

Keynesian Policy Solutions in a World of Neoclassical Design Mechanisms: Paradoxes of the Global Crisis

Gary A. Dymski

University of California Center Sacramento (to 31/12/09)

University of California, Riverside (1/1/10 - on)

AKB II – 11 September, 2009

Or ...

Why are these two men smiling?



British Chancellor of the Exchequer Alistair Darling, left, stands with U.S. Treasury Secretary Timothy Geithner on Friday (September 4, 2009)

Well, at least they *were* smiling ...



After the pre-G-20 meeting of finance ministers and central-bank governors...U.S. Treasury Secretary Tim Geithner, British finance minister Alistair Darling, French finance minister Christine Lagarde, China finance minister Xie Xuren and Canada's finance Jim Flaherty pose for a group picture **Sept. 5** in London.

Paradoxes of the Global Crisis

The current scenario of the American economies can only be understood in the broader global economic context.

But this context presents us with several paradoxes:

1. Positive – if very weak - GDP growth has been restored for much of the global economy. But unemployment and sub-employment is deepening, as is employment insecurity.

Paradoxes of the Global Crisis

2. Investment spending is not returning to former levels. Why not? Three factors:
- The stagnation of consumer demand has led corporations to continue cutting productive capacity – and jobs - rather than expanding it.
 - There is fear that overbuilding of commercial real-estate will produce more bank defaults.
 - Banks have in most of the world significantly tightened their lending

Paradoxes of the Global Crisis

3. The third paradox is that while the situation is one of *global* crisis, most meaningful debates about “what is to be done” are occurring at sub-global levels.

EG: the G-20 meeting last week agreed to disagree about whether “stimulus measures” should be continued. It *did* agree that firmer financial regulation was needed – but not what type – and called for increasing bank capital requirements.

Paradoxes of the Global Crisis

4. The government policies that have most reduced the impacts of crisis are *pre-neoliberal* “safety net” and family-support policies, primarily in the global North – France, Germany

But 30 years of neoliberalism in economic theory and policy have devalued such policies.

So no one has proposed how countries without safety nets can create them now.

Instead, government aid is used to support positionally-powerful corporate sectors (US, German autos) or to underwrite insolvent financial firms/sectors.

Global Keynesianism in a World of Neoclassical Design Mechanisms

The accepted wisdom. Government should:

- use fiscal stimulus, temporarily, as needed
- subsidize core financial institutions, temporarily, bring them back to health, make them competitive again
- only then readjust financial regulations to avoid these financial meltdowns of the last years from happening again.

This **global consensus** about the **global non-consensus** is leading us in 2009-2010 to:

1. Weak, spatially uneven, recovery or stagnation. The nearly-global government responses to this Great Recession have stabilized GDP by bolstering profits, without boosting the levels of secure employment.

Global Keynesianism in a World of Neoclassical Design Mechanisms

2. Continued stagnation of investment: temporary stimuli, & bank-recovery programs don't address consumer overindebtedness, fears about overcapacity, and lack of bank credit.
3. Absence of global coordination. The strong are afraid or unable to share success with the weak, and the weak cannot force action.

[It recalls the Keynes-White debate at Bretton Woods.]

China recovers, but cannot escape.

The US stagnates, but cannot move.

Europe recovers & stagnates, & cannot move.

Global Keynesianism in a World of Neoclassical Design Mechanisms

4. Governments remain afraid of punishment by financial markets. So spending is tentative & temporary. The realms of secure employment are reduced even with stimulus packages.

One example: the crisis of state governments in the US, including public universities and schools.

*In sum, the paradoxes observed today derive from governments' global use of a non-global policy toolkit – an **accepted wisdom** – adapted for a world that will again function in a neoliberal way, as before the crisis.*

Global Keynesianism in a World of Neoclassical Design Mechanisms

Of course, **Brazil's situation** is different. And this is one key point. Brazil is:

- Growing relatively fast (compared to others ...)
- Planning for longer-term development
- Anticipating the growth of a larger middle-class
- Hoping to capture dividends to equalize opportunity and expand infrastructure.

In short, Brazil is playing one game in a global economy that is playing another.



First look: a photo-capture of a World-Cup qualifying game.
Second look: Brazil and Argentina in the global economic situation. If Brazil is winning, why isn't Argentina "winning"?

Global Keynesianism in a World of Neoclassical Design Mechanisms

What explains the above paradoxes is precisely that there is no global Keynesianism in view. Neither demand-push Keynesianism nor Davidsonian Bretton-Woods II Keynesianism. No government is planning for one, taking action in anticipation of one.

