

Another Crisis, for All ?

What After the Black Week ?.

Alberto Graña.

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After the recent somewhat scary August week signed by global uncertainty, volatility and signs of global economic deceleration we hurried up to finish our reflections in a short written Essay to put under your consideration recent global events and trends for further discussions. In the making we have been working in a daily basis (by follow up of diverse academic, public and private research centers and leading opinions), of what we considered central indicators or axes of ongoing globalization process, in particular, dealing with the US, Eurozone and their possible impact to Latin American and Caribbean countries.

Convenio IIEc/UNAM- UARM/III

Primer Ensayo prospectivo de las tendencias de la globalización.

Dedicado a **Vicente Santuc Laborde S.J.** inspirador y mentor del Observatorio de la Globalización y muy querido amigo. Por ello, nos pareció pertinente compartir un comentario de Vicente sobre el documento de Prospección Metodológica del Observatorio de la Globalización, preparado por Alberto Graña y previamente discutido Vicente Santuc SJ Bernardo Haour SJ (en Lima) y con Oscar Ugarteche y Fidel Aroche (en México DF).

RE: Observatorio Globalización

Lima, 3 de julio de 2010

“Gracias Alberto por el envío del texto que encuentro sustancialmente mejorado.

“ Las diferentes dimensiones del mundo económico, sus variables, sus procesos etc. están muy bien situados, a mi manera de ver. Al principio se habla de crisis de la filosofía, y en los numerales 14 y 15 se habla de “filosofía social o visión del mundo” y de “aspectos ontológicos de la globalización”, allí se enuncian, creo yo, aspectos sustantivos. En un libro reciente de Michel Serres titulado más o menos “Era de crisis”, él subraya como estamos llevados a revisar nuestra manera de pensarnos y de pensar el mundo.

Hasta la fecha, occidente ha manejado variables de la dialéctica “Dueño/Esclavo” para organizar la convivencia humana; pero ahora nos dice él, tenemos que ver la irrupción de un tercer factor/interlocutor que es la naturaleza.

Vivimos en las consecuencias de nuestras decisiones o falta de decisiones (mercado, tecnologías etc.) que acaban por dominarnos y que no controlamos. Pero las reacciones de la naturaleza a lo que hacemos o dejamos de hacer son otra dimensión a tener en cuenta. En tu texto dices algo al respecto, pero no me parece un espacio de observación suficientemente subrayado”. Mil gracias Beto por tu excelente texto”

Vicente Santuc
Rector UARM

Nota: el presente Ensayo se publica en Inglés debido a que fue también presentado a un debate internacional propiciado en ese idioma por UNESCO sobre la crisis mundial denominado *A Recovery for all ?*. Para la elaboración del presente ensayo se tomaron en consideración las valiosas opiniones de los colegas que mencionamos a continuación.

With many thanks to Recovery-**human-face. E-Debate: A Recovery for All ? in particular to those** participants that intervene in the topics of our Essay: **Jonh Weeks** (Professor Emeritus of Economics, <http://jweeks.org>), **Barry Herman**, (The New School), **Harry Shutt** (Economic consultant and author, West Sussex, UK), Costas Lapavitsas & **Andy Storey**(SOAS, UK and University College Dublin), **Mathias Vernengo** (Associate Professor University of Utah), **Sabri Oncu** (Kadir Has University), **Guy Standing** (University of Bath, UK). **Ann Pettifor** (Fellow of the New Economics Foundation, <http://www.debtonation.org/>), **Magdalena Sepúlveda** (UN Independent Expert on Human Rights and Extreme Poverty).**Alberto Graña** (Investigador principal, www.obela.org). **Jayati Ghosh**, Professor, Centre for Economic Studies and Planning, School of Social Sciences, Jawaharlal Nehru University, New Delhi:Last but not least thanks to **Isabel Ortiz** and **UNICEF** colleagues for enlightening the complex food prices problem facing many African Countries and the world.

