The dog that didn't bark: inflation and power in the contemporary capitalist state

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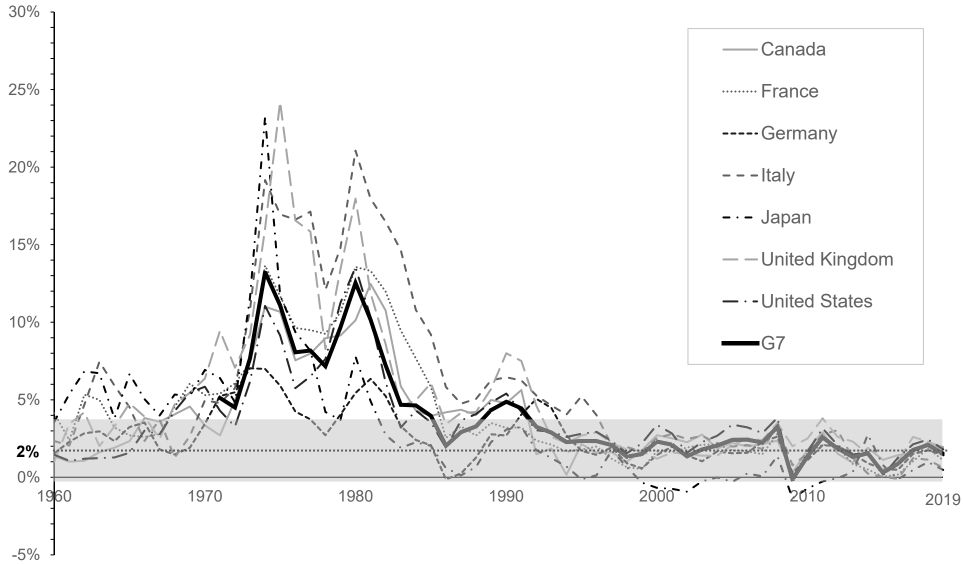
More than a decade after the global financial crisis, inflation in major capitalist economies remains very low. This tells us something important – and disturbing – about the weakness of social democracy in the twenty-first century.

'*All* levels of inflation, high and low, are the outcomes of political conflicts'.[1]

Inflation in Western Europe and North America has been low and stable since the early 1990s (chart 1). Like the dog that did not bark, this is a significant and under-appreciated event. It reveals something surprising about the political economy of contemporary capitalist states. Despite a surge of activism online and in the streets, despite the electoral upheavals in the UK and elsewhere, there is still no hard distributive conflict in the countries of the capitalist core. In the context of spectacular rises in economic and social inequality and insecurity, this finding is astonishing. It tells us that, for all the energy and enthusiasm invested in it, much of the political and social activism over the last decade has been ineffective and perhaps misdirected.

How could such a stark conclusion be deduced from so benign a trend as low and stable inflation? The pivotal causal claim, defended below, is the safety valve theory of inflation: under certain conditions, this claim goes, inflation acts as a safety valve on distributive conflict, and thus as a kind of crisis management tool.



If this is correct, and if the valve emits no steam, it follows that there is little pressure in the underlying boiler. In other words, despite the misery of austerity and crumbling public services, of rising inequality and falling life expectancy, of zero-hour contracts and rising rents; despite the injustice of golden parachutes among industrial ruins, of bank bailouts among benefit cuts, of stock market records among wage stagnation; all this notwithstanding, the activism and the tactics of the last decade have failed to raise the pressure in the boiler.

Why should we view inflation as a safety valve for distributive conflict? While a fuller explanation will be given below, the argument can be summarised using a different metaphor, involving four boxers and a cake.

Distributive conflict arises when there is more demand for cake than there is cake to go around. Assuming that baking more cake has already been tried, adjudicating this conflict means denying a sufficient number of claims until the remaining claims match the amount of cake available.

