



Notes: How to Meet a Liquidity Crisis

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Article citation:

Gaffney, Mason. "Notes: How to Meet a Liquidity Crisis." 24 February 1991. Notes.

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How to Meet a Liquidity Crisis

Notes by Mason Gaffney, 24 Feb 91

The following problem is met. An economy has plenty of hard or "frozen" capital, following years of investing in what Quesnay called avances souveraines and avances foncieres, i.e. infrastructure and land development. An acute shortage of loanable funds arises, signalled by a sharp rise of interest rates. The problem tends to aggravate itself because, without soft capital to complete and to operate the hard capital, the hard capital cannot be recovered to meet the shortage of soft capital. A flexible economy, guided by resourceful people will take recourse in the following stratagems.

1. Lower consumption, raise current saving.
 - a. Private, personal consumption and saving.
 - b. Retiring public debt. This implies higher taxes. Higher taxes reduce consumption more than they do saving. (The structure of taxes is also important, but is not covered here.)
2. Increase service from existing, available resources:
 - a. Use labor more, working longer hours and years.
 - b. Use land and hard capital more intensively, by means of swing and graveyard shifts, and by crowding.
3. Defer children; women join the work force full time.
4. Draw down older capital, including consumer capital:
 - a. Squeeze more value from it before scrapping
 - b. Apply more labor for operation. If the crisis is extreme, use less for maintenance, rehabilitation and repair.
5. Draw down exhaustible natural resources (subject to #8, below).
6. Build everything cheaper, especially foregoing longevity.
7. Abort most investments of deferred benefit, e.g. planting trees.
8. Apply more labor downstream, where capital coefficients are lesser, and apply less upstream.
9. Speed all turnover, raise the flow/fund ratio.
10. Import capital:
 - a. Repatriate our capital abroad
 - b. Borrow from abroad.

11. Force saving by raising the money supply (as was done after the recession of 1981-82).

12. Internalize corporate profits, i.e. stop dividends.

13. Internalize other institutional profits, e.g. from trusts, foundations, pension funds, insurance companies, etc.

14. Draw down business inventories (again, as in 1981-82).

Remember, the above are not all recommended as long-term policies. Some of them are unpleasant in the short run, and harmful in the long run. The moral of that, however, is this: avoid getting trapped in liquidity crises in the first place!