summed it up:

... When times are so dire that banks are reluctant to lend or borrowers to borrow whatever the cost, interest rate cuts lose their punch... In those circumstances, central banks turn to what economists call "quantitative easing" — unorthodox methods of pumping money into an economy and working to lower the long-term interest rates that central bankers do not usually control....

The initial quantitative easing program saw the Fed buy \$1.75 trillion in debt held by Fannie Mae and Freddie Mac; mortgage-backed securities and Treasury notes between November 2008 and May 2010. A second round, dubbed QE2, involved an additional \$600 billion in long-term Treasury securities purchased between November 2010 and June 2011.

The Fed began "Operation Twist" in September 2011 with a pledge to swap \$400 billion in securities. The extension announced in June will involve swapping bonds worth \$267 billion more.

(The New York Times, Sunday, June 24, 2012)

And, this is the tip of the iceberg of quantitative easing debt, added to the sovereign debt of countries around the world, over the past five years. No wonder nations are beginning to falter under the weight of the debt they now carry!

What is significant is that all the additional money pumped into world economies since 2008 has not yet resulted in massive stagflation problems⁸. So, if it hasn't produced 1920s boom conditions⁹, and it hasn't produced the stagflation problems of the 1960s and 70s¹⁰, where has all that money gone?

Simplistic Models

In the simplistic models to which too many politicians and economists are addicted, pumping money into the economy through financial

institutions should result in increased lending at cheaper interest rates. This should stimulate both consumption and productive enterprise. That increased activity should result in:

- job growth,
- consequent reductions in unemployment rates,
- generation of new wealth, itself recycling into the economy,
- resulting in 'a take-off into self-sustained economic growth'
- and consequent communal and individual wellbeing.

It sounds so logical – inevitable even! Yet, it hasn't happened!

Here we are, half way through 2012, and unemployment levels in Western countries have grown, not shrunk. Investment has stalled. There are increasing numbers of destitute people thronging the highways and byways of our cities – and even our country towns.

Nations are teetering on the brink of bankruptcy, and banks are still under threat! And all this was supposed to have been prevented by the wide range of 'stimulus packages' devised by our brightest economists and implemented by compliant governments. What on earth has gone wrong?

It appears that over the past forty years, since the triumph of neoliberalism in Western nations¹¹ and the elevation of the Greenspan of this world into positions of power, two interconnected economies have emerged:

- There is the economy upon which the vast majority of people in the world depend for economic wellbeing: the mundane economy of productive enterprise which generates jobs and incomes and has, in the past, funded community needs¹².
- And, feeding on it and crippling and distorting its activity, there has emerged another, a vortex economy; one which could not have emerged in its present form in the age of [protectionism and regulation](#). It is populated by a new breed of capitalists, dedicated to unregulated internationalized financial manipulation¹³.

The players in this emergent economy accept no responsibility for, or commitment to, the stimulation and maintenance of employment and social welfare. This vortex economy, syphoning wealth from the 'real'

economy, produces a global fund management pool, a largely illusory realm of internationalized electronic wealth manipulation, relocation, redistribution and aggregation.

The Vortex, the Global Fund Management Pool and Stalled Economies

In the interface between the mundane economy of material production and consumption and this new, emergent, internationalized economy, money is removed from general circulation, accumulating within various 'investment' portfolios.

Vast sums are employed in securities, derivatives, currency and equities trading, entering an illusory realm of internationalized electronic wealth manipulation, relocation, redistribution and accumulation; decoupled from the realities of the stimulation and maintenance of both employment and social welfare; much of it no longer accessible to fund community needs.

As a Wikipedia entry on the [Size of the global fund management industry](#) in 2010 explained:

Conventional assets under management of the global fund management industry increased by 10% in 2010, to \$79.3 trillion. Pension assets accounted for \$29.9 trillion of the total, with \$24.7 trillion invested in mutual funds and \$24.6 trillion in insurance funds.

Together with alternative assets (sovereign wealth funds, hedge funds, private equity funds and exchange traded funds) and funds of wealthy individuals, assets of the global fund management industry totalled around \$117 trillion.

Growth in 2010 followed a 14% increase in the previous year and was due both to the recovery in equity markets during the year and an inflow of new funds.

(Accessed 8 June 2012)

A great deal of that asset accumulation is a consequence of an inevitable concentration of wealth and stalling of market exchange resulting from apparently equitable market exchanges¹⁴ (see [Iglesias and de Almeida \(2012\)](#)).

Many current models of wealth generation and flow assume a cyclic

process, with created wealth invested to fund new productive growth, ensuring both employment and social welfare. The emergent unregulated system however, appears more closely to resemble a spiral than recyclic model.

Wealth injected into the system spirals upward to pool within global fund management portfolios. The recycling which occurs at this level is, far-too-often, a process which remains trapped within the global fund management industry.