So far, so good. But now consider a scenario where four professional boxers, burly men and women all, are in a rage because they have not yet gotten what they consider theirs. They all demand one third of the cake, but there is only one cake to go round. In that case, might it not be easier for an adjudicator to write four vouchers, for a third of a cake each, and mail them from a safe distance? The one-third vouchers might only be good for a quarter-cake in the end – this is where inflation comes in – but if the process of translating vouchers into cake is sufficiently complicated, the adjudicator might escape the wrath of the boxers, who might, for example, turn on each other instead.

Where distributive conflict is intense, in other words, governments may prefer to grant or recognise all demands, knowing full well that this will cause inflation, rather than having to face the wrath of those parties whose demands it would otherwise have to reject explicitly. In this manner, tolerating inflation can act as a safety valve, for it permits (and is caused by) writing more vouchers than there is cake to go round.

The remainder of this essay proceeds in three steps. First, drawing both on the safety valve theory and on contemporary financial data and press statements, I show why inflation could reasonably have been expected to increase after 2008. Second, diving further into the political economy of inflation, I explain why inflation nevertheless remained quiescent. Third, I draw out the implications of this account for our understanding of power in contemporary capitalism.

Why was it reasonable to expect inflation post-2008?

Dogs bark. Inflation increases in response to monetary stimulus. Thus went common sense in the late 2000s and early twenty-teens:

> 'The Federal Reserve's aggressive rate cuts in the last 10 days are having one unpleasant side effect: they're boosting bond investors' concern about inflation'.[2]
>
> 'Significant inflation is on the horizon ... Many economists and bond market commentators complain that inflation is on the horizon'.[3]
>
> 'Because the Fed will be printing money, for a lack of a better description, some inflation is expected'.[4]
>
> 'The planned asset purchases risk currency debasement and inflation'.[5]

In addition to verbal inflation expectations, certain financial trends pointed in a similar direction: between 2008 and 2013, the price of gold, a traditional inflation hedge, increased from approximately $840 per ounce to nearly $1700.[6] Consumer expectations of inflation, too, spiked periodically, reaching highs of more than double the prevailing inflation rate in June 2008 and again in the spring of 2011.[7]

The absence of inflation was surprising not just because it did surprise a lot of people. It was and is also surprising because it *should* surprise us: based on convincing theories of the political economy of inflation, it was reasonable to expect an inflationary surge after 2008.

Economists agree that the main driver of inflation is monetary expansion, i.e. growth in the money supply.[8] However, this explanation is only proximate:

'Economic factors ... can explain how inflation happens, but economic factors alone cannot explain why'.[9] To understand the why of inflation, the why behind monetary expansion, we have to dig deeper.

Historically, most cases of monetary expansion resulted from a ruler's desire to raise revenue. For weak states with low tax capacity – i.e. most states for most of history – this was among the easiest ways to command real resources: 'In an age when the imposition of direct taxes remained a logistical and economic challenge for many [states], the levying of seigniorage by the manipulation of the monetary standard represented an invaluable source of revenue'.[10]

But this explanation falls short today: modern states can procure greater revenues in a less disruptive and more legitimate manner, through outright taxation and the issuance of bonds. Except in times of war, advanced capitalist states in the twentieth century have largely refrained from inflationary monetary financing.

Yet, as chart 1 shows, the 1970s and 1980s *did* see significant inflation, at rates ten to fifteen times higher than today. The end of inflation as a furtive tax, then, was not the end of inflation *tout court*.

