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The shape of the coming crisis

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While the Eurozone is embarking on a very moderate period of recovery, alarmist predictions are multiplying about the overall trajectory of the world economy: “Chinese growth slows, world economy suffers”, was, for example, a headline in Le Monde of 20 October 2015. “On the economic front, there is also reason to be concerned” says Christine Lagarde [1], and Jacques Attali [2] announces that “the world is approaching a great economic catastrophe”.

Let us begin with a brief overview: world growth is slowing, mainly in the emerging economies with the exception of India. This tendency is self-reinforcing, with a fall in prices of raw materials, and it is being transmitted to the advanced countries. International trade is also slowing down, at the same rate as world GDP, as if productive globalisation had reached a ceiling. The Eurozone is registering a very timid and uneven recovery. The USA and the UK are doing relatively well, but growth is tending to slow in the former and appears artificial in the latter.

In the “financial sphere”, quantitative easing is feeding stock-market bubbles rather than productive investment, which is stagnating. And the

mere prospect - held back so far - of a renewed rise in Fed interest rates hangs like the sword of Damocles and is destabilising the currencies and markets of many countries. In short, “Uncertainty, Complex Forces Weigh on Global Growth”, to quote the IMF's formula in its latest survey. [3]

From this impressionistic picture, we can draw out three essential characteristics:

- The persistence of “the legacies of the global financial crisis”;
- disturbances in the world economy;
- the prospect of “secular stagnation”;

The legacies of the global financial crisis

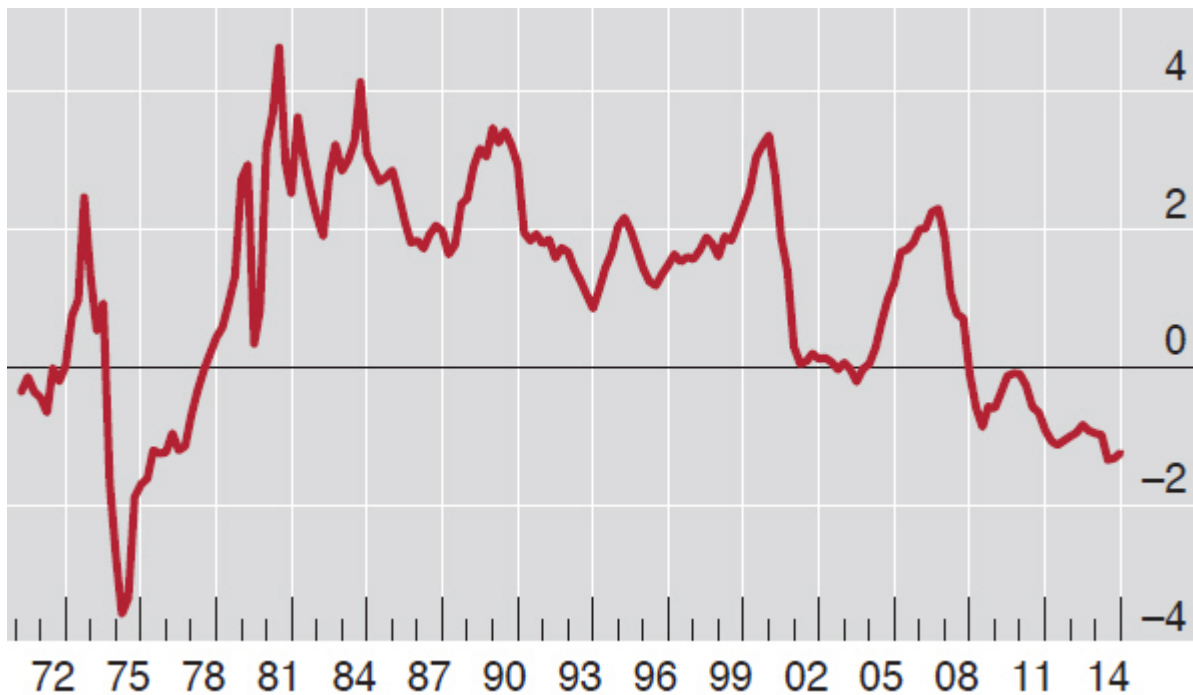
Quantitative easing means a central bank buying securities. In this way, the bank creates money which, injected into the economy, is supposed to kick-start it. We can even concede that this worked for a time in the USA. Nevertheless, the new fact is that we have begun to see that this course of action has substantial collateral effects.

