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BOOK REVIEW

From economic stagnation to systemic fragility?

Jack Rasmus, *Systemic Fragility in the Global Economy* (Atlanta, GA: Clarity Press, 2016), ISBN: 978-0-986769-4-7, 490 pp., $29.95

ABSTRACT

Advanced economies are in a rut of slow growth. Growth in emerging economies has also slowed. Explanations are meager and policies have not worked or have made problems worse. The Trump administration of hard-line billionaires will likely exacerbate problems. Jack Rasmus's book *Systemic Fragility in the Global Economy* offers a penetrating analysis of economic stagnation in advanced economies by providing a sustained and systemic focus on the role of finance, an analysis that probes further than mainstream economic analysis. Rasmus has made a signal contribution to contemporary economics and provided a vitally important X-ray of the political economy of stagnation.

KEYWORDS

Economic stagnation; finance; financial asset investment; quantitative easing

JEL CLASSIFICATIONS

N1; N2

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 the crisis has been sluggish as well, with growth around 2 percent in the United States (2.2 percent in 2017, by International Monetary Fund estimates), 1.5 percent in the European Union (EU) (2017), 0.9 percent in Japan (2017). An ordinary period headline is, "U.S. in weakest recovery since '49" (Morath, 2016).

Emerging economies and developing countries 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) and the "new mediocre" (IMF, Harding, 2016) —noted, but why? (Secular stagnation derives from Alvin Hansen's 1938 adaptation of Marx's tendency of the rate of profit to decline, hence real interest rates decline, therefore policy interest must decline, notes Sinn [2016].) Or, uncertainty—which is odd because policies have not changed for years. Or, corporate hoarding—corporations, particularly in the United States, 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, and the "fourth industrial revolution," 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 health care, education, and 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 do not work, and (b) indications are that 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 United States, United Kingdom (UK), (EU), and Japan. Other standard policies are, in the EU, *austerity*—which may cut deficits but obviously does not generate growth (and, by depressing tax revenues over time, worsens deficits)—and structural reform. Besides privatization, the main component of reform is labor market flexibilization, in other words depressing wages and incomes. This has been implemented in the United States since the 1970s and 1980s, in the UK in the 1990s, in Germany and South Korea in the 2000s, and is now on the scaffolds in Japan, France, and Spain (and possibly Italy). The objective is to boost international competitiveness by depressing wages and benefits, which (a) ceases to have an 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, and (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.
- 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" (p. 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" (p. 220). Low interest rates and zero interest rate policies (ZIRP) benefit governments (by lowering their debt and interest payments) and banks (by affording easy money) while they lower household income (by lowering return on savings and lower value of pensions), so in effect households subsidize banks (p. 471).
- Quantitative easing policies, massive injections of money capital by the U ($4 trillion), UK ($1 trillion), EU ($1.4 trillion), and Japan ($1.7 trillion) since 2008, or "about $9 trillion in just five years" (pp. 185, 262). Add China ($1–4 trillion) and add government bank bailouts over time and, according to Rasmus, the total global liquidity injected by states and central banks is on the order of $25 trillion (p. 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 is not determined by liquidity but by expectations of profit.
  b) Funds that are invested in the goods economy leak overseas via multinational corporations (MNCs) investing in economically more developed countries (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 (p. 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" (p. 473).
- The postcrisis attempts at bank regulation overlook the shadow banks, even though the 2007–8 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, and so on; a typology is on p. 224.) The integration of commercial and shadow banks is a further variable. Shadow banks control on 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 (p. 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 to 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" (p. 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 are not new. Note work on austerity and finance (Blyth, 2013, 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, and bank bailouts) and provide stability are destabilizing, act as a break on growth, and worsen the problem. According to Karl Kraus, psychoanalysis is a symptom of the disease that it claims to be the remedy for, and the same holds for the central bank policies of crisis management.

This does not mean that 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 is not 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 percent. 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. Asian countries have been less dependent on western

finance than Latin America and Africa and having learned from the Asian crisis of 1997, have built buffer funds against financial turbulence, stand apart from general financial fragility, and tend to ring-fence their economies from Wall Street operations. 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 overinvestment, but has next led to major initiatives of externalizing investment-led growth in new Silk Road projects in Asia and far beyond (One Belt, One Road, Maritime Silk Road, Asian Infrastructure Investment Bank, Silk Road Fund, etc.; Nederveen Pieterse, 2017). Even so, China also faces a huge debt overhang (Pettis, 2013, 2014).

It may be appropriate to add notes about the trend break of the Trump administration. First, a general ongoing shift from monetary to fiscal policies and the shift toward protectionism in advanced economies have been in motion regardless of the election of Trump. In the case of the United States, this includes rejection of the Trans-Pacific Partnership (TPP) as well as the Transatlantic Trade and Investment Partnership (TTIP). The Trump administration represents "a bonfire of certainties," yet in macroeconomic policy in many respects the likely scenario is back to the old normal of supply-side economics and trickle down, the Reagan-era package. Deregulation now goes into overdrive. What institutional buffers there are to rein in banks, shadow banks, and corporations will shrink further. Those who advocate dismantling government agencies are appointed to head the agencies (such as labor, education, energy, environment, housing, and justice) to better implement deregulation from the inside. Corporate tax cuts come with attempts to bring back funds from overseas. American corporations are hoarding cash already and corporate tax cuts adding more will boost stock buybacks and chief executive officer stock options, but investment? The American middle class is shrinking, malls are closing, and department stores are downsizing. The Trump cabinet of billionaires, a return to the Gilded Age with generals for muscle, is an entrepreneurial state, not in an ordinary sense but the entrepreneurialism of plutocracy, the state apparatus placed in the service of capitalism with a big C. A no-pretense version of the antigovernment ethos adopted since the Reagan administration ("get government off our backs"), antigovernment government, gloves off. Pundits have sternly criticized emerging economies for disrupting the liberal international order, but now an American government changes the rules by sliding to transactional deal making. If the old problem was double standards, the new problem is no standards.

This is part of a slow deterioration of institutions that has been in motion since the Reagan era. A cover headline of the *Economist* is "The debasing of American politics" (2016), but it is the debasing of institutions that matters more. If market incentives lead and everything is for profit—health care,

utilities, prisons, media, education, and warfare—institutions gradually decline, such is the logic of liberal market economies bereft of countervailing powers. Corporate media are a major factor in the decline of the public sphere. Part of the profile of emerging economies and developing countries is rickety institutions. Investigations and trials for corruption in several emerging economies indicate that norms and standards have been rising during recent years, while in the United States, the reverse is happening and the country may be slipping to emerging economy status. Several emerging economies no longer tolerate Big Boss behavior (e.g., South Korea, South Africa) while in the United States it becomes the new normal. 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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