THE LAW OF VALUE AND THE GLOBAL FINANCIAL CRISIS
/or what are the real reasons for the current economic slump/

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The modern world is in the vortex of an unprecedented as yet crisis. Nobody is capable of predicting neither the scope of the Slump nor its depth. Not to mention its duration.

Most publications related to the global financial crisis concern only the external symptoms of the Slump without looking into its deep reasons and driving forces. Given that, the risk of repeating the crisis in the foreseeable future is not only probable, but almost certain. This paper aims at focusing the attention of the leading economists, politicians and administrators to the forgotten laws and regularities of market economy, underlying and steering the driving forces of the global financial crisis.[1]

I

Everybody is panic-stricken. The government of the economically most powerful nation, where the crisis was generated, most likely advised by the same financiers, who gave rise to the crisis, infuses over 700 billion dollars of the budget, i.e., inflationary money in order to forestall the spreading fire, but instead of being put down, it is vehemently blazing up.

The other governments of the leading economic nations across the world are trying to do the same. Not a few thinking people around the world are asking themselves – is there anybody to explain to those gentlemen that a fire cannot be extinguished by what has kindled it? To put it differently, the burst-out fire cannot be put down or neutralized by

[1] For more details see Mihailov, Em., V. Adamov. Theory of Money and Credit. V. Turnovo, ABAGAR, 2004.

infusing additional inflationary money supply, which is useless to economic turnover.

It has turned out that there is nobody to explain all of this. Or, if there is someone, there is none to hear them out. In the course of over two generations in the West everybody has studied economy and economic policy based on the so-called "economics", which is an alleged scientific counterfeit of political economy and economic science at large. "Economics" can teach us almost nothing about economic laws and the nature of the key value categories and mechanisms of market economy such as money, credit, interest, inflation, etc… Even the functions of money are turned upside down. Instead, in the textbooks of economics there are hundreds of pages dedicated to money supply and demand with all sorts of graphs, models, etc… The rest of the textbooks are full of material related to "making money", an issue which is critical to businesses. However, there is no explanation anywhere that "making money" cannot be an end in itself; that money is not the end, but the means of achieving progress and prosperity. Moreover, should there be no real high-quality and market-demanded goods and services behind this money the latter is instantly turned into a useless attribute of economic life. The millions of money created in this fashion exist only on account or virtually and cannot be transformed into real assets.

For over two decades now economic scientists – financiers and dealers on financial and other markets as well as politicians and administrators have been ignorant of the fact that capitalist economy is steered by the "invisible hand" of the objective economic laws and whenever we do not comply with them they hit us hard.

The demonizing of gold and the transformation to paper and equivalent monetary systems does not obliterate the operation of the economic laws. The well-known thought of Lord Keynes on the English Bank`s gold, which must lie "dead" in its vaults so that politicians and administrators employ economic regulators has been in fact realized rather perversely – in an unscrupulous and speculative money-making and hollow profits. Under these circumstances the economic laws elbow their way, hard as it is, and “impose their willpower” via crisis manifestations such as deflation, deflationary depression and, of course, hyperinflation. All of those are **contemporary forms of the global financial crisis manifestation.** All of this is rather unintelligible and hard to explain owing to the reasons emphasized above.

It is no accident that hundreds and already thousands of specialists from countries with a developed market democracy in large numbers are looking for and buying the most well-known economic work of the forgotten by all of us in recent years Karl Marx – “Capital”. To meet its solvent demand the printing houses in the USA, England, Germany and France cannot manage to print it.

Thinking pundits intuitively feel that thence they can learn something they have not studied and do not know. And that “something” will not only give them an explanation of what is going on right now in economy, but they are also hoping that it will save a part of their wealth. However, they know that “Capital” is nor economics; that in it are lacking the primary formalities filling up the contents of economics.

Neither do they know that “Capital” is difficult to read and understand and, therefore, one needs a lot of time, effort and a solid package of key economic knowledge to comprehend it. The kind of knowledge they do not have. In compensation they can find it in another landmark economic work, even longer forgotten. The case in point is “The Wealth of Nations” by Adam Smith.

Then and then only will they be able to understand that the first three chapters of “Capital” devoted to value, commodity and money are at the root of comprehending what is happening today on current financial markets. However, we need to point out that the first three chapters of “Capital” have been “skipped” by the “old” political economists from the former socialist countries as well as by those from the Western democracies. Very few were indeed those who understood it. But nobody wanted to understand them. Not to mention the socialist party high-profiles and their functionaries who wrecked the “communist experiment”…

The culprits for the crisis are not the “golden boys” of Wall Street and the administration of the weakest recent president of the USA as he is called by thinking Americans. Nor is the greediness of the dealers /as yuppies in our country reckon/ the sole reason for the slump. The latter just pursued their material interests and benefited from the existing situation in economy.

The aspiration for profit, even the greediness and avidity in the pursuit of this profit have always been and always will be the driving force of economic and social progress under capitalism. And this can hardly be denied or repealed by anybody.

The current global crisis is just the second critical indicator in this respect following the Great Depression. The third indicator will be the last one and, I hope we get away with it. i.e., I hope we get wiser sooner. The prominent American analyst Robert Prechter more than five years ago warned that “…the forthcoming deflationary depression would be worse than the ones during the last two hundred years.”[2]

The problem is that SOMEBODY has to monitor, control, regulate and govern/manage/ this pursuit bringing it in line with the direction of public interest and social progress. It is well-known that this SONEBODY can be only the state wit its financial institutions and the central bank. No one else is capable of doing this.