Another Crisis for All ?. So what after the Black Week?

Alberto Graña. Investigador principal www.obela.org

So what after the Black Week?

After the recent somewhat scary August week signed by global uncertainty, volatility and signs of global economic deceleration we hurried up to finish our reflections in a short written Essay to put under your consideration recent global events and trends for further discussions. In the making we have been working in a daily basis (by follow up of diverse academic, public and private research centers and leading opinions), of what we considered central indicators or axes of ongoing globalization process, in particular, dealing with the US, Eurozone and their possible impact to Latin American and Caribbean countries.

Moral Hazard Rents

No matter time-space boundaries greed and power, debts and wars, appears as regularities in human stupidity. Despite the fact that it was written *at the end of 16th century*, allow us to suggest an episode of the Shakespearean tragedy *The Merchant of Venice*. The Merchant of Venice (Antonio) compromises to payback three thousands ducats borrowed to a Jew usurer (Shylock). It was also stipulated the penalty for default. In that case, Shylock was allowed to cut a pound of fresh flesh from Antonio's chest.

By the early 1980's the Polish and Mexican governments unilaterally cease their sovereign debt services owed to private US banks. This action ignited a "domino" default payments in several other Latin American and Caribbean countries (LAC). By that time, R. Reagan and M. Thatcher continued deregulation and privatization processes started in 1971 by US government unilateral decision to declare Gold inconvertibility to USD. This decision not only bust Bretton Woods accord but also inaugurated the establishment of USD *Fiat money*.

As a result, *after 1971* the currency policy pursued by the US had a direct impact on LAC economies, in at least two ways: to begin with, the USD *debasement* policy had and has an immediate effect in those countries holding USD as a *reserve currency*, affecting their *relative values of International Reserves denominated in USD*. Back to 1971, countries that trusted -the official US gesture that the USD "*was good as gold*"- experienced overnight the devaluation of their International and Gold Reserves (at the moment at 33 USD/1 ounce troy. Today at USD 1.735). Nowadays, two thirds of international reserves are held in USD.

Secondly, since 1971 the US authorities entail other countries to a sort of *monetary seigniorage*. That means that currencies attach to the USD transferred not only currency volatile fluctuations, but also surplus value that is lost on trade and services transactions paid, or international reserves held, in USD (to the US economy and the banks). Perhaps, this fact explains the recent creation of *Sovereign Funds*, held by important US partners

countries (China, Saudi Arabia, and others) in their aim to compensate the loss of value of commodities and services being paid in USD.

We must take the *Moral Hazard Rents* concept -that underlies the ongoing predominant rentist monopoly - and to depict the rent extraction circuit. In fact, a recent study made by Kaplan and Rauh shows that “banks extract significant rents from the implicit and explicit support provided to them by the *central bank*”. The authors conclude that: “ in such an environment, the system will evolve to a state which maximizes the rent extracted from “insurance commitments” by the central bank or other state agencies” (*Inequality and Moral Hazard Rents in the Financial Sector*. h/t Tyler Cowen).

Deficit monetization and inflation

It's our understanding that the *US deficit monetization* might not necessarily turn to be inflationary (or hyperinflationary) particularly in the US. Just because -since 1971- this country exert the *unique privilege* to hold his external debt in his own Fiat money. And, thus, the US is able to pay his debtors just by printing his own money or printing money to buy bankers bonds.(QE). Perhaps this fact partially explains why during the recent global turbulence, investors hold for refuge in Gold as well buying 10 year US Bonds. (Bloomberg.11/08/11). Investors confidence in US bonds might be related to this US privilege. So, we concur with Sabri Oncu's opinion (E-debate) that stands, “the US is safe until she loses this privilege”. And, for good or for bad, “It would take a while”. So, it is more likely that the US literally inflate or deflate the world with massive Fiat money creation.

