

## An X-ray of Economic Stagnation

Review of Jack Rasmus, *Systemic fragility in the global economy*. Atlanta, GA, Clarity Press, 2016

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Advanced economies are in a rut of slow growth, the new normal (El-Erian), or is it the end of normal (Galbraith 2014)? Growth was slim before the 2008 crisis and recovery after crisis has been sluggish as well, with growth around 2% in the US (2.2% in 2017, according to IMF estimates), 0.6% in the EU (2016), 0.7% in Japan (2016). An ordinary period headline is, 'U.S. in weakest recovery since '49' (Morath 2016).

Emerging economies and developing countries (EMDC) face a 'middle-income trap' and 'premature deindustrialization'; energy exporters see oil prices collapse from above \$100 per barrel to below \$50 (2014) and advanced economies are in a 'stagnation trap'.

Explanations of the conundrum are perplexingly meager. Many accounts are merely descriptive, such as secular stagnation (Summers 2013)—noted, but why? Or, uncertainty—which is odd because policies haven't changed for years. Or, corporate hoarding—corporations, particularly in the US, are sitting on mounds of cash, buy back their own stock, buy other companies and reshuffle, but are not investing—noted, but why? Or, a general account is that advanced economies are on a technological plateau, broadly since the 1970s (Cowen 2011, Gordon 2016). With the rise of the knowledge economy and the digital economy (along with the gig economy as in Uber, Airbnb and freelance telework), contributions of Silicon Valley (Apple, Google, etc.), innovations in pharma and military industries, also in emerging economies, innovations abound. However, as Martin Wolf (2016) notes, 'today's innovations are narrower in effect than those of the past'. Besides, the shift to services in postindustrial societies means a shift toward sectors (such as healthcare, education, personal care) where it is hard to raise productivity.

If we consider policies, the picture gets worse because a) implemented year after year, they clearly don't work, b) indications are they make things worse.

Fiscal policy is generally ruled out because of fear of deficits. The policy instrument that remains is monetary—low interest rates and quantitative easing (QE), implemented in the US, UK, EU and Japan. Other standard policies are, in the EU, *austerity*—which may cut deficits but obviously doesn't generate growth (and by depressing tax revenues over time worsens deficits)—and structural reform. Besides privatization, the major component of reform is labor market flexibilization, in other words depressing wages and incomes. This has been implemented in the US since the 1970s and 80s, in the UK in the 90s, in Germany in the 00s, and is now on the scaffolds in Japan and France (and possibly Spain and Italy). The objective is to boost international competitiveness by depressing wages and benefits, which a) ceases to have effect when every country is doing the same, b) assumes the key problem is cheap supply, whereas supply is actually abundant and what is lacking is demand, c) by depressing wage incomes it further reduces domestic demand. No wonder these policies make matters worse.

Thus, explanations of slow growth fall short and policies have been counterproductive. This is where Jack Rasmus's book comes in. It offers the most pertinent analysis of the stagnation trap I have seen. There are many steps to the analysis but it boils down to his Theory of Systemic Fragility. I review the main points of his approach, for brevity's sake in bullet form.

- Taking finance seriously, not just as an intermediary between stations of the 'real economy' (as in most mainstream economics) but with feedback loops and transmission mechanisms that affect the real economy of goods directly and indirectly.
- A three-price analysis—beyond the single price of neoclassical economics (the price of goods), the two-price theory of Keynes and Minsky (goods prices and capital assets prices), Rasmus adds financial assets and securities prices (408).
- The long-term, secular slowdown of investment in the real economy (chapter 7) and the *shift to investment in financial assets* (chapter 11). This has been occurring because financial asset prices rise faster than the prices of goods; their production cost is lower; their supply can be increased at will; the markets are highly liquid so entry and exit are rapid; new institutional and agent structures are available; financial securities are taxed lower than goods; in sum, they yield easier and higher profits. Financial asset investment has been on the increase for decades, has expanded rapidly since 2000 and 'from less than \$100 trillion in 2007 to more than \$200 in just the past 8 years' (212).
- In government policy there has been a shift from fiscal policy to monetary policy. 'Central banks in the advanced economies have kept interest rates at near zero for more than five years, providing tens of trillions of dollars to traditional banks almost cost free' (220). Low interest rates and zero interest rate policies (ZIRP) benefit governments (it lowers their debt and interest payments) and banks (affords easy money) while they lower household income (lower return on savings and lower value of pensions), so in effect households subsidize banks (471).
- Quantitative easing (QE) policies, massive injections of money capital by the US (\$4tr), UK (\$1tr), EU (\$1.4tr) and Japan (\$1.7tr) since 2008, or 'about \$9 trillion in just five years' (185, 262). Add China (\$1-4tr) and add government bank bailouts over time and, according to Rasmus, the total global liquidity injected by states and central banks is in the order of \$25 trillion (263). The injections of liquidity into the system allegedly aim to stimulate investment in the real economy (by raising stock and bond prices), which raises several problems:
  - a Investment in the real economy isn't determined by liquidity but by expectations of profit.
  - b Funds that are invested in the goods economy leak overseas via MNCs investing in EMDC, where returns are higher (and more volatile).
  - c Most additional liquidity goes into financial assets, boosting commodities, stocks and real estate, and leading to price bubbles (177). 'The sea of liquid capital awash in the global economy sloshes around from one highly liquid financial market to another, driving up asset prices as a tsunami of investor demand rushes in, taking profit as the price surge is about to ebb, leaving a field of economic destruction of the real economy in its wake' (473).