Why? Because inflation has another use: where distributive conflict is intense, governments can use it as a safety valve. This theory, outlined in brief above, was first formulated by Maier, Goldthorpe and Hirsch in the 1970s.[11] More recently, it was integrated into a larger framework of post-war capitalism's political economy by Wolfgang Streeck.[12] As Streeck notes:

> ... democratic capitalism [is] a political economy ruled by two conflicting principles, or regimes, of resource allocation: one operating according to marginal productivity, or what is revealed as merit by a 'free play of market forces', and the other based on social need or entitlement, as certified by the collective choices of democratic politics. Under democratic capitalism, governments are theoretically required to honour both principles simultaneously, although substantively the two almost never align.[13]

In the frequent case where these two principles do not align, inflation offers governments a way out. Instead of directly denying the distributive claims of any one group – such as workers' demands for higher wages, firms' demands for higher operating surpluses, or investors' demand for higher profits and returns – governments can choose to grant or recognise them all. Governments grant additional claims on resources when they directly inject purchasing power into the economy through monetary creation. They recognise additional claims when they give banks the right to private money creation and accept the money creation decisions that banks then make. If, in this way, more claims on society's resources are recognised than there are resources available, inflation (mediated through an increase in the money supply) is the result. Simply put, '[t]he granting of price and wage claims [as well as credit claims] beyond the given money value of the national product produces inflation'.[14]

From the perspective of government, the advantage is clear: avoiding direct refusals and granting (in their sum excessive) claims deflects distributional conflict away from politics and back into civil society and the market place. Here, the identification of a target against which to mobilise is difficult, since causal links are opaque and responsibilities unclear. Even where mobilisation succeeds, government is less likely to be the target, with protesters instead more likely to focus on non-state actors, such as banks and multi-national corporations from the point of view of workers, or unions from the point of view of capitalists and the bourgeoisie.

This does not mean that every bout of significant inflation is intentionally engineered by government actors – just as often, it may be the result of explicit or implicit negotiations where all other outcomes are vetoed, and inflation is then tolerated. But it does mean that, when inflation occurs, it is usually as a result (intended or merely tolerated) of intense distributive conflict.

We should therefore expect modern governments to permit inflation whenever, in their judgement, the expected political costs of additional inflation are lower than the expected political costs of directly denying enough claims (starting with the claims of the politically weakest groups) to make the total sum of remaining claims compatible with available resources. The more powerfully and the better the weakest groups are organised, and the lower the costs of an extra dose of inflation, the more likely that governments will turn to inflation.

Inflation, of course, is not the only safety valve available to governments in response to distributive conflict. Turning again to Streeck, we can read the history of advanced capitalism after World War II as so many stages in the conflict between the two principles of allocation described above, and the successive use of so many safety valves to manage this conflict. When the post-war boom abruptly ended in the early 1970s, governments were faced with distributive claims that in their sum exceeded the now smaller-than-expected pie. In a context of strong trade unions and historically low rates of profit, directly denying unions was politically suicidal. Denying investors was expected to lead, given already low rates of profit, to an investment strike. At first, governments accommodated both, and inflation was the result. For a while, this safety valve delayed the day of denying either unions or investors their claims.

However, as investors and unions fought each other to a stalemate in the late 1970s, the political costs of continuing to tolerate inflation mounted and mounted, until eventually they became prohibitive. With inflation now politically unavailable, but the sum of demands still exceeding available resources, governments turned to a second safety valve: public debt. This allowed governments to grant additional distributive claims, without causing inflation and without increasing taxes in the short run.

As the safety valve of public debt, too, was eventually exhausted, the 1990s saw an across-the-board reduction in public deficits, particularly in the United States. This was accompanied (and made possible) by a turn to a third safety valve, aptly titled 'privatised Keynesianism': the deliberate creation or toleration of opportunities for private citizens to finance additional consumption through private debt.[15] Individual debt replaced public debt; private demand 'took the place of state-governed collective demand in supporting employment and profits in construction and other sectors'.[16] This last safety valve was widely recognised as the origin of the 2008 financial crisis.[17]

What this brief history adds to the safety valve theory of inflation is the following addendum: governments will only turn to inflation if the expected costs of tolerating or fostering inflation are lower than the costs of using other available safety valves, in particular those of public or private debt.