US monetary expansion and global speculation

Is QE hyperinflationary?. It's inflation necessary to stimulate economic growth ? Is inflation a policy to *burn* public debts (*IMF, Redwood and Bootle, Rogoff,)?*

Between leading economist in the US (and abroad) we can find a huge disagreement on the possible effects and impact of US deficit monetization policy (and on the ineffectiveness of the Stimulus Plan launched in 2009 by President Obama). So far, academics and politicians have been unable to reach a consensus on the real impact (to the US economy -and the world-) of monetary expansion (qe) as a tool to stimulate -to a certain extent- artificially economic growth.

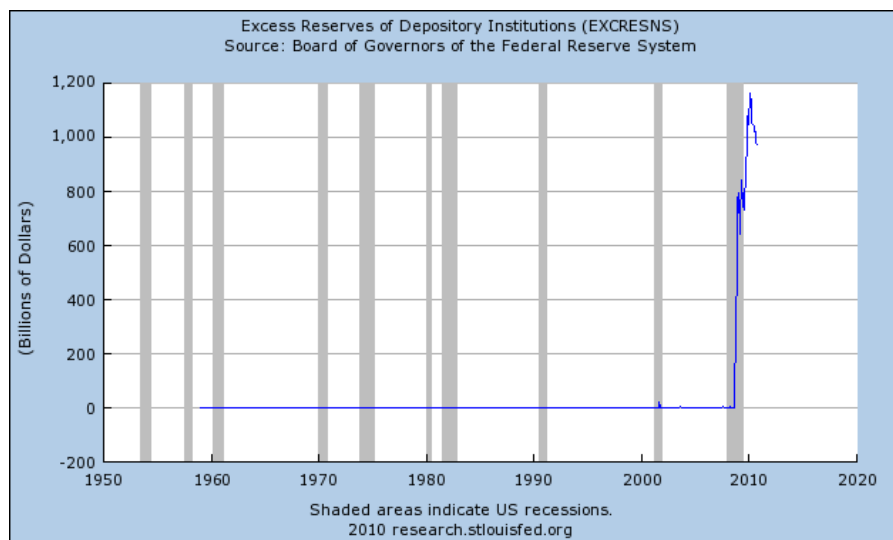
For the time being, we in LAC's countries are worried on the possible effect and impact of monetary expansion to our countries. Two rounds of large scale of asset purchases (qe1+qe2) already contributed to rapidly expand liquidity through the SIFI's and by global speculators.

Empirical evidence shows that during 2005 – 2010 financial speculation increased substantially in future commodities markets. According to the *Bank for International Settlements* : “Unregulated OTC (over the counter) activities also exploded during this period, reaching a nominal amount of \$12 trillion in non-gold commodity contracts in 2008”. That amount is more or less the same magnitude of the *2009 US GDP* or the *Debt ceiling* (*Escalating food prices The threat to poor households and policies to safeguard a Recovery for All*. Isabel Ortiz et al February 2011. UNICEF. Policy and practice Box 1., Food Prices and the

Case for Enhanced Regulation. During 2005-10). (*Baffes and Haniotis 2010 in: Escalating food prices*. <http://onlinelibrary.wiley.com/doi/10.1111/j.1471-0366.2009.00249.x/abstract>)

Excess reserves

One of the major questions that arises to us is about volatility, competitiveness and accountability of *Systemic Important Financial Institutions* (SIFI). Also known as “to big to fail”. (*Do SIFI Have future?*. Thomas M. Hoening. Pres Chief Exc. Officer. Federal Reserve Bank of Kansas). This is pretty relevant because SIFI’s have been mostly benefited with previous monetary expansions (qe1+qe2, amounts USD 2.3 Trillions). Indeed, during (2008-IV to 2009-I) systemic turmoil, SIFI’s found promptly, massive and extensive public support on cash and capital shortages and also in credit access by a number of facilities, literally, being tailored according to the boiling situation (TAF, TARF, TSLF, among many others).