The president of the Federal Bank of Dallas, Richard Fisher (a minority voice in the Fed), summarises his scepticism thus: “the money we have printed has not been as properly circulated as we had hoped. Too much of it has gone toward corrupting or, more appropriately stated, corrosive speculation [4]”. In his speech, he went so far as to quote a verse by Jonathan Swift, from 1735: “Money, the life-blood of the nation/ Corrupts and stagnates in the veins,/ Unless a proper circulation/ Its motion and its heat maintains.”

The inefficacy so far of monetary policy can be explained by various mechanisms or secondary effects which weigh upon the current conjuncture. To start with, this injection of money is blind and nothing guarantees that the liquidity will be used in a manner that is favourable to investment. On the contrary, it will feed speculation and provoke an increase in asset prices which will benefit only the richest and which will lead to the creation of a bubble.

Historically low interest rates

Quantitative easing simultaneously leads to a reduction in interest rates (figure 1). This could contribute to re-starting investment in housing and productive investment in general. A recovery in investment is in any case the key issue for an overall recovery. But that recovery has not taken place, because businesses are not investing, for lack of outlets and/or profit. They restore their margins, make money, increase mergers and acquisitions, pay out dividends, but their investment is flatlining.



Central bank official interest rates
Germany, USA, Japan),
Source : BIS-BRI [5]