Wealth exchange and growth become insulated within a kaleidoscopic virtual realm, creating a world of virtual wealth manipulation with its own experts, entrepreneurs, risk and profit takers¹⁵, far removed from the mundane world of productive material enterprise, employment and social welfare.

In most recyclic models of wealth generation and flow, no distinction is made between the health of such global funds and the health of productive enterprise. So, it is easy to confuse the two, assuming that, in order to ensure the health of productive enterprise, one must ensure the health of global fund management portfolios¹⁶.

This has resulted in massive bailouts of the global fund management industry, with the funds absorbed into that realm having a marginal or negative impact on employment and social welfare conditions. Under these conditions, the injected 'quantitative easing' funds bypass their intended targets and move directly into the global fund management pool.

This results in a number of problems:

- the global fund management pool grows rapidly, giving an illusion of economic stimulus and consequent 'health';
- productive enterprises, the intended targets of the 'stimulus packages', find themselves scrabbling for crumbs from the table of vortex economic activity¹⁷;
- sovereign debt, the putative original cause of all the problems, rapidly expands;
- social welfare rapidly deteriorates as governments are pressured into 'reducing costs' in order to reduce sovereign debt (resulting as much from 'quantitative easing' costs as from social welfare and government administration costs – which, themselves, are all-too-often a result of an exclusion of

community costs from basic production costs¹⁸);

- and, with rapidly diminishing purchasing power, communities and individuals rein in their spending, retail activity contracts and market activity stalls.

Far from addressing the problems of the mundane economy, quantitative easing has magnified them.

We need to ensure a true recycling of funds from the global fund management industry back into the real-world realms of employment and social welfare¹⁹. To do this, it is essential that the pooling of wealth within the vortex economy is short-circuited, that processes are established through which wealth can be redirected back into both employment and community needs²⁰.

As Iglesias and de Almeida (2012) suggest: "To avoid condensation and the thermal death of markets some regulation, or some minimum allowance is necessary..."²¹. Their explanation:

...in a large class of exchange models, the system converges to a very unequal condensed state, where one or a few agents concentrate all the wealth of the society while the wide majority of agents shares zero or almost zero fraction of the wealth. So, in those economic systems a minimum entropy state is attained.....

Numerical results..., as well as some analytical calculations..., indicate that a frequent outcome in these models is *condensation*, i.e. concentration of all available wealth in just one or a few agents. This final state corresponds to a kind of equipartition of poverty: all agents (except for a set of zero measure) possess zero wealth while one, or a few ones, concentrate all available resources. In any case the final configuration is a stationary state of "equilibrium", since agents with zero wealth cannot participate in further exchanges.

...Making a parallel between physics and markets, if the second law of thermodynamics, when applied to the whole universe, has as a corollary the "thermal death of the universe", the concentration – or condensation – of wealth leads to a "thermal death of markets", since markets need exchanges, or flux of capital, to survive.

If all agents, with a few exceptions, have zero wealth, there are no exchanges.... What seems to be a fair exchange rule has the implication of spreading misery.

To avoid condensation and the thermal death of markets some regulation, or some minimum allowance is necessary to favor the poorer agents. Even the introduction of a risk-aversion factor, as discussed in the introduction does not impede the condensation. When there are no regulations and/or when no one can win more than he has, the dynamics leads to a condensed state and to a frozen economy.
(2012, pp. 85, 87, 90-93)

Ah, the sun has struggled through the clouds. It's time to turn that intellectual irritant off (Bloomberg I mean); to meander through the gardens with the dogs! Life can be pleasant if you don't examine its flaws too closely or take them too seriously!

See, the depression has lifted, the sun is shining!

End Notes

- ¹ What a pity that Japan is following the well-trodden post-1970s path of Western governments: increasing retail taxation rather than building sovereign debt funding into its base economy.
(For more on all this, see '[A comparison of holders of sovereign debt in various countries](#) ', also '[Japan's apparent ability to ignore its deficits](#) '.)
- ² See '[Speculators Tell The Story Of Their Attack Against The Baht](#) ' for the kind of activity this sort of speculative prediction can trigger.
- ³ See [The consequences of the disenfranchising of the peasantry of England in the early 16th century](#) for more on this.
- ⁴ See [As Isolation Ends, Myanmar Faces New Ecological Risks](#) (Charles Schmidt, *Science* 17 August 2012: Vol. 337 no. 6096 pp. 796-797) for more on this, as the author says:
Myanmar's environment is at a crossroads, its fate hinging on how recent reforms reshape the country.
- ⁵ How well he would have fitted in to this 21st century! I'm certain that Bloomberg commentators would have treated him with deference and canvassed his views on what should be done about the current difficulties around the world!
- ⁶ Twelve weeks later (14th Sept. 2012) and, as Robin Harding,

writing for the *Financial Times*, put it:

The US Federal Reserve has [launched an open-ended effort](#) to spark recovery by injecting an extra \$40bn into the economy each month through purchases of mortgage-backed securities.