<http://research.stlouisfed.org/fred2/series/WRESBAL>

Since 2009-I to August 2011 it’s noticeable an astonishing expansion of *Excess reserves* (money deposited by the banks in addition to legal Fed’s requirements). According to our calculations between January 2009 and today (August 2011) Fiat money created by the Fed to the banking system would amount USD **807** billion (the difference between USD 793 bill and today’s 1.6 Trillion). But if we compare today’s excess reserves (august 2011) to August 2008 level (USD 10 bill), the amount of Fiat money almost double to *USD 1.6 Trillion* (*Why not create new banks from QE3?* November 2010)

This figures admits a few comments. Firstly, SIFI’s are literally “sitting” on the Excess reserves deposited in the Fed instead of being lending this money to enterprises and families.

Secondly, Excess reserves have a financial cost to the economy (because FSI Section 128 of the Economic Stabilization Act of 2008, that allowed the Fed to begin paying the banks an interest).

Thirdly, every USD *Excess reserves* maintained by SIFI's (earning interest paid by the Fed) *comes out* from the US real economy (infrastructure, social expenses, unemployment, wages and salaries, states and counties budgets) and from US partners countries pegged to the USD (and, countries tied to *Free Agreements Treaties* with the US).

Last but not least, excess reserves financial costs - according to the Congressional Budget Office- "pale" in comparison to excess reserves economic and social opportunity costs (that is: "lost tax revenues worldwide resulting from decreased economic activity and damage to the short-term commercial paper and associated credit markets").

Indeed, *Excess reserves* might turn out increasingly a Drag at the expense to the whole economy as well as the world's economy.

A recovery for all?

Can we "measure" winners and losers of each crisis occurred since 1975 in the US?. Kevin Drum Research Report suggested that in 1975-76 crisis (and even during 1982-83 respective) *Wages and Salaries* where almost equivalent in absolute and relative terms to *Corporate Profits* in the National Income participation (see Chart). But if we take notice in the last outcome (2009 II-2010 IV) we have a completely different picture: *Wages and Salaries* represent a meager 1% and *Profits* 88% of the US National Income.

Winners and losers from the ongoing Great Recession (2009 II-2010 IV)

Recession's ending	National's Income Growth (NIG)	Corporate Profits Growth (CPG)	Accrued Wage and Salary Growth (WSG)	CPG Share of growth (in % of N.I)	WSG Share of growth (in % of N.I)
Six Quarters	Bill USD	Bill USD	Bill USD	%	%
1975 I-1976 III	462	148	174	32	38
1982 IV-1984 II	817	227	205	28	25
1991 I- 1992 III	237	-4	119	-1	50
2001 IV-2003 II	333	178	50	53	15
2009 II- 2010 IV	528	464	7	88	1

Kevin Drum. Jun. 30, 2011. Report from researchers at Northeastern University's Center for Labor Market Studies.

To start with, on the side the "losers" of the ongoing crisis we can also count 44 States of the Union. The upcoming fiscal year, according to the *Center on Budget and Policy Priorities*, will be "one of the states' most difficult budget years on record. Retiree benefits for state employees add yet another strain, with the states facing a \$1.26 trillion shortfall" (*Enterprising States Recovery and Renewal for the 21st century*).

An according to other sources , "household net worth fell from the 2007 peak to the 2009 valley by a

total of \$17.5 trillion, or 25.5%, and is still nearly \$10 trillion away from its all-time high".(*Inflating Away America's Future*. Michael Pento, Guest Writer, Money Morning.JUNE, 2011).

In sum, as a recent report stated, "a massive transfer of income has occurred while middle class incomes stagnated". Nowadays, almost at 4 years after the beginning of the so called "*Great Recession* the outcome to the crisis have been so far "solved" by means of concentrating more political and economic power *vis a vis* maintaining initial conditions of high inequality at national and international level.