Should all of this continues, soon the thinking people will name the society we are living in not capitalism but something different. The best corresponding name would be *A Society of Total Profiteering, Commission-Mongering and Banditry.* A society where producers and

[2] Prcechter, R. Conquer the Crash.. Ciela, 2007, p. 97.

traders profiteer, politicians and administrators profit from commissions, scoundrels and all the rest commit crime unpunished.

Such a society, unlike the capitalism well-known to us, has no future. It will collapse based on horrendous economic and political contradictions and battles. Humankind cannot and must not allow this in the 21st century.

What did the American government and the Federal Reserve of the USA do to prevent or at least alleviate the financial crisis? They not only apathetically observed the actions of the almost entirely deregulated banking system and of the rest of the market-makers on the financial markets, but they also stimulated them to a certain degree.

Obviously, the lethargy of the leading democracies` governments and their central banks of issue is not due only to the dominating doctrine of liberalism and to the tendency toward total deregulation of the financial sector. Certain representatives of the high-profile administration had material interests as well.

But what can be said of the highest level of the current monetary-credit policy – the international one, whose key and constant goal is maintaining order and stability of the international /worldwide/ finances as a crucial condition for the development of trade and world economic progress. This is the very reason for the establishment and functioning of the International Monetary Fund /IMF/ and the World Bank, and other institutions as well. [3]

What did they do to deter the financial crisis? Did they duly warn the American government? Did they propose to it relevant and competent measures for counteraction? Let the readers answer these questions themselves. The world financial institutions contented themselves just to

[3] I for one, in my lectures delivered to students of finance have proudly asserted not once that we are preparing them to perform in the most dynamic realm of economic life. We used to point out that the so-called financial industry, i.e., the industry of making money almost out of nothing is the most dynamically developing industry. It was our pride, the pride of financial science lecturers. I am speaking in the past tense since today I am no longer proud of that, but feel certain guilt, though quite an indirect one.

ascertain that a global economic and financial crisis was starting in the world, commensurable with the so-called Great Depression of 1929-1934. Was this enough? Did it justify the existence of these institutions in their present mode? Or this was a total failure of their activity and an undeniable evidence that the world needs a new Bretton Woods system or, to be more specific, a New world financial order?!

I, along with many other financiers, for years on end admired the impetuous development of the financial sector of contemporary economy. We were even proud of that.

The government of the most powerful country and the Federal Reserve not only apathetically observed the non-problematic, ruthless and speculative ”money-making”, they also facilitated and supported it. And the money supply, the supply of book-entry and electronic/as it is called/ money, which strangely enough in economic science is viewed upon just as money supply, has been developing headlong in recent years along with the profits of the “golden boys” and the commissions of their powerful patrons – politicians and administrators.

Bu let us go back to “Capital”. The readers of Karl Marx`s work must have certainly noticed that in volume one, chapter three a specific economic law is mentioned. This is the law of the correspondence between money and commodity supply in the sphere of circulation. Marx called it the Law of the Amount of Money in Circulation. According to this law the necessary total amount of money in circulation in a given economy is not arbitrary. At any given point it depends on three key quantities:

- the amount of goods and services produced and subject to realization in a given economy;
- the prices of these goods and services, and
- the speed of money circulation.

This dependency can be illustrated, as is well-known, by the following formula:

$$AM = \frac{A.P}{T}$$

Where AM is the amount of money necessary for the economic turnover;

A – the amount of goods and services produced and subject to realization in a given economy;

P – the prices of the goods and services;

T – the number of turnovers of the national monetary unit during the respective period of time.

The relation and dependency between the commodity and money supply as we have already pointed out is by nature an economic law, although it is only one of the forms of manifestation of the universal or key law of market economy – *the Law of value which maintains market equilibrium, so crucial to equivalent exchange.*

The law-governed relation and dependency was detected by A. Smith in "The Wealth of Nations" and later it was formulated by Karl Marx in "Capital". Today this law, undergone various mathematical modifications and interpretations is being employed by all economists studying the relation between money, commodities and prices.[4]

In the process of its flow money not only handles the exchange and distribution of wealth in a given economy, it is constantly being transformed from one form into another, i.e., from ready money to book-entry and electronic forms, and vice versa. This flow and transformation is natural, normal and is carried out daily. The only problem arises when people try to turn all of their book-entry monetary assets in the banks into banknotes on hand and withdraw them thence. This is impossible because book-entry money is manifold more than money on hand owing to the very nature of the current monetary emission.

[4] See Friedman, M. Money Mischief. S., 1994, p. 52 and below.

When the correspondence between commodity and money supply is disrupted the mechanism of inflation is put into effect which forcibly restores the disrupted market equilibrium through the rising of prices and the devaluation of money. Thus the mechanism of inflation neutralizes the usual misuses of monetary emission mechanisms.

There is a different situation under the conditions of the current crisis – it is not that only there is a disrupted correspondence between commodity and money supply, which can be easily overcome through the mechanism of current inflation, the financial industry for a short period of time has created an *enormous useless money supply.* It cannot be devaluated through the mechanism of classic inflation. The quoted by us P. Prechter[5] talks about “deflationary depression”, even about “deflationary catastrophe” and probably he is quite right. Simply the value of financial assets is melting down and disappearing via the decrease of the prices of the investment financial “instruments”, no matter what their concrete form is. [6]

This mechanism is not well enough studied by economic science because it is entirely new. Financial science is yet to study and acquire knowledge. We only know that this mechanism first hits investment banking and then spreads across the rest of the financial sector and the real one. Despite the fact that the financial crisis commenced in one country, it rapidly invaded the whole world.

[5] See Prochter, P. Ibid., p. 97-99
[6] Ibid.