In its Fall 2016 prognosis for the capitalist economy, the International Monetary Fund (IMF) has notably scaled back its growth prediction for the USA. Sluggish investments – possibly also due to insecurity over the country’s future political leadership – have slowed growth by 1.6% for the coming year. In the summer the IMF was still expecting 2.2%. ‘Growth has been too weak for a long time now’, IMF Economic Counsellor Maurice Obstfeld noted in his presentation of the Report.¹ ‘And in many countries too few people have been able to benefit from it. This has political consequences, which will probably depress growth still further.’ The IMF sees numerous dangers for the world economy as a whole, which call into question any recovery in the coming year. Among them, according to Obstfeld, are ‘a halting development in China, a further collapse of raw material prices, increasingly strained financial markets, disturbances due to climate change, increased trade barriers, and geopolitical tensions’. Obstfeld and IMF Managing Director Christine Lagarde are therefore demanding more stimulus from the political sector to promote growth.

¹ Dotted line represents pre-crisis and post-crisis averages of 6.1% and 3.1% respectively. Sources: IMF, World Economic Outlook, Subdued Demand: Symptoms and Remedies, October 2016.
In view of weakening worldwide growth, Lagarde appealed to the member countries to do everything to reinforce it. Depending on the specific situation, each country needs, she insisted, to create an appropriate mix of monetary and fiscal policy and structural reforms in order to remedy weak growth in the world. ‘Every country can do something.’ The goal proclaimed in Brisbane in 2014 of raising the worldwide growth rate by two percentage points within five years will not be reached, she said, in the context of what has been planned. At present, according to Lagarde, we are entering a 1.5% growth path.

In the reports published around the Fall meetings on the international economic situation (World Economic Outlook), on financial stability (Global Financial Stability Report), and on the financial situations of countries (Fiscal Monitor), the IMF economists on the whole painted a dark picture. They agreed, above all, that the low-interest policy pursued by central banks had missed the target of stabilising economic growth; the still ailing global financial system and the incapacity of the banks to implement reforms led to the insufficient promotion of growth due to their lending; insurance companies and pension funds had increasing solvency problems; debt – especially private debt – was at an all-time high worldwide; and the weak economic development and growing threats were boosting populism.

Not only is the economic dynamic of the USA, as the world hegemonic power, weakening; since the great economic crisis of 2007 the capitalist centres (the USA, Japan, the EU, and Great Britain) are showing no coherent upswing, which has its effect on world production and world trade. The crippling of the world economy can be clearly seen if we look at world trade. From 1970 to 2007 its share in global GDP rose from 27% to circa 60%; but after this world trade has stagnated and in the most recent period it has tended to weaken still more.
The political establishment and the economic elites of capitalist societies have not managed to shift gears for a prosperous future. Present-day attempts to move the ossified world trade order through free trade agreements (TTP, TTIP, CETA) are being met with considerable resistance from civil society. An increasing number of citizens see their prosperity being eroded or endangered and few of them have benefited from the policy of recent years. Moreover, there is great doubt about the theory that secular stagnation can be overcome through qualitatively new free trade agreements.

The effect of declining world trade is already disastrous for the emerging economies whose export volume makes up a greater portion of global GDP than that of the EU and USA together. The emerging markets piled up too much debt in the boom phase and created too much industrial capacity. Major adjustments will come – as we see in Latin and Central America and Africa. Stagnating or even declining prosperity will find global expression in seismic policy shifts.

The global economy is not recovering, although in reaction to the crisis the central banks have implemented one of the biggest interventions ever carried out in the history of capitalism. The central banks jumped in when the capitalist global economy was on the edge of a sharp drop. They used the
option of acting as a ‘lender of last resort’ in crisis situations.

Already in recent decades the central banks have repeatedly lowered interest rates when growth in individual states left something to be desired, and they have regularly used other monetary measures as soon as there were threats of bigger financial crises. The idea behind this is still that low interest rates stimulate consumption and investment activity and indirectly spur economic growth. In the highly developed economies, the buying up of government bonds by central banks do not represent a dangerous development in the sense that they would endanger monetary value or lead to inflation. The stabilisation of low interest-rate levels is indeed the result of expansive monetary policy, but it was also deliberate. For if they were higher the world economy would find itself in a still weaker condition than it already is in.