Social responses, yesterday and now

We recall during the early 80's two emblematic labor organizations as the last line of resistance to global deregulation: the *Professional Air Traffic Controllers Organization* (PATCO,1981) during Reagan's administration(paradoxically, one of the few unions that supported his 1980 electoral campaign). And, in Britain's the *National Union of Mineworkers* (1984-85), during Thatcher's administration. Both labor unions were unfortunately defeated. Time after we found in our search that since the 80's the decline of Unions might be strongly linked to the observed rising income inequality (*Major Study Links Decline of Unions to Rising of Income Inequality*. Josh Harkinson. August 2011).

So far, nowadays *social responses* to austerity policies (and global food price spikes) had been expressed in diverse massive strikes, public demonstrations and violent riots in the core and European countries. And, of course, in the Arab World as well. But, the complexity of the situation (many of the Arab countries are engaged in civil war) goes far beyond the possibility of our present essay. Nevertheless, in the present juncture outcomes in the Arab world turn out to be volatile components of globalization process mainly as its role of oil producers.

The national social responses seem to follow diverse agendas campaigns depending on national peculiarities and structural constrains. According to Lapavitsas "In Greece are working around the necessity to implement democratic *audit sovereign debt commissions* carried out by support of civil organizations trade unions and political parties". Also in *Ireland* have launched debt audit campaigns with the support of expertise personnel being commissioned to "trawl through the public accounts to tackle several questions". *In Island*, there was a referendum to the population in order to default to British and Dutch banks.

But the social movements occurred in Greece, Ireland, Island, Portugal and Spain (US and Britain) have been so far responded by governments by adopting structural austerity measures. In the European cases this policy has the seal of the IMF, ECB and UE (called "The troika"). Indeed, in analyzing this austerity programs we can found a remarkable trend of *loss of national sovereignty* and also a unacceptable compulsory expense cuts and a privatization processes. In the US after bipartisan Debt ceiling war agreement it becomes clear that Obama's administration have no considerations whatsoever to increase direct, wealth or speculative taxation, to finance public deficits. Nevertheless, it was a bad surprise *Obama's extended tax benefits to the rich*.

Back to the Merchant of Venice, the jury finally decided to execute the terms signed in the Time Bond, that is, to allow Shylock get a pound of *fresh flesh of Antonio's chest*. But, and this a very important but, the knife cutting had to be made *without the shed of any single drop of blood*. At the end, Shylock loss his capital and belongings in favor to the State and Antonio. As Shakespeare brilliantly suggests: *greed always drives to disaster*.

US Stimulation Plan

Recent figures show's that just a few of these monetary expansion are being addressed to *productive or natural resource conservation or even social purposes*. On the contrary, the monetary stimulus is being channeled to SIFI's largely enlarging the riskier global speculative Chain, that is : *banks-investment banks-shadow banking, the same model that already get the world into this mess in the first place*.

Despite USD 2.3 trillion monetary injection (qe1+qe2), and USD 16.115 billions in emergency loans to *Systemic Financial Institutions* , we can hardly see real signs of improvement in employment or in real salaries or in consumption. In fact, yesterdays (9/08/11) FOMC statement indicated that *"economic growth so far this year has been considerably slower than the Committee had expected. Indicators suggest a deterioration in overall labor market conditions in recent months, and the unemployment rate has moved up. Household spending has flattened out, investment in nonresidential structures is still weak, and the housing sector remains depressed. However, business investment in equipment and software continues to expand"*

Moreover, recent report of OECD indicates signs of global economic deceleration. Not only in the 3 major economies and the Eurozone, but also in BRICS countries that are already also affected by inflationary processes, particularly in the food prices. Not to mention recent signs of protectionism among nations and a *currency turmoil* that just started by the Japan Central Bank and followed by the possible peg to the Swiss franc to the euro.