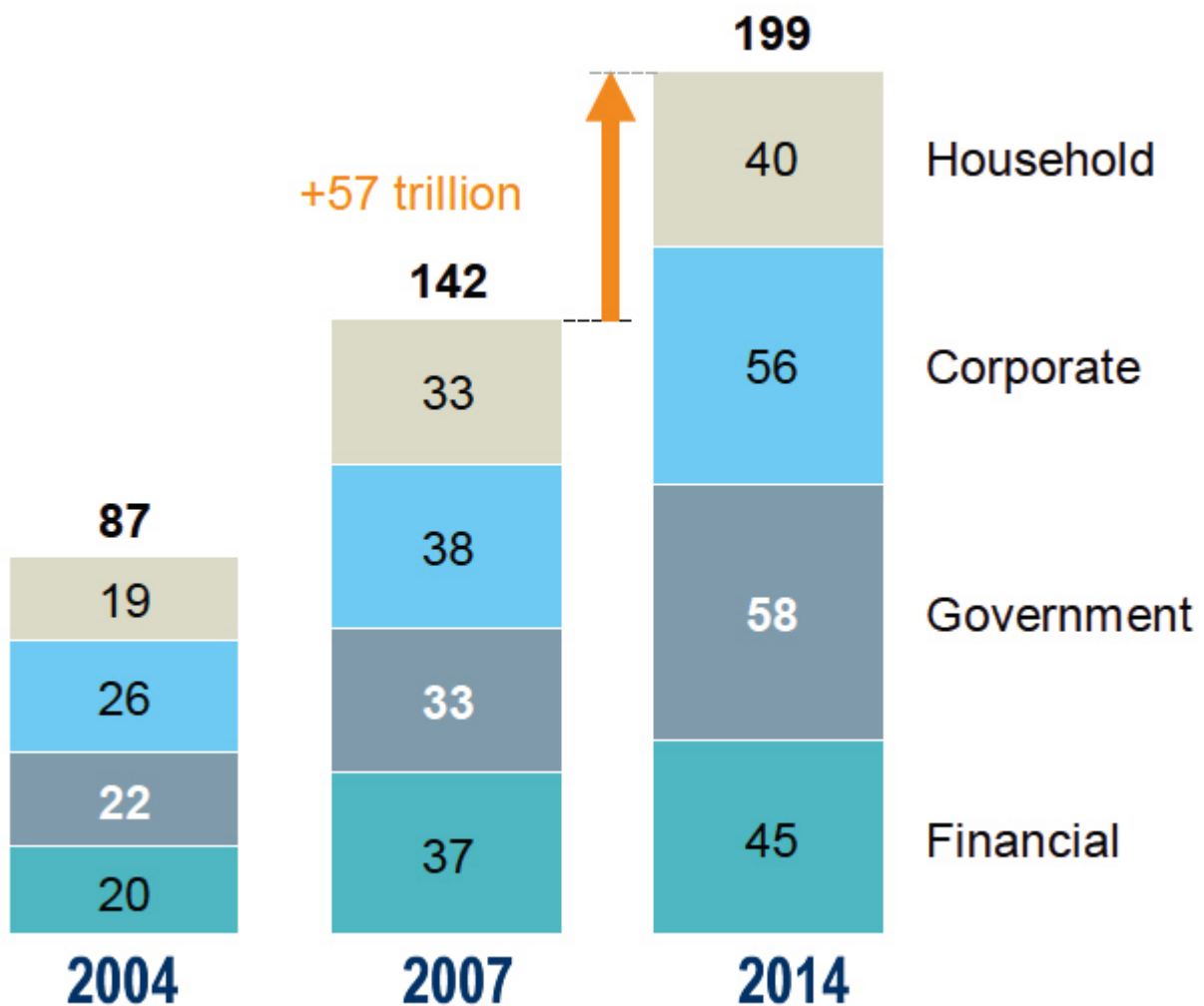
Over the same period, the injection of money leads to an inflation in financial asset prices, but not to inflation in prices of current goods and services. Low interest rate and weak inflation together mean that real interest rates (discounting inflation) cannot become strongly negative. Nominal interest rates approach what American economists call the ZLB (zero lower bound). This limit is, for some, like Lawrence Summers [6], the result of secular stagnation, characterised by high rates of saving, aversion and a weak tendency to invest. To rescue the situation, negative real interest rates would be required to re-launch activity, and they are out of reach. This interpretation is dubious, because it misses out the most structural

determinants of possible secular stagnation [7].

Nevertheless, Summers is right on one point when he expresses a fear that “If a recession were to occur, monetary policymakers would lack the tools to respond. There is essentially no room left for [monetary] easing...” The same worry was expressed by Claudio Borio [9], the economist of the BIS (Bank for International Settlements, headquartered at Basel), when he presented his annual report: “Interest rates have been exceptionally low for an extraordinarily long time. They reflect the central banks' and market participants' response to the unusually weak post-crisis recovery, as if they are fumbling in the dark in search of new certainties.” In other words, we have asked too much of monetary policy for relaunching growth.

Accumulation of debt

The result is a huge accumulation of private and public debt. According to a study by the McKinsey Global Institute [9], this debt represents almost 200,000 billion dollars at the world level, or 286% of global GDP, up on 269% in 2007, before the crisis struck. The increase is particularly clear for state debt, but also for businesses (figure 2).



Global stock of debt

Source : McKinsey Global Institute

In particular, the debts of non-financial businesses in emerging economies have quadrupled between 2004 and 2014. The IMF asks itself whether one should worry [10], and it tells businesses to prepare themselves for the effects of a worsening in financing conditions: “as advanced economies normalize monetary policy, emerging markets should prepare for an increase in corporate failures and, where needed, reform corporate insolvency regimes”.

This panorama thus leads us to two scenarios which could unleash the next crisis. The first has been described by François Morin in his latest book [12]. His point of departure is the existence of financial bubbles in public debt, but also on the financial markets which have been doped up by very low

interest rates. The trigger element could be the failure of a systemically important bank, with a chain reaction on other big banks.