With this understanding in place, we can now see why it was reasonable, at the time, to expect inflation to rise. Rising inequality and the sharp, possibly secular, slow-down of growth made an intensification of distributive conflict likely. The recession implied that the sum of past demands, unless revised downwards, would exceed the sum of present resources. The tremendous increase in inequality before the crisis meant that any further downwards revisions, certainly at the bottom of the income distribution, would cut into flesh, not fat. Even though labour was weakened by decades of anti-union legislation and jurisprudence, it was reasonable, in this light, to expect a re-assertion of working-class demands, even if initially in inchoate form.

And indeed, it looked like the downtrodden *did* demonstrate power after 2008. New movements *did* emerge. Public places *were* occupied, a new generation of activists mobilised themselves and took to the stage. Indeed, more than a few luxury cars or boutiques were torched, whether in Ferguson, Hamburg, London or Paris. Radical left-wing parties *did* score election victories, and even where they failed to do so, they left their mark on their opponents and on public discourse. If inflation remained quiescent, the people did not.

Concerning the other safety valves, private debt levels had reached historic highs in the run up to the Great Recession, while, driven by bank bailouts, public debt quickly shot up after 2008.[18] At the same time, inflation remained low and stable – see chart 1 above – suggesting that the costs of tolerating or granting additional claims on output were moderate at best. Indeed, more than low-cost – in the context of an over-leveraged population, an inflationary strategy would likely have brought net gains for the economy as a whole: through redistributing wealth from (low propensity to spend) creditors to (high propensity to spend) debtors, it would have increased aggregate demand, and thus brought into operation workers and resources that were otherwise idled. Finally, governments being major debtors themselves, they had a direct, material interest in pursuing or permitting a higher rate of inflation, as this would have lowered the real value of their debts, too.

Since it is states – through their governments, parliaments and central banks – that pursue, permit, or prevent inflation; since a context of high leverage and idle resources would have made a burst of inflation macroeconomically productive; since the other safety valves for managing distributive conflict were already at full capacity; and since distributive conflict, at least superficially, appeared to intensify, it seemed eminently reasonable to expect governments to act and legislate in ways that would lead to higher inflation. If not during the crisis itself, then in its increasingly bitter aftermath, as the initially inchoate efforts of those at the sharp end of rising inequality and insecurity would, one might have expected, coalesce into a powerful challenge.

And indeed, perceptive observers such as Streeck pointed out this potential dynamic at the time: 'Others may be secretly hoping for a return to inflation, melting down accumulated debt by softly expropriating creditors – which would, like economic growth, mitigate the political tensions to be expected from austerity'.[19]

Why was there so little inflation after 2008?

Yet, more than a decade after the crisis, inflation remains as subdued as ever. Why?

If inflation is a safety valve, if the other safety valves are clogged, and if this valve nevertheless emits no steam, we must conclude that there is little pressure in the underlying boiler. If the political economy account of inflation is true, what the absence of inflation indicates is that *no excess claims on the resources of society have been recognised or created* over the last decade.

This is astonishing. Since 2008, great energy and courage has been shown by many movements with clear distributional goals. However, the political economy of inflation outlined here suggests that energy and courage are not the same as power and organisation. To square these two observations – wide-spread, broad-based, citizen-led mobilisation, and quiescent inflation – we must distinguish more clearly between protesting and political campaigning on the one hand, and the levying of distributive claims on the other. The former can be, and often are, tools for the latter; but they are separate nonetheless.

In contemporary capitalism, there are only two agencies that can issue universally recognised distributive claims: banks and states. More specifically: banks and central banks. As the only agencies capable of money creation, these two can issue *additional* claims on society's resources, i.e. without first obtaining them through taxation, services rendered, or as a gift.[20] Any action that does not alter the behaviour of these two agencies is therefore unlikely to result in durable increases in inflation.

