Life after the (next) financial crisis

It is now some seven years since the start of the global financial crisis (GFC), signalled by the collapse of Lehman Brothers in September 2008, which threatened the solvency of major banks round the world, requiring emergency state-financed bail-outs on a massive scale to avert the perceived threat of total financial meltdown. At the same time it triggered the first world-wide recession since the 1930s, entailing a sharp fall in output and living standards and subsequent chronic stagnation of the global economy.

In their attempt to bring about recovery from this disaster the governments of the world's leading economic powers have quite properly focussed their attention on the need to bring down the huge burden of debt which was the principal cause of the crisis and which still overhangs the economy - even though a significantly higher proportion of the burden has now been assumed by the public sector. While there has been broad agreement that this process of “deleveraging” is to be achieved by restoring higher rates of growth – thereby generating sufficient extra resources to pay down debts to a more manageable level – there has been a divergence of view between those who believe this can best be achieved by means of austerity (reducing / eliminating budgetary deficits via cuts in public spending or rises in taxation) and those who favour trying to boost activity via yet more public borrowing.

In terms of official rhetoric it is clear the “austerian” view has broadly prevailed among developed world (OECD) governments, in that most governments have insisted on the need for fiscal consolidation – whether through higher taxes or (as most of them prefer) reduced public spending – as the unavoidable route to economic salvation. Meanwhile the only major economies that have pursued fiscal expansion – Japan and, more especially, China – have also seen their indebtedness (public and private) rise as a percentage of GDP. In the case of China this reflects the government's concern to sustain the level of activity and employment without worrying too much about the level of its debt ratio, which was much lower than in the industrialised West until 2012 but by 2014 exceeded that of the US (public and private).

But if there are differences of view about the right response to the crisis in terms of fiscal policy there is complete unanimity over monetary policy, which all are agreed needs to be as loose as necessary to avert renewed symptoms of financial breakdown – or at least postpone them as long as possible. This involves not only setting official interest rates at very low levels – often negative in real, inflation-adjusted terms – but engaging in “quantitative easing” (QE - or monetisation of public debt), whereby central banks are enabled to buy government bonds so as to support their market price and hold down interest rates. In this way officially sponsored market distortion has enabled states and institutions to be shielded from the bankruptcy that would be their fate if normal price discovery were to be permitted and their assets accordingly “marked to market”.

Yet in spite of such concerted efforts of manipulation the global economy has been unable to emerge from the paralysis into which it sank seven years ago. Amid the welter of positive spin and bogus statistics put out by mainstream propagandists to try and convince the public – and the investor community in particular – that a return to growth and “business as usual” is actually occurring, or just about to, it is sufficient to consider just two indicators to demonstrate that in reality this is not happening, nor remotely in prospect without some drastic change of official policy.

Global debt. Although comprehensive official figures are not available, data published in February 2015 by the authoritative McKinsey Global Institute (MGI) - the business and economics research arm of McKinsey & Company – aggregate global debt (public and private, including households) has not only not fallen since 2007 but has actually risen by 40 per cent to US$ 199 trillion (2014). This figure is equal to 286 per cent of global GDP, which can be conservatively estimated to be at least three times the ratio prevailing in 1990. It might well be thought that these figures - http://www.mckinsey.com/insights/economic_studies/debt_and_not_much_deleveraging – demonstrate beyond doubt that neither fiscal austerity nor expansionism can possibly rescue the world from its manifest state of bankruptcy. Equally the lack of official or media reaction to them speaks volumes for the political and ideological paralysis now gripping world leaders.

Interest rates. As noted above, sustained official intervention and market manipulation has been deployed to maintain interest rates at artificially low levels and thereby prevent the insolvency of the vast majority of institutions, public and private, from being revealed to the world. On the other hand this "financial repression" has had the effect of discouraging new fixed investment of the very kind that is needed if the world is to stand any chance of growing its way out of the crisis. This is because, in a climate of heavy indebtedness and consequently depressed household incomes - as well as low rates of interest, investors naturally tend to see the potential rewards of investment as outweighed by the risks. Equally it is well understood that if there were to be any genuine sign of a sustained revival of economic growth it would be reflected quite quickly in pressure for higher interest rates. Hence the continual attempts by central bank and other mainstream spokespeople to convince the markets that they are on the point of raising base rates – even though they know that any such action would trigger a catastrophic market meltdown. The reality is better reflected in the actual level of base rates, which in the case of the Bank of England has now been stuck at 0.5 per cent since March 2009 – a phenomenon without precedent in the 320 year history of the Bank, during which the rate had never previously been set at less than 2.0 per cent – not even during war time or the Depression of the 1930s.

Exactly how or when a way will be found of escaping from this intolerable trap is hard to tell, although given the now manifest failure of official strategies that have long been known to be unworkable, it seems hard to believe a renewed market upheaval could be postponed beyond 2015. It is equally hard to see how this can occur without entailing an explosion in debt defaults or write-offs and a massive collapse in asset markets in general.

The manner in which such a development can be expected to unfold will depend on how willing the ruling élite proves to be to accept the inevitable consequences of the conclusive failure of the existing economic model. The possibilities range from extremes of either

a) Unleashing conflict on a localised or global basis in order distract attention from the deeper economic and political malaise – given the intensifying disorder in many parts of the world at present this approach (which might be comparable to the recent actions of Vladimir Putin vis - à- vis Ukraine) seems all too likely – or
b) Acceptance of the need for an emergency, overtly collectivist package of measures to stabilise the global economy, in which corporate / financial interests would be subordinated to priorities of survival and social stability (in contrast to 2008).

Making the optimistic assumption that somehow a critical mass of humanity survives the coming upheaval with the capacity to devise more rational ways of ordering their affairs, they will need to understand, if they are to avoid further such disasters in future, that what has happened is more than just another "bust" within the course of the traditional business cycle. Rather it signifies a more profound transformation in the economic landscape brought on primarily, but not exclusively, by technological change. Most significantly, as spelt out in my most recent blog-post - http://harryshutt.com/2015/04/08/the-withering-away-of-the-financial-industry/ - this will entail the marginalisation of the financial sector from its current ruinously dominant position in the economic order. What this will mean for the future evolution of human civilisation is of course hard to foresee. However, what is undeniable is that it will give us the opportunity for permanent deliverance from irrational enslavement to the insatiable god of finance capital.

Harry Shutt - April 2015

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In his early work as an economist in the 1960s he was mainly preoccupied with the problems of the developing world and how the living standards of the overwhelming majority of the world's people could be raised to bring them closer to those of the industrialised world. By the 1970s, however, as the post-war boom started to evaporate, he realised the need to focus on a more integrated, global approach to development. This led him to work for a British trade union for a period before eventually becoming a freelance consultant in 1979, which he has remained ever since.

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