Unlike previous programmes, the Fed's third round of quantitative easing – nicknamed QE3 – does not have a defined limit and will continue until the labour market improves.

(Robin Harding, *Financial Times*, September 14, 2012, [Bernanke takes plunge with QE3](#))

⁷ (Rand, Ayn, "Brief Summary", *The Objectivist* 1971 Vol. 10 No. 9 p. 1) The flaw in all this, of course, is that since reason flows from one's ideological understandings, it inevitably reflects those and we're trapped in a tautology (similar logic to that underpinning the monetarist policies Greenspan advocated and pursued).

⁸ Though there are worrying indications that if it is continued this might be around the corner – as an increasing number of commentators are now suggesting.

⁹ See [Quantitative Easing, Financial Collapse and Protectionism](#) for more on this.

¹⁰ See [Neoliberalism: A Cure for Economic Stagnation](#) for more on this.

¹¹ See [The Triumph of Neoliberalism](#) for more on this.

¹² I think they call it 'Main Street' in the US; in contrast to that other thoroughfare, 'Wall Street', that increasing numbers of people are seeing as part of the problem rather than the solution.

¹³ See these Bloomberg reports for some of the bizarre consequences of kaleidoscopic, unregulated or poorly regulated vortex economic activity:

Editorial (Aug 7, 2012), [Knight Blowup Shows How High-Speed Traders Outrace Rules](#); and

Whitney Kisling and Nina Mehta (Aug 7, 2012), [Joyce Puts Knight Survival Over Shares in Rescue Deal](#)

¹⁴ See [A serious concentration of wealth in the hands of a small number of companies](#) for more on this.

¹⁵ When those involved in this activity speak amongst themselves

they tend to distinguish their activities as 'trading' in contradistinction to 'investment' activity. It is commonplace to hear 'traders' speak of 'trading and investing' as separate realms, each with its own resources, experts, and *raison d'etre*.

Since potential profits (and, of course, losses) from trading are often much higher, and more immediate, than those from investment activity there tends to be a disproportionate emphasis on trading over investment, with lower levels of wealth funding being available for 'investment' than for 'trading'. When trading results in significant losses, 'investment' funds are all-too-often tapped to cover them.

A great deal of what is classified as 'investment' funding is directed not into mundane economic activity but into various corporate acquisition/takeover/raiding activity which has marginal to negative impact on employment and social welfare.

(See Peter Lattman and Eric Lichtblau, *New York Times*, October 10, 2012, [E-Mails Cited to Back Lawsuit's Claim That Equity Firms Colluded on Big Deals](#) for an example of this kind of activity).

¹⁶ Of course, pension assets and mutual funds do need to be protected – at present they are all-too-often poorly differentiated from other global fund management activities – but this is best done through similar guarantees to those provided to bank deposits under US FDIC regulations, not by providing a blanket stimulus package to the global fund management sector. (See [Federal Deposit Insurance](#) for an example of this kind of insurance, also [A History of the FDIC 1933-1983](#) for a historical contextualization.)

¹⁷ Productive enterprise funding, classified as 'investment' activity, is provided from the 'investment' resources of the global fund management pool. Such investment usually provides lower and slower potential profit margins than the various 'trading' activities of the vortex economy and funding costs reflect this difference.

The recent Libor (London Interbank Offered Rate) scandal of 2012, through which banks subverted the intent of various stimulus packages by manipulating interest rates, all-too-often resulted in increased costs to borrowers. This rate manipulation scandal, while serious, is, however, a diversion from the far more important problem of unequal competition

for funds between longer term 'Main Street' investment needs and shorter term 'Wall Street' vortex economic activity.

See [New York Fed Knew of False Barclays Reports on Rates](#), (Michael J. de la Merced and Ben Protess, *New York Times*, 14 Jul 2012) for some of the consequences of Libor manipulation in the post-2008 era. As the authors report,

"As much as \$800 trillion in financial products are pegged to Libor, so any manipulation of this rate is of serious concern," said Representative Randy Neugebauer, the chairman of the House Financial Services Subcommittee on Oversight and Investigations, which initially requested the documents from the New York Fed. "We'll continue looking into this matter to determine who was involved in this practice and whether it could have been prevented by regulators."

For a relatively straightforward explanation of all this, see [Breakingviews: Guide for the perplexed: Libor litigation](#) (*Reuters Breakingviews*, July 12, 2012) This manipulation, of course, directly influenced the effectiveness of quantitative easing activity, since it controlled interest rates to the advantage of the banks.