These actors, however, are (currently) well insulated against popular pressure: beginning with central banks, these are protected by walls both constitutional and physical. In the case of the European Central Bank, for example, Article 123 of the Treaty of the Functioning of the European Union prohibits central bank financing of public expenditure. Article 130 states that 'neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body'.[21] Further, a special agreement between the ECB and the German state grants the ECB headquarters immunity from German law enforcement: 'No official of the Government or person exercising any public authority, whether administrative, judicial, military or police shall enter the premises of the ECB except with the consent and under the conditions approved by its President'.[22]

The physical protective features, i.e. the actual walls, of most central banks are equally impressive. While in most cases this is a historical legacy, partly explained by central banks' role as stores of national gold reserves, the European Central Bank's Frankfurt headquarters, too, are physically very well protected. Even though the ECB stores its gold reserves in London, Paris, Lisbon, New York and Rome, its new headquarters, completed in 2014, feature a wide ditch, a double security fence and wall, buildings significantly removed from the road, and an airport-style security entrance.[23] Occupying Zuccotti Park was a feasible option, at least until the city of New York decided to send in armed police. Occupying the headquarters of the EB, in contrast, is next to impossible for peaceful protesters. This is not incidental.

Turning to commercial banks, many of those, too, have significant physical safety provisions. More importantly, however, they are protected by their individual subservience to the market, and by their collective (and sometimes individual) indispensability for the continued functioning of contemporary, financialised capitalism. While individual banks can be targeted by protestors, this is predictably ineffective even for small and midsized banks, i.e. those more amenable to pressure from below. Local banks that went ahead and recognised claims founded in a moral, not a market, economy, would lose market share and eventually go bankrupt or face acquisition. Targeting systemically important banks, or commercial banks as a group, is a more viable strategy, insofar as, due to their systemic importance, their bankruptcy would not be permitted. If protestors could compel the creation of additional purchasing power *here*, this would in turn compel the central bank to back up those claims. This, however, is a challenging goal to achieve through collective action from below, and has not yet been attempted successfully.

If both banks and central banks are protected against direct protests and pressure, as outlined above, could not governments and parliaments be pressured to compel banks and central banks in turn? The answer is: yes in principle, but not, so far, in practice. With the very partial exemption of the Trump White House, none of the G7 governments has come under sustained popular pressure to challenge the independence or the current mandate of their respective central banks, or to compel banks systematically to extend (likely loss-making) credit to marginalised populations. Mobilisation has been too weak to move governments in this direction. Governments or parliaments have not had to say, as they did in the wake of World War II, 'the only way to meet these *other* demands is to abolish central bank independence'.

Instead, strategies of dispersion, such as union busting or the banning or breaking up of protests, have suppressed collective action. Scapegoating, for example via fostering or tolerating xenophobia, has diverted anger from plutocrats to the wretched of the earth. And a decades-long campaign of *divide-et-impera*, via constructing markets that are systematically larger than existing structures of collective action, has succeeded in pitting the workers of the world against each other and in giving bosses and owners faux-objective reasons to reject wage claims from below. Through these and other means, governments have succeeded in preventing distributive conflict from rising to a point where inflation is the least-cost answer, where a repoliticisation of central banking is a live concern, or where commercial banks would be re-subjected to political control.

Taken together, this amounts to the successful and continued depoliticisation of much of distributive politics. In the current institutional settlement, neither central banks nor commercial banks have any systematic incentive to give weight to the second of Streeck's two principles, nor can they be easily compelled to do so. Neither social needs nor moral economy rights are reflected in profit calculations. Neither matter, today, in the mandates or practice of the Federal Reserve, the Bank of England or the ECB.

In sum, the surprising absence of inflation since 2008 is due to the fact that none of the political initiatives undertaken since then have succeeded in levying *effective, additional* distributive claims. This was not for want of trying, but rather because, on the one hand, the agencies in whose power it is to recognise or deny these claims, i.e. banks and central banks, have turned out to be supremely well insulated against the kinds of politics and protests that have been attempted over the last decade; and, on the other hand, because tactics of division and scapegoating have reduced the organisational power of the downtrodden to fight for their share.