The second scenario relates to the IMF's worries regarding emerging economies. The trigger here would be an increase in interest rates by the US Federal Reserve Bank and the hardening of conditions for financing business which the IMF refers to. It would lead to a bursting of bubbles, starting with the emerging economies, with repercussions for the rest of global finance.

In summary, the risk factors focus around this contradiction: on the one hand, quantitative easing policies are not getting any traction on the real economy, are feeding bubbles and have set world finance on a course which cannot continue indefinitely. But an increase in interest rates would provoke an uncontrollable bursting of bubbles, in a context where states have almost no ammunition left to save the banks again.

In defence of fictitious capital

Christine Lagarde is therefore right to speak of “sequels to the global financial crisis”. More precisely, the overall picture is as follows: the period preceding the crisis was characterised by an enormous accumulation of fictitious capital, in other words, of drawing rights on future surplus value to be produced by the exploitation of wage labour. For capitalism to start anew on a healthy basis, it would have been necessary to destroy this fictitious capital (and surely also a part of the productive capital). There have been losses, but around the world policies were guided by an essential principle: preserve the fictitious capital and the drawing rights that it represents. That was done in two ways: on the one hand, by converting private debts into public debts and, through austerity measures, drawing on surplus value; on the other hand, by massive injections of liquidity. In the first instance, we can say that capitalism respected the law of value, because it tried to adjust the ratio of fictitious capital/surplus value by increasing surplus value. In the second instance, on the contrary, it tried to deny or subvert the law of value by acting on the numerator. At the most fundamental level, the next crisis could be interpreted as being a severe re-assertion of the law of value.

Even if it gives priority to austerity via "structural reforms", capitalist

Europe is turning, rather tardily, towards artificial solutions. There is quantitative easing à la Juncker, which is tottering just as much as in the USA. But there is better: the latest big idea of the European Commission is to launch an "Securitisation Initiative" [12] which will be a part of a broader "Capital Markets Union" project. Under the cover of regulation, the real objective is to restart securitisation markets, but this time "safely", to thus obtain "over €100bn of additional funding", or "half of pre-crisis levels" [13]. It should be recalled that this objective was also that of the IMF in... October 2009, when it tried to "discern how securitization can positively contribute to financial stability and sustainable economic growth." [14] Here is a striking example of systematic will to favour the rise of fictitious capital.

Before the crisis, the world economy was structured around a China-US axis, often called "Chinamerica" [15]. This axis is starting to disintegrated, and without a doubt that is one of the key elements of the remodelling of the global economy.

The end of "Chinamerica"

The disintegration is symmetrical: on the one hand, the American model is departing from its pre-crisis operation - growth on credit - because of a renewed increase in the rate of saving and a reduced dependence on energy imports. These two factors reduce the motor role in the global economy which the USA had previously played.

China is currently in a transition phase, fraught and difficult to be sure, towards a model centred on domestic demand. It is clearly moving away in any case from export-based growth: exports' portion of Chinese GDP went from 36% in 2006 to 26% today. The complementarity between the two biggest economies is declining and this move, with its collateral effects on emerging economies and Europe, is unbalancing the whole world economy.

This reorientation of the Chinese economy is manifested by a change in the structure of its external trade [16], but also contributes to a slowdown in world trade. It is another subject of worry for economists, who puzzle about the causes and wonder if this is an ephemeral phenomenon or something more structural. All the evidence is that we are seeing a lasting change of

trends [17] which corresponds to a slowdown in the splitting-up of value chains. The organisation of production across two different zones of the global economy characteristic of contemporary globalisation is reaching its limits, and, with it, the faster growth of global trade than of world GDP which it drove. This phenomenon is particularly marked with regard to China, but also the USA, Korea and Japan, which confirms that the China-USA axis is in the process of coming apart.