At the beginning of the twenty-first century, due to chronic over-accumulation, the capitalist economies were faced with a secular capital surplus and thus with a global ‘savings’ glut. With their expansive monetary policy the central banks reproduced the scissors phenomenon of a stagnating real economy and the superabundant accumulation of money capital. In their reaction to the 2007/2008 global crash they went over to crisis-management mode: following the lead of the US central bank (the Fed) they used an expansive monetary policy to try everything to prevent a collapse of the markets. But nine years have passed since then, and now it is clear that the central banks are, so to speak, prisoners of their own ‘salvage policy’.

![Graph 4: Central Bank Assets](image)
The continued intervention of the central banks is leading less to economic expansion and increasingly to market distortions. It is obvious that excessive money creation has no positive influence on real economic growth and produces the opposite effect. The ‘penalisation’ of savers by an illogical monetary policy leads to fewer investments in the real economy and weakens productivity, efficiency, and thus prosperity. Increasing state interventionism via expansive credit policy favours the real-estate sectors and the development of financial instruments. The more the central banks intervene, the greater will the imbalances be and the greater the consequent dislocations in the real and financial economy.
The most important point is that with an abundant supply of capital the worldwide weakness in real investments produces a so-called savings glut or an over-supply of money capital. This leads to low and, in the end, negative capital-market interest rates. The interest rate loses its control function for the allocation of investment-seeking capital. The blame for this does not lie with the central or currency-issuing banks.

The paradox is that many companies are swimming in liquidity. In view of the further aggravation of unequal distribution and the inflated volumes
of credit there are no impulses to expand investments. The accumulation of debt has by now reached such a level that a return to a normal interest-rate cycle has been made impossible because this would have dire consequences for the economies and the political relations of forces.

Since the great recession of 2009 economic growth in the industrialised nations – and then later also in the emerging countries – has remained weak. Europe especially has had difficulty in transcending the pre-crisis level of added social value. The USA is growing somewhat more robustly, and with an unemployment rate of 4.9% it has recovered to a condition of nearly full employment.

Nine years have passed since the great crisis of 2007/2008. In times of a pronounced economic boom cycle a rapid recovery would have long ago turned into a new recessionary development phase, for as a rule after such a long time economic recovery already slackens again. In the present case a recovery has not even really set in. In the USA too, recovery has levelled off onto a flat path.

Europe is still waiting for the recovery, as is Asia. The same goes for Latin America, where structural problems of the region repeatedly come to bear. There is no trace of a return to an accumulation cycle borne by investments. It is true that on the global level there is no downturn, but there are at the most disparate developments and on the whole a depressive stagnation. Although the 2008 financial crisis is over we are still caught in a circuit of expansive credit policy, fragile accumulation, and accelerated growth of financial assets.
WAYS OUT OF SECULAR STAGNATION?  

Structural transformation of the global economy – the China factor

Global economic growth is not decided in Europe. It is secondary whether the euro area will come out of its condition of stagnation and whether Germany’s European hegemonic power will grow by 1.5% or 1.9%. Much more crucial is always whether the economy in China will continue to grow by 6.5% or 7%, and whether China’s party and state leadership can continue politically and socially to control the more or less serious decline of growth.

Emerging doubts about the strength of the Chinese economy, the surprising devaluation of the yuan, and worries that the US Fed will soon raise the prime rate have for some time now been frightening investors out of their routine. This has freed many to look at the deeper problems of the global economy.

First thesis: A shift in trend has become apparent. The economic importance of the emerging countries for the global economy has almost tripled in the last two decades. Their GDP today accounts for about 40% of the world economy. With its dramatically increased economic output, China has risen to be a locomotive of the world economy. The most recent data on China’s economy has increased concern that the economic dynamic is waning. The party and state leadership is proceeding to weaken its own currency to strengthen its export industry.

In fact, economic growth in China is weakening. Despite this, China’s economy clearly continues to be the greatest contributor to global GDP growth. For a world economy that has manifestly not overcome the contradictions of the 2007 accumulation crisis and that could not withstand a new drop into recession without major dislocations, China’s role is central to further development.

Graph 10: China’s Economic Growth

Source: Financial Times, zerohedge.com
Second Thesis: The patent difficulties the People’s Republic of China has in maintaining the high growth rate of around 7% is creating problems for a broad segment of raw-material exporting countries and is leading to market contractions in the main capitalist countries.