Such deliberate manipulation might well be shown to be illegal. However, the major problems of inflated costs of financing for 'Main Street' are due to legitimate competition for funding between vortex economic activity and economic activity in the mundane economy of productive enterprise which generates jobs and incomes and has, in the past, funded community needs.

¹⁸ Paul Krugman has spelt out some of the problems facing people in countries being required to 'reduce costs':

Why, then, are there demands for ever more pain?

Part of the explanation is that in Europe, as in America, far too many Very Serious People have been taken in by the cult of austerity, by the belief that budget deficits, not mass unemployment, are the clear and present danger, and that deficit reduction will somehow solve a problem brought on by private sector excess.

Beyond that, a significant part of public opinion in Europe's core - above all, in Germany - is deeply committed to a false view of the situation. Talk to German officials and they will portray the euro crisis as a morality play, a tale of countries that lived high and now face the inevitable reckoning. Never

mind the fact that this isn't at all what happened - and the equally inconvenient fact that German banks played a large role in inflating Spain's housing bubble. Sin and its consequences is their story, and they're sticking to it.

Worse yet, this is also what many German voters believe, largely because it's what politicians have told them. And fear of a backlash from voters who believe, wrongly, that they're being put on the hook for the consequences of southern European irresponsibility leaves German politicians unwilling to approve essential emergency lending to Spain and other troubled nations unless the borrowers are punished first.

Of course, that's not the way these demands are portrayed. But that's what it really comes down to. And it's long past time to put an end to this cruel nonsense.

If Germany really wants to save the euro, it should let the European Central Bank do what's necessary to rescue the debtor nations - and it should do so without demanding more pointless pain.

([Paul Krugman, *New York Times*, September 27, 2012, Europe's Austerity Madness](#))⁴⁰

There is, all-too-often, an apparently ideologically induced blindness to the logical absurdity of attempting to address the problems of unmanageable sovereign debt by expanding sovereign debt through quantitative easing! This results in an equally ideologically driven insistence on eroding social welfare and government activity in order to 'lower sovereign debt'. (See [Public-Private Partnership: We need to 'Stimulate' Private enterprise](#) for more on this.)

As in Greece, the necessary reductions in social welfare and government costs, required to cover the quantitative easing driven growth in sovereign debt, result in social chaos and governmental paralysis. And this, all-too-often, merely reduces sovereign debt to pre-quantitative easing levels. As Michael Birnbaum ([Deal reached on \\$170 billion Greek bailout](#), *Washington Post*, February 21 2012) explained:

...unemployment has already spiked to 21 percent — 49 percent for those younger than 25 — and the economy contracted by 7 percent in the third quarter of 2011.

Europe has demanded that the public sector shrink by 150,000 people, that the minimum wage be lowered by 22 percent, that pensions be cut and that Greece do more to

sell off its publicly owned companies, among other measures that filled a 50-page booklet.

See [Economic Efficiency and the Virtues of De-Regulation and Businesses have always seen social costs as externally imposed, avoidable costs](#) for more on this.

¹⁹ See Sarah Anderson (*Institute for Policy Studies* June 21, 2012) [Letter From Financial Industry Professionals in Support of Financial Transaction Taxes](#) for a letter addressed to G20 and European leaders from 52 financial industry professionals recommending financial transaction taxes be instituted. As the letter says,

Dear G20 and European leaders,

As individuals with first-hand knowledge and significant experience in the financial industry, we urge you to introduce small financial transaction taxes (FTTs). These taxes will rebalance financial markets away from a short-term trading mentality that has contributed to instability in our financial markets. They also have the potential to raise significant revenue.

²⁰ The most direct and certain ways in which wealth investment redirection might be achieved are modified and adapted versions of those spelt out by [Roosevelt and his team in the 1930s](#).

Of course, any attempt at such re-regulation would directly challenge some of the most powerful financial corporations in this brave new world. Any government which attempted such re-regulation would face powerful opposition. This would require very determined and coordinated 'bloc politics'. See [Capitalism: global restructuring, sovereign debt, benign bloc politics, safety nets](#) for more on this.

²¹ See Iglesias and de Almeida [Entropy and equilibrium state of free market models](#), *The European Physical Journal B – Condensed Matter and Complex Systems*, Volume 85 (2012), Number 3, 85-95

⁴⁰ (A word of caution on Krugman's position: Krugman believes in the virtues of free trade and globalization, however, he wants to mitigate the effects of the consequences. So, he writes as a person concerned for mitigating effects, while still supporting the fundamental causative policies. Rather like a Climate Change Denier who, while believing that climate change isn't happening, sees the consequences and wants to mitigate their



impacts in people's lives.

Much of the confusion which people often feel in trying to come to grips with economic solutions to social problems stems from similar mismatches between basic economic presumptions and massaged explanations/mitigations of social outcomes. The consequence is that for many, economics seems to be just too difficult to get one's head around: "The confusion I feel must be because I am missing something!!")