So, what we can see so far is an intimate and complex feedback between money, capital and future's commodities markets. According to a specialized private source a peg from the Swiss franc to the euro "might save the collapse of all those countries that are currently approaching default due to the strength of the Franc relative to other currencies".

According to Bloomberg, "Fed Chairman Ben S. Bernanke signaled that the central bank may consider a third round of large-scale asset purchases". Also, the FOMC -followed by EU central Banks- had also decided to maintain negative interest rates for the next two more years. According to our expectations, the bigger the scale of public doubtful assets purchases to SIFI's, the greater the indicators of a scary scenario of their insolvency.

Other scenario- that we slightly explore latter – have to deal with the widespread knowledge that a "bid of inflation is needed" to stimulate growth,. This mechanical or

desperate recipe is already being suggested by diverse leading economist. And, by the ineffable IMF.

Deflation trends

Despite the differences of opinion among economists, there are a shared concern about not to fall in a state of *deflation*. What we witness so far are ongoing *deflational trends*. For example, in *deflated economic and geographical spheres in the US* (real state industry, labor markets- wages-salaries, living and working conditions, default situations of important *states and counties*, lack of *human capital formation*, idle and *industrial capacity* in *geographic depressed urban and suburban zones* -already owned by the banks.

We also see deflated and regressive tax collection byproduct of ongoing fiscal exonerations policy that actually taxes a few on profits and excess wealth and much on the middle class salaries. And, we also see *overvalued* corporate financial profits, highly overvalued stocks and future commodities. And almost four decades debased USD policy.

By the same token, *P. Krugman wrote in june 2011, "if we are not literally experiencing deflation, we are nonetheless facing the same apparent impotence of monetary policy that Japan was already facing in 1998. (P.Krugman. Mr. Keynes and the Moderns. June 18, 2011)*. On the e-debate, Sabri Oncu was the only participant who considered the danger of deflation ("Further, why should we worry about inflation when we are in a global depression"? "We should worry about deflation. Deflation appears to be what the Fed is worried about or, at least, what Bernanke is worried about").

¿Deflation trends are encouraged by the ongoing monetary and fiscal policies?.

Since October 2008, deflation trends seems a more likely scenario if we take a closer look to 2009 Stimulation Program results in terms of National Income growth: 88% corresponds to corporate profits, and only 1% correspond to wages and salaries. We suspect that this figure expresses popular consumption decline (to rely on food stamps) and or to engross what Guy Standing calls the "Precariat class".

Deflation trends calls our attention when we witness US cities to go bankrupt (for example, Central Falls Rhode Island, Alabama Jefferson County, Harrisburg-Pennsylvania State capital).

It is important to recall that according to data compiled by Bloomberg that "80% of US municipal-debts bonds *is issued through negotiated deals with one or more banks* ("until the 1970s, almost all states and municipalities sold bonds competitively, inviting sealed bids from bankers"). These *private* arrangements have led to deals such as Jefferson County, Alabama's failed sewer-debt refinancing that cost taxpayers and investors billions of dollars and may prompt the county to declare bankruptcy this week".

So, are we witnessing an extension -from federal to county level- of privatization of public goods and *public spheres* of decision ?. Now it make sense what a publication mention about that Alabama's bankruptcy is indeed "80 Percent Private".

Deflation's logic has also to do with what Keynes called people's "*postponed demand*", that is to people "*..put off their purchases, not because they lack purchasing power, but because their demand is capable of postponement and may, they think, be satisfied at a lower price latter on*". Deflation is also a general sentiment of pessimism (and anger) that things will get worse, no matter what. (FT.Consumer sentiment at 30 year low in the US.12/08/11 <http://www.ft.com/cms/s/0/0a681646-c4df-11e0-9c4d-0144feabdc0.html#ixzz1UuqgXjnB>).