China was and is an important growth engine for the global economy:

- It intensified its growth model, which primarily rested on exports and domestic infrastructure investments. It extended its capital stock. It invested in new road networks, railway lines, harbours, airports, and cities.
- Its need for raw materials like petroleum, iron ore, copper, and coal exploded.
- The worldwide prices of these raw materials established a super-cycle lasting several years.
- The exporters of these raw materials – from Australia and Indonesia to Brazil, Canada, Chile, Saudi Arabia, and Russia – could develop their own economies thanks to the profitable business this provided them.
- China generated a massive surplus in its trade balance and its current account. Furthermore, capital investments were pouring into the country. In a system of flexible exchange rates China’s currency, the Renminbi, could therefore have steadily gained value.

The growth rate in China is still high at almost 7% but clearly lower than the annual average of 10% of past decades. If China’s GDP were to reach the 6.7% mark in accordance with the government’s official 2016 goal – which is only a little over the most recent IMF prognosis (6.6%) – China would account for 1.2% of global GDP. For this year the IMF is now expecting worldwide growth of only 3.1%; but in this case China’s contribution to world GDP growth would be responsible for almost 39% of the total.

The contribution of the other important economies, on the other hand, comes out to significantly less. The USA, as the hegemonic power, will increase its economic product in 2016 by a mere 2.2%. With this result the leading power will altogether account for only ca. 0.3% of worldwide GDP growth, which amounts to about a fourth of China’s contribution. It is true that the tempo of the Chinese economy’s growth has clearly decreased relative to its average 10% annual growth in the period from 1980 to 2011. However, even after the transition from the ‘old’ to the ‘new normality’ (in the official vocabulary of the Chinese government) the world economy remains highly dependent upon China.

A continuing global growth dynamic supported by China’s domestic economy has three important consequences:
Ways Out of Secular Stagnation?

First, without China’s contribution to the global growth dynamic, worldwide GDP in 2016 would reach about 1.9% and thus be clearly below the 2.5% threshold classified by the IMF and the World Bank as stagnation.

Second, a possible but not likely hard landing of China’s economy would have a disastrous effect on large parts of the global economy. Every 1% drop in China’s GDP directly reduces global GDP by about 0.2%. Including the spillover effects of foreign trade, the negative impact on worldwide growth would be about 0.3%. A massive weakening of China’s growth would trigger a sharp recession in the world.

Third, the global effects of a successful structural change of the Chinese economy remain positive. The tendency would be towards a stronger rise of imports than of exports. The reason is that rising wages countrywide make it increasingly difficult to be the ‘world’s workbench’. With many incentive and promotional measures, the Chinese authorities are therefore trying to stimulate the development and establishment of upmarket (and clean) production. At the same time, the consumption of the Chinese is itself to become a stronger growth motor. The unavoidable structural change in China continues to make possible a strong counterweight to an otherwise stagnating worldwide economy.

China must carry out a structural transformation, for the time is over in which the world’s second biggest national economy expanded for years, sometimes by much more than 10%. This boom phase has left a legacy of macroeconomic imbalances, a wide social gap, and increased political risks. But in stark contrast to the important national economies of the highly-developed world, in which there is very limited scope for this, the Chinese authorities have control capabilities for loosening monetary policy to spur economic activity. To the extent that the Chinese leadership is in a position to maintain this multi-dimensional policy and its reform focus, the weak and still vulnerable world economy can only benefit from this.

The reconstruction of the Chinese economy is proceeding. In the last year the share of service workers in economic output totaled to 50.5%, which corresponds to a 2.4% growth relative to the previous year. In so doing the tertiary sector is slowly outstripping industry – whose share of GDP last year was 40.5%. Thus in 2015 the tertiary sector, with 8.3%, rose more sharply than industry, with a growth of 6.0%. These emerging changes in economic structure show that structural transformation is indeed advancing. In view of the growth slowdown the government has laid great stress on regulating loans and controlling debt.
The debt burden makes up more than 250% of GDP, which is now too high. Structural change must therefore be tied to a weakening of credit expansion. Reassuring comparisons with the similarly high liabilities of the US or Japan are misleading because in the long run rich countries have less problems with financing their loans than do emerging countries, which are at a lower level of development. The decision-makers in China are thus engaged in a risky re-orientation process: they want to decrease the debt burden, stabilise growth, not depress the market with debt default, and at the same time avoid price bubbles. To stabilise growth the state is keeping up investments. On the other hand, the enterprises are hardly still investing.
The rapidly growing debt burden was the price paid for the high growth dynamic with its positive effects on the global economy, since economic output grows thanks to higher debts. In the recent period lending has clearly grown more than the economy. As a result the debt burden rises in comparison to economic output, and the debt ratio has accelerated even more. In order to reduce the ratio of debt to GDP the debt level must be lowered. The present high rate of growth in loans is based on government-directed investments in infrastructure and on an expansion of the real-estate market.