Desynchronisation and volatility

The instability of the global economy is also aggravated by desynchronisation between the USA and the Eurozone. A detailed study by the IMF [18] shows that these divergences have substantial collateral effects (spillovers). The authors show their worries by asking “whether liftoff in the U.S. may not only strengthen the dollar vis-à-vis the euro, but also push interest rates up in the euro area, or whether QE in the euro area may not only weaken the euro, but also continue putting downward pressure on US yields”.

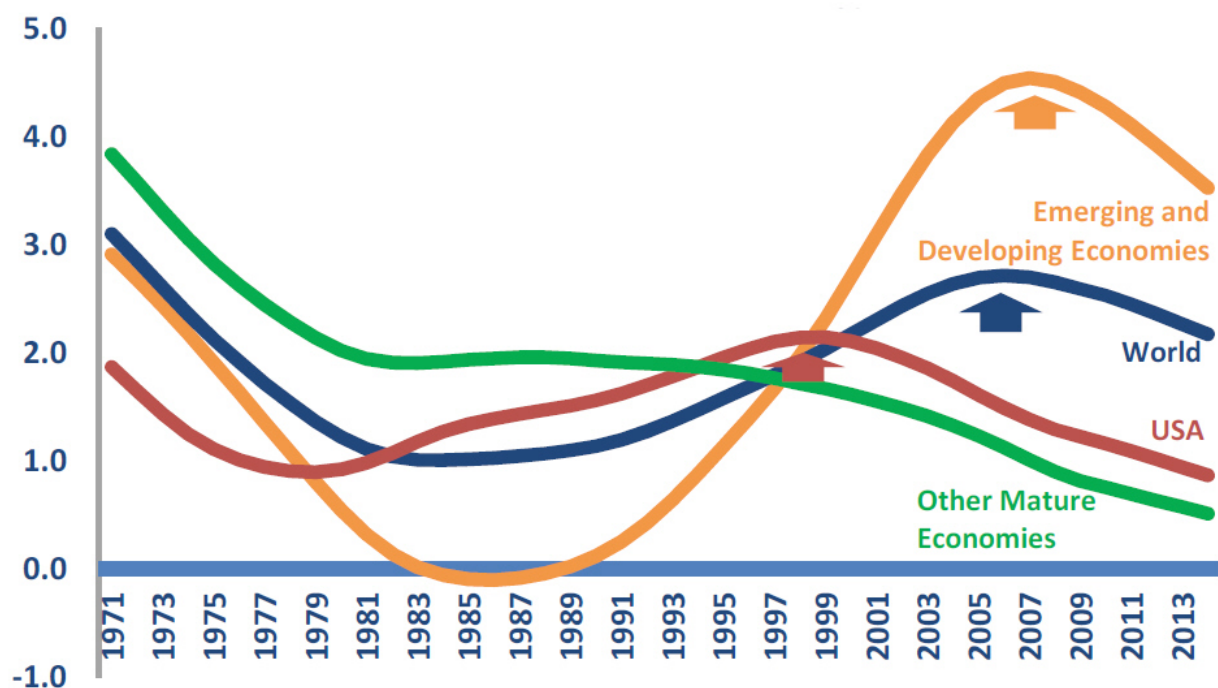
The same document has an interesting insight into the emerging economies. Its authors distinguish two transmission channels. The “traditional” channel is that capital goes towards the zone which is enjoying renewed growth (the USA or the Eurozone), with a resulting appreciation in the value of the currency in the zone enjoying this influx of capital. But they identify another channel, the “risk-appetite channel”: capital anticipates a recovery in the emerging economies driven by the recovery in the “centre” zone. This influx of capital into the emerging economies leads to an appreciation in the value of their currency.

These analyses show that the functioning of the world economy is eluding regulation, and that the emerging economies are exposed to movements of capital which have destabilising effects, whether entering or leaving. The recent period has been characterised precisely by an increased volatility of those movements of capital.

The exhaustion of productivity gains

Presenting the latest projections by the OECD, its chief economist Catherine Mann stressed that “the potential growth slowdown in advanced countries is an ongoing concern” [20]. And Christine Lagarde, for the IMF, evoked the “new mediocre”, in other words “the risk of low growth for a long time” which, according to her, “looms closer”.