- The post-crisis attempts at bank regulation overlook the shadow banks, even though the 2007-2008 crisis originated in the shadow banks rather than the banks. (Shadow banks include hedge funds, private equity firms, investment banks, broker-dealers, pension funds, insurance companies, mortgage companies, venture capitalists, mutual funds, sovereign wealth funds, peer-to-peer lending groups, the financial departments of corporations, etc.; a typology is on 224.) The integration of commercial and shadow banks is another variable. Shadow banks control in the order of \$100 trillion in liquid or near liquid investible assets (2016, p. 446).
- Add up these trends and policies and they contribute to several forms of fragility, which is the culmination of Rasmus's argument. Rasmus distinguishes fundamental, enabling and precipitating trends that contribute to fragility (457).
- The explosion of excess liquidity goes back to the 1970s and has taken many forms since then. QE policies amplify this liquidity and have led to financial sector fragility, which has been passed on to government balance sheet fragility (via bank bailouts, low interest rates, and QE), which have been passed on household debt and fragility (via austerity policies). 'Austerity tax policy amounts to a transfer of debt/income and fragility from banks and nonbanks to households and consumers, through the medium of government' (472). This in turn leads to growing overall system fragility.

While Rasmus aims to provide a theory of system fragility, in the process his analysis gives an incisive account of the stagnation trap. Many elements aren't new. Note work on austerity (Blyth 2013) and finance (Goetzmann 2016) and note, for instance: 'The world has turned into Japan,' according to the head of a Hong Kong-based hedge fund. 'When rates are this low, returns are low. There is too much money and too few opportunities' (Sender 2016). However, by providing an organized and systemic focus on finance and liquidity, Rasmus makes clear that the policies that aim to remedy stagnation (low interest rates, QE, competitive devaluation, bank bailouts) and provide stability are destabilizing, act as a break on growth and aggravate the problem. According to Karl Kraus, psychoanalysis is a symptom of the disease that it claims to be the remedy of, and the same principle holds for the central bank policies of financial crisis management.

This doesn't mean the usual arguments for stimulating growth (spend on infrastructure, green innovation, etc.) are wrong, but they look in the wrong direction. For one thing, the money isn't there. Courtesy of central banks, the money has gone by billions and trillions to banks, shadow banks and thus to financial elites and the 1%. Surprise at corporations not investing is also beside the point when government policies at the same time are undercutting household income and consumer demand, reproducing an environment of low expectations.

Criticism of QE has been mounting, even in bank circles ('it's the *real* economy, stupid'). Yet the role of finance remains generally underestimated. Rasmus's analysis of central bank policies overlaps with that of El-Erian (2016), but his critique of economics is more fundamental and his theory of fragility and its policy implications are more radical. A turnaround would require fundamentally different policies and, in turn, different economic analytics.

Let me note some reservations about Rasmus's approach. One concerns the unit of analysis—the global economy. His analysis overlooks or underestimates the extent to which East Asian countries stand apart from general financial fragility. They have been less dependent on western finance than Latin America and Africa and having learned from the Asian crisis of 1997, they have built buffer funds against financial turbulence and tend to ring-fence their economies from Wall Street operations. But, of course, this remains work in progress. Second, Rasmus adds China's stimulus spending to the liquidity injections of western central banks. However, the bulk of China's stimulus funding *has* been invested in the real economy of infrastructure, productive assets and urbanization, which has led to over-investment, but which has next led to major initiatives of externalizing investment-led growth in new Silk Road projects in Asia and beyond (One Belt One Road, Maritime Silk Road, Asian Infrastructure Investment Bank, Silk Road Fund, etc.). Meanwhile, Rasmus has made a signal contribution to contemporary economics and provided a vitally important X-ray of the political economy of stagnation.

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