Commodities and food prices

Making the precision that there are much research to do to disentangle the relations between the USD fluctuations and national food prices formation, UNICEF's report (on the recent spike on food prices) place the idea that *structural factors* driving the crisis seem to *prevail on* short run policies and prices. We just may add that commodities and food prices fluctuation might also explained by Trans National Corporations dynamics (TNC). This is particularly true in the unregulated and monopolistic Food Industry. Take the recent case of a TNC firm (Cargill-ABF) accused of manipulating the British wheat market. Cargill-OBS last month bought all the available UK feed wheat(<http://www.foodnavigator.com/Financial-Industry/Cargill-and-ABF-owned-firm-accused-of-manipulating-wheat-market>)

Thus, while the USD debasement policy is one of the factors to take into account to explain commodities prices movements, at the same time, we cannot ignore what Jayati Ghosh (www.networkideas.org) called "the other underlying supply forces (that) are playing an important role in the expectations that drive such market activity".

Free market political economy

After three decades of *free market* capitalism, evidence points out that every financial and economic crisis have been so far being *sorted out* by concentrating even more economic and political power. The whole time combined with increased social unrest and structural wealth inequity. We find this way of capitalist crisis resolution clearly unevenm general terms. But from the sovereign debt issue standpoint it might also be *unlawful* if it is submitted to public *Debt audits* (Ecuador) with technical and social consultation (Greece, Island, Irland).

Therefore, -to interpret the ongoing crisis- we will better pursue on the ground of political economy considering the social struggle already taking place to define who in society is going to pay for the huge SIFIs private losses caused on behalf of Moral Hazard Rents philosophy. Krugman for instance recognized "*a powerful political movement in the US (...) preferred to risk financial catastrophe rather than agree to even a penny in additional revenues*". In essence, we do foresee whatsoever no official attempt or political will to finance the ongoing crisis mainly by means of increasing direct taxation and cutting tax benefits on the overwhelmingly wealthiest few.

We wrote before (A Graña. 2006 www.obela.org) that core capitalist countries might already be facing a structural long term downturn phase (“Kondratieff’s B”).

Meanwhile, global speculative capital seeks for refuge in the future’s commodity markets, or everywhere, but volatilizing both. In our understanding, this might be explain because of the present banking monopoly unwillingness to pay more taxes or to channel monetary expansion to finance massive environmental and productive investment undertakings. Instead, if the use of this monetary expansion where to be used to buy doubtful assets of SIFI’s-as it appears to be- this policy might push further already existing deflationary trends (mainly in the US, Britain and Japan). So far, It’s to soon to foresee if there are already conditions to establish “new conditions”(of the magnitude of Bretton Woods) for a new long term business expansion cycle.

In our view, *mainstream economic* thinking is in jeopardy. Just as it was prior Keynes and 1929-38 Global Depression. In this day and before, *free market* neoclassical assumptions stridently contrasts with our ongoing rampant rentist monopolistic capitalism. In our understanding, this rentist capitalism nature is opposed to, for instance, a Schumpeterian capitalist social vision, so to speak.

At this transitional and confrontational point of the Story of capitalism, ¿ how to address governability without more direct state regulation and intervention ?. By the way, what we will do with the pillars of economic neoclassical economics. Say’s law?, rational behavior?., automatic price stabilizers?, perfect competition ?.

Last but not least, we wonder if extremist political positions showed up during the recent US Debt ceiling “war”(and Downgrading debate) advocates US Secretary of Treasury Andrew Mellons advices to President Hoover at the beginnings of the Great Depression :
.... “*the best way to get the economy growing again was for the government let the Great Depression run its natural course: liquidate labor, liquidate stocks, liquidate the farmers, liquidate real state(...) It will purge the rottenness out of the system. People will work harder, live a more moral. Life*”. (Alan S. Blinder. *Americas Weak Recovery*. Foreign Affairs June 29 2011).

Pretty scary thoughts, in a certain way, not that far from German National Socialism philosophy.

Alberto Graña

Lima, 16 de Agosto de 2011.