Underlying this configuration, there is the exhaustion of gains in productivity. This tendency is not new, as it was set in motion in the developed countries from the start of the 1980s, with strong fluctuations in the case of the USA. But, in the end, the emerging economies took up the baton and the productivity gains they made could in large part be captured by the “old” capitalist countries. At the start of the crisis, the emerging economies kept up world growth. But the great dislocation in the world economy could have reached an inflection point: the most recent data from the Conference Board show that growth in hourly labour productivity has clearly fallen in the emerging economies since the start of the crisis (figure 3).

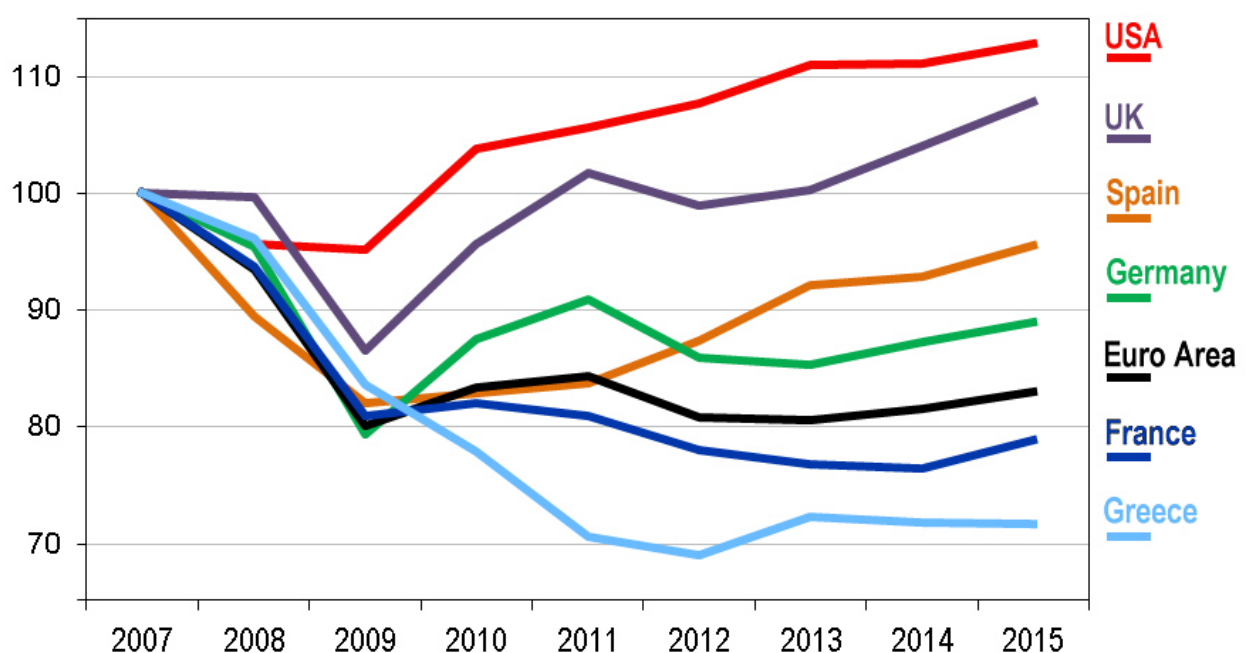


Tendencies in growth of labour productivity
Source : The Conference Board [20]

However, productivity, and more directly global factor productivity, is an essential element in the dynamic of the rate of profit. That rate has been restored in the major capitalist countries, in spite of the exhaustion of productivity [21]. This achievement was only made possibly by a whole series of initiatives: financialisation, growth in indebtedness, inequality, fall in wage share, etc. At the same time, the drying-up of profitable investment opportunities leads to a stagnation in productive investment rates.