Global economy – between secular stagnation and credit expansion

Years after the Great Crisis, the capitalist global economy is still in a dangerously unstable mode. It is unstable because the expansion of the credit system included constraints. No corrective is emerging in either extreme of disequilibrium – neither in a speculative boom nor in deflationary debt liquidation. The boom is feeding on itself just as the economy spirals ever deeper into depression. This process can only be stopped through state intervention. In depression this means fiscal and monetary policy support to stop the self-destructive, deflationary debt liquidation.

Since the outbreak of the Great Crisis almost ten years ago now (2007/2008) we are passing through a cascade of various phenomenal forms. Between phases of the intensification of contradictions the financial markets cool down and the social process of reproduction recovers, although not evenly in all countries. The point of departure for the structural crisis in contrast to a normal business-cycle crisis was a drastic price correction in
the real-estate sectors and after ailing mortgage loans in many capitalist countries, out of which a bank crisis and later a public debt and banking crisis developed.

The following years will probably be characterised by attempts to deal with the accumulated mountain of debt, that is, to clear them. Private households would have to reduce their debts and states consolidate their budgets. If private consumption and investment expenditures still decline aggregate demand will be suppressed. Debt reduction is a protracted process; in all historic cases it requires years. It began with the outbreak of the financial crisis in 2007, and there are no signs of a return to accelerated capital accumulation. We are once again seeing symptoms of a possible financial crisis.

Contrary to conventional wisdom, financial crises are inevitable phenomena of the basic instability of the capitalist economy. In longer phases of accelerated capital accumulation (with economic growth), banks, enterprises, and consumers lose their aversion to risk and, driven by the desire to valorise their assets, begin to expose themselves to ever more adventurous financing – stimulated by the merciless competition between the banks, which contributes to the invention of new financial products and to attempts by banks to circumvent the prevailing regulations. The financial markets begin to overheat, and the number of alternative options are constantly diminished. In the end, enterprises, financial institutions, or private individuals pin their hopes on expected price rises of assets that they have bought on credit. The end of the party is normally triggered by an actually minor event, which throws the whole financial branch into crisis.

The capitalist economies are now in a liquidity trap. That is, the tendency to ‘secular stagnation’ means strongly flattened growth rates for the economy, meagre rates of price increase (which is called deflation), and at the same time the central banks have recourse to the lowest extremes of their prime rates, which cannot be much lower than zero. At the same time a decided uncertainty prevails in the international financial markets vis-à-vis the incontrovertible instability. In view of frictions in the global credit cycle, the present situation is assessed as extraordinarily fragile. It is acknowledged that since the beginning of the financial crisis there has been no global debt reduction, and that, instead, debt has sharply risen, that derivative products have lost nothing of their complexity, and that their enormous number has grown still further. It is seen that politicians and central bankers have shirked their responsibility to citizens through their policy of high debt and the risky, untested measures not directed towards reinforced growth and greater financial stability but to more inflation.
Once again the policy of life on credit is facing the danger of tipping over and coming to an abrupt end. The world financial system and world economy are in turn caught in the logic of an uncontrollable expansion of credit. There is the threat of a new great depression with bank collapses, state bankruptcies, mass unemployment, and social and political conflicts within and between countries. Policy has stuck to the supposedly tried and true means, that is, still cheaper money and still more debt. This only means continuing to fight the symptoms and not the actual causes.

The leading central banks have now once again transformed the traditional business-cycle and financial cycle of the last decades into a dangerous ‘asset-price cycle’. Today, in view of the incredibly long low-interest-rate phase, and in terms of the booming bond, stock, and real-estate markets, the world economy ought to find itself in an analogously strong upswing – but this is not the case. Even below-zero interest rates are not enough to get a world with a shrinking or stagnating labour force and without advances in productivity back onto a growth course.

In the last 30 years this economic policy not only covered up the increasing crippling of the economic driving force; it also further aggravated the problems. Continually rising debt has only served to finance consumption and speculation. The value of assets resulting from this debt has risen sharply everywhere. The interest on it, however, must as always be financed from income, which in the end leads to decreased demand. At the same time investments have been made that on closer analysis have not paid off. Overcapacity, bad investments, and nonperforming loans are depressing the market and reinforcing deflationary forces. It is becoming continually clearer that debts enable advance consumption. The growing gap between productive capacities and stagnating mass income is threatening development.