Learning from quiescent inflation

Since the early 2010s, both public and private debt have been at levels where, at least according to common sense, further increases cannot easily be used to defuse distributional conflict. Inflation, on the other hand, is and has been available since 2008: it is currently low and stable, and even if doubled it would be well short of the levels seen in the 1970s. As the tool that is most available to 'manage' distributional conflict (i.e. defuse it without deciding it), it indicates the extent to which governments feel that they are caught between a rock and a hard place. *Were* governments to believe that they could not easily deny the claims of either capital or labour, they would take actions that would result in inflation rising.

The absence of inflation therefore indicates that hard distributional conflict itself is absent. Governments in the capitalist core no longer feel the need to stave off the fundamental conflict of democratic capitalism, between the moral and the market economy, by resorting to inflation. The underlying stresses, far from becoming more exposed or being delayed once again (through a renewed surge of inflation or debt), have been, this indicates, 'resolved': the principle of 'market allocation … governed by the interests of those owning scarce productive resources and thus in a strong market position' has won out.[24] Despite a decade of organising, of protesting, of publishing, and of changing the zeitgeist, the principle of 'political allocation … preferred by those with little economic weight but potentially extensive political power' has not (yet) been reasserted successfully.[25] For anyone committed to the priority of democracy over capitalism, this is deeply worrying indeed.

This essay started from the observation that inflation has remained low and stable since the mid-1990s. I argued that inflation, though an economic phenomenon, is caused by an excessive amount of politically recognised and hence effective claims on the resources of society. The key implication of this theory – the safety valve theory of inflation – is that, just as 'the generally rising rate of inflation [of the 1970s] reflect[ed] a situation in which conflict between social groups and strata ha[d] become *more intense* and also to some extent *more equally* matched',[26] the absence of inflation today indicates *less intense* and *less equally matched* social conflict.

The upshot is clear: the democratic promise of social market democracy – that the market is ultimately subservient to democratic politics – has been broken. Given the presence of high and growing inequality, in material conditions, in opportunities, and in political representation, combined with the extraordinary growth in economic insecurity they entail, any impartial observer would expect a powerful political challenge on the terrain of distribution. And indeed, Occupy and cognate movements have repeatedly issued such a challenge over the last decade. Had these challenges had sufficient force, they would have been reflected in growing inflation. The *absence* of inflation shows that they did not. A retrenchment of capital's claims

– driving down the capital share, driving down income and wealth inequality – is always hard, and has only ever been achieved in truly exceptional circumstances. What is disappointing, however, is that not even the intermediary step was achieved: scaring the authorities into conceding labour's claims though without curtailing capital's claims – at the price of inflation.

No doubt, this was in part because tactics of division and scapegoating proved effective at disorganising the masses. No doubt, however, this was also due to tactics and strategies of the left that, even if reasonable at the time, have turned out to be incomplete at best, misguided at worst. Symbolic, rhetorical challenges, such as those successfully brought forward by Occupy Wall Street, *Los indignados*, *la nuit debout*, or UK Uncut have not, it turns out, created genuine counter-power. Political movements focused on winning elections, defending public services and ending austerity may have succeeded in preventing an even worse evisceration of the public realm and the moral economy; but they have failed, hitherto, to turn the tide and to take the fight to the enemy. Perhaps the left of the 2010s was too electoral, too small-c conservative, too ready to accept the rules of politics and the public sphere as they stand. Perhaps there is simply no alternative to the hard graft of building counter-power via durable, resilient organisation: in the work place and in the street; in religious, cultural, ethnic, and in sexual communities; in the village and in the metropolis.

Why precisely the left of the 2010s failed, and what precisely should be done instead, are the questions that must now be answered in greater detail. How genuine counter-power can be built today, at every level of society, is what we must find out. We need, in other words, a renewed analysis of how power operates in twenty-first century capitalism. We need a Gramsci, a Luxemburg, or perhaps a Lenin, for our time

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Notes

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