The rate of profit in disorder

There is no alternative for capitalism, other than getting the neoliberal model back on track, while trying to reduce destabilising factors. In this quest for a way out of the crisis, the key question is clearly the restoration of the rate of profit, which can only be achieved in the first instance by an increase in the rate of exploitation. However, a striking fact is the disparity of performances. Among the advanced countries we can see differentiation in rates of profit, in the first place between the USA and the Eurozone, and then again within the latter (figure 4). This phenomenon implies a sharpening of competition between multinationals, which would tend to lead to a general downturn in the rate of profit. This is, in any case, the finding announced by the McKinsey Institute [22] which foresees that global corporate profit should move from 9.8% of GDP in 2013 to 7.9% in 2025, more or less back to its 1980 level.



Rate of profit 2007-2015

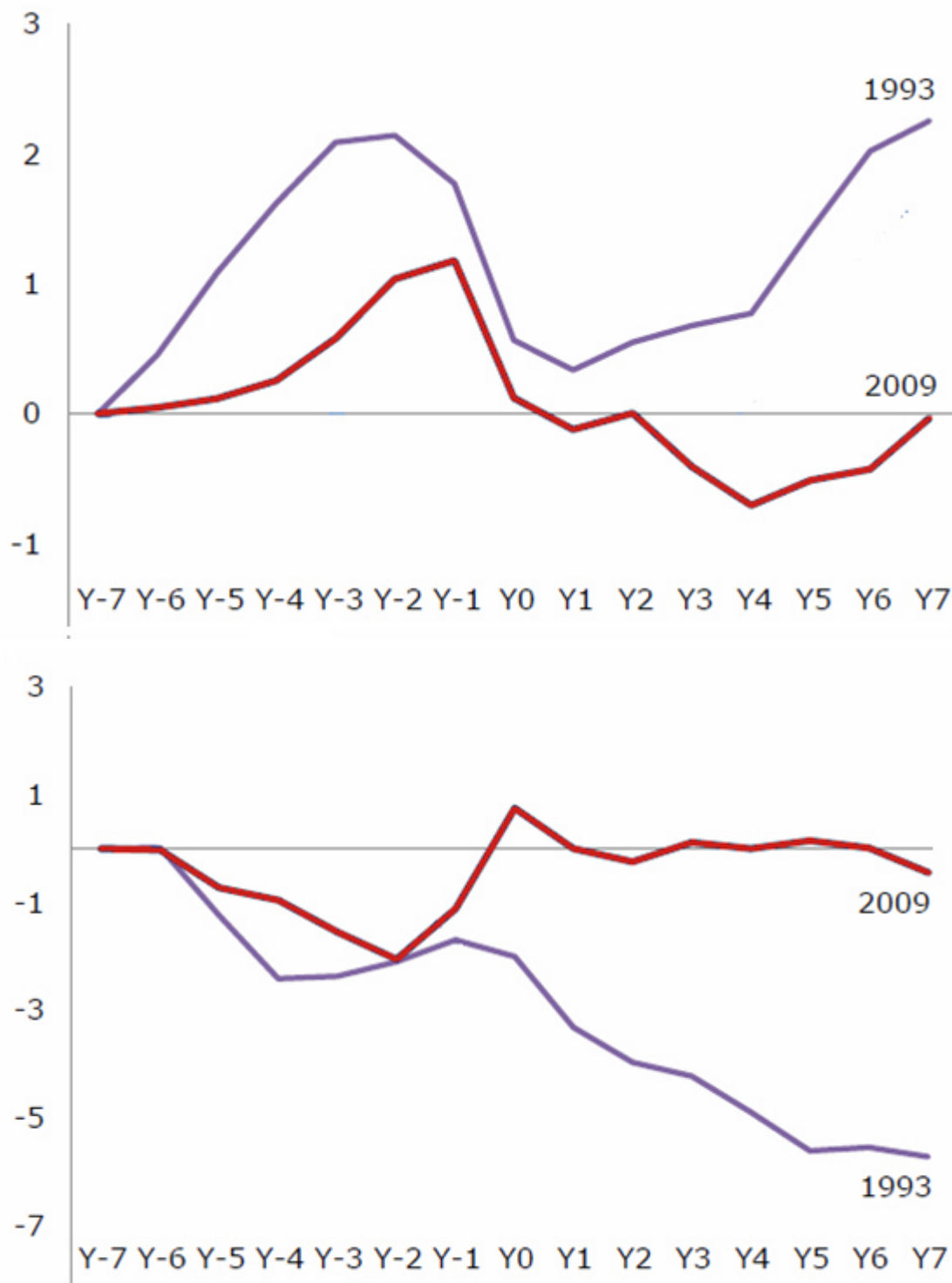
Base 100 in 2007. Source : Ameco, 'Net returns on net capital stock: total economy'