A (state-accompanied) drastic remedy or a ‘New Deal’

What could the solution be? Aside from a crash triggered by a secondary event there is an alternative. The central banks, supported by government policy, can bring the economy back on a path of growth after an induced ‘creative destruction’, a cleansing shakeup, for instance through a decisive prime rate increase. Tottering enterprises and banks are swept out of the market so that something new can emerge from the ruins. Or a bridging subsidy can be established through which private households and companies can be rehabilitated, banks recovered, and the economy made self-sustaining again. A severe financial crisis is defused and its distortions cleaned up by state intervention, be it in the form of the central bank, the oversight authorities,
or the ministry of finance.

A drastic remedy to clean up worthless asset titles would not be a popular one. The property and conditions of reproduction of all population groups, however diverse, would be touched. The owners of assets would have to make their contribution to the removal of the non-performing loans and to the financing of the urgently needed investments. Companies, if they want to avoid higher taxation, would have to invest more. The state would have to invest more in public infrastructure. The future ensuring of prosperity would be purchased by a longer lean period with higher unemployment. A collapse into a longer crisis phase cannot be excluded.

The alternative to a state-accompanied cleansing and accommodation process is an extraordinarily concerted reform effort, a kind of New Deal consisting of monetary, fiscal, and structural policy, with which the important national economies and consequently the world economy could be manoeuvred back onto a development path. Monetary policy alone could never accomplish this. It is still not too late to involve the central banks in a reform option. State investments in infrastructure financed through the bond market could be efficiently and successfully implemented in the USA, Germany, Great Britain, and thus in the EU and euro area. The accumulated needs in all these national economies is enormous. Loan capital at low interest rates is available, and investments in infrastructure would improve the conditions of life and production.

An effective social reform policy is tied to a radical change of direction and a socio-political overall concept. Full employment can be achieved with the extension of state expenditures on public investments or for a qualitative change in mass consumption. By contrast with the approaches to macroeconomic global management implemented up to recent years, these measures need to be rooted in a long-term planned structural policy, both in terms of taxation and in the expansion of public investments and mass consumption. Without an expansive wage policy no lasting domestic economic growth can be created. It is not a matter of more economic growth within the traditional income and consumption structures but of the formation of a socially and ecologically more sustainable mode of life. A fundamental reform of the capitalist economy has to be planned such that a long-term structural policy is pursued through combatting the existing inequality in income distribution.

Such a restructuring has to centrally focus on four dimensions. First, the big disparities in income and assets have to be reduced. In the first place, the ‘accumulated claims upon production’ \(^3\) have to be cut back through taxation. Second, the extent of flexibilisation – both on the factory level and
throughout the society – have to be regulated. Third, in every reform of the social security systems account has to be taken of the actual precarisation of sections of wage labour and the increased significance of interest and asset income. We have to expand the financial basis of social security from work income to other forms of income or revenue (interest, rent) if we want to realise a universal security system for all members of society. And, fourth, we need a new regime of controls on capital movement and of the control and taxation of international financial flows.

The debts that have been created in order to uphold the illusion of growth and prosperity have become unbearable and are increasingly smothering the economy. The mountain of debt has so far been prevented from collapsing only through low interest rates. Therefore an important first step is the cleansing of bad debt within an orderly process.

Part of this orderly clean-up is the reduction of the unsecured liabilities funding pension and healthcare benefits in an aging society. For years, experts from the Bank for International Settlements have been calculating the actual debt of western industrialised countries – that is, including the hidden burdens on future benefit entitlements – at several hundred percent of GDP and have called for drastic countermeasures.

The world’s leading politicians and central bankers have set out on a bridging operation, when they did not allow the economy in winter of 2008/2009 to collapse but instead intervened. The road map reads: the central banks make liquidity available and buy time so that government policy can create demand through investment programmes and tax cuts and at the same time implement a sustainable economy through structural reforms.

The central banks were left in the lurch. With growing desperation they have repeatedly bought time, but the politicians have let this tick away unused. The signs are now increasing that the central banks have come to the end of their road. The collateral effects of their extreme policy, for example the negative rates of interest, are becoming increasingly painful, while the danger of new, potentially disastrous speculative bubbles is growing in the financial markets.

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