No profit, no recovery

This divergence can be illustrated by means of a more detailed analysis of the conjuncture within the Eurozone. The exercise has been undertaken recently by the European Commission [24]: it compares the timid current 'recovery' with others. The results of this study are illustrated by figure 5 which compares the cycle 2002-2015 with the previous (1986-1999). In the two cases, the reference year is the year preceding the lowest point (respectively 1992 and 2008). Two key variables in the dynamic of capitalism are examined: investment and wage share. The profile are comparable in terms of the phase in the cycle preceding the recession. But what happens next tells two very different stories.

After the 1993 recession, investment fell, but revived progressively and after six years regained its pre-crisis level. The wage share, which had risen slightly from its 1989 low point, returned to its inexorable downward tendency and fell by almost 4% of GDP between 1992 and 1999. It was a good way out of the crisis for capitalism, with an improvement in profitability and a recovery in accumulation.

But what has happened after the latest crisis is not a classic cycle. Wage share increased strongly in 2009, then fell, but now it has stabilised at 2% of GDP higher than its pre-crisis level. In other words, the return on capital has not revived. And we see the effects on investment: it started to revive in 2011, following the pattern of the previous recession. Then the sharpening of austerity policies created a double dip in growth and investment fell again before starting to recover from 2014. Today it remains more than 1.5% of GDP lower than its pre-crisis level.



Two episodes of recession in the Eurozone

Financial causes and real effects

Understanding how finance and production interact is an essential but difficult task. A recent study by BIS economists [24] sheds some light on this

question by proposing a model which links “financial causes” to their “real consequences”. The authors construct an index measuring the contribution of labour reallocation across sectors to aggregate productivity growth. Then they show that this index is significantly correlated (negatively) to financial booms. In other words, when credit grows faster than GDP, employment moves to sectors with lower productivity. They also show that the value of this index before the financial crisis determines the subsequent trajectory of productivity. And this mechanism is self-perpetuating, because the recourse to credit feeds what it is supposed to compensate for, i.e. the slowdown in productivity. This modelling of links between productive efficiency and financial movements seems particularly pertinent to an analysis of the Eurozone.

The coming crisis?

One conclusion follows from this (too) swift review: the “great recession” has opened a period of “chaotic regulation” at the global level. A new crisis seems today to be more or less inevitable. It is difficult to tell where the point of rupture will be (stock exchange, bank, debt, exchange rate?), but this episode will in any case be evidence of deep structural contradictions.

Global capitalism is currently subject to a fundamental tension. On the one hand, the crisis which opened in 2008 was dealt with according to two essential principles: don't clear the accounts (the “legacies”); reconstitute the pre-crisis neoliberal model, while seeking to control the most deleterious effects. In practice, this means guaranteeing the rights to draw on future surplus value acquired by the “1%” and the freedom of action of the banks and the multinationals. But the fundamental mainspring of capitalism's dynamism, that is, productivity gains, is currently heading towards exhaustion.

This configuration leads to complex interactions between changes within the productive sphere and the manipulation of financial and monetary instruments. This is why, as in 2007-2008, the precise location of the trigger for the next crisis will not provide an adequate explanation of the deeper causes. (A l'Encontre, October 2015. Translated by Ed Maltby)

Notes

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