So success in the global economy is **zero-sum**: you use available tools to extract gains from other global areas, other nations in your global area, other regions in your nation.

To succeed you need access to the very neoclassical design mechanisms, macro (Euro-zone, NAFTA, ..) and micro (financial arbitrage and fee-making) that you know got you into this mess. Because ...

Global Keynesianism in a World of Neoclassical Design Mechanisms

there is no alternative.

there is no .

Global Keynesianism in a World of Neoclassical Design Mechanisms

Some global South nations have the elements for success in the short-run that constitutes the eternal future under neoliberalism: market potential (population) and resources.

China: burned its environment and sacrificed a generation of workers. The result: prosperity with inequality, environmental disaster, a government struggling for control.

India: its environment already burned, has nurtured a generation of knowledge workers. The result: prosperity with inequality, a government struggling to control.

Russia: burned its people, sold its oil. The result: inequality without prosperity, environmental disaster, a government struggling to control.

Global Keynesianism in a World of Neoclassical Design Mechanisms

Brazil:

sold its oil, sold its planes, sold its soja, sold its wood ... sold its oil; or ...

Burned its people; or nurtured a generation of knowledge workers?

The result: prosperity with inequality, or inequality without prosperity, Environmental disaster coming, or environment already burned?

A government in control, or struggling to control?

Global Keynesianism in a World of Neoclassical Design Mechanisms

We are in a brave new world: it no longer is the neoliberalism of 1980; but it cannot be reset to mid-20th century.

Philip Stephens, *Financial Times*, September 3, 2009:

“On one side, the re-emergence of powers such as China and India is creating a more competitive, multipolar system. These rising nations, understandably, want to assert their own interests after two centuries of western hegemony. On the other side, the fact of closer interdependence deprives even the US of the capacity to act both effectively and independently.”

“The result is a contest between the centrifugal impulse inherent in a multi-polar system, and the centripetal force of interdependence.”

Global Keynesianism in a World of Neoclassical Design Mechanisms

My **core assertion**: In the current situation, Keynesian stimulus is needed, long-term investment is needed, growth with equality is needed. But the ability of government authorities to do these things in much of the world is ***blocked*** or ***undermined in advance***.

Blocked: Regional compacts among governments have created mechanisms in the past 30 years based on the “rules” of a neoliberal world with mobile, partially regulated capital.

Global Keynesianism in a World of Neoclassical Design Mechanisms

Undermined in advance: Many market practices have arisen in the neoliberal (deregulated) era that are based on arbitrage opportunities. These often reward and encourage both speculation and exploitation, and will undermine efforts at longer-term structural reforms.

Further, there is a ***perverse interaction*** between regional-coordination mechanisms and market incentives. Regional-coordination mechanisms are designed so that governments without fiscal and monetary discipline will be punished – and should be punished – by mobile capital and dog-eat-dog trade regimes.

Global Keynesianism in a World of Neoclassical Design Mechanisms

This lesson has been so deeply understood by economic policy-makers that we apparently don't need the IMF to wield its stick anymore. Governments do it on their own.

National policies are based on the premise that an attractive set of fiscal and monetary-policy conditions will attract buyers of goods and investors of capital.

Examples:

the Clinton Administration

the 2002-05 PT Government

the Obama Administration?

Neoclassical Design Mechanisms: Regional Coordination

Regional consortia? **European Union:**

- Rules about fiscal discipline restrain effective Keynesian policies.
- The “Euro area” makes less robust economies (Greece) dependent on stimulus by stronger ones (Germany)
- Unequal inherited “safety net” policies create a situation in which workers and families in stronger economies (Germany, France) are relatively protected, while those in weaker economies have governments that cannot protect them.

Neoclassical Design Mechanisms: Regional Coordination

NAFTA:

- Cross-border production complexes are failing (autos – US/Canada; assembly – US/Asia/Mexico).
- Cross-border movements of labor – as immigrants, “guest workers”, or undocumented labor – have become embedded in macro (im)balances.
 - Mexico’s dependence on remittance payments from workers in the US (up to 10% of its adult population)
- Governments have unequal abilities to create policies that provide “safety net” support and adjustment periods for redundant workers.
 - “Anti-immigrant” resentment emerges as a powerful theme in US politics (Obama’s “health policy” speech on Wednesday)
 - A crisis of legitimacy in Mexico.

Neoclassical Design Mechanisms: Regional Coordination

Even where no compacts exist, patterns are fundamentally changing. **Latin America:**

- 1982 – Latin American debt crisis, followed by the “Lost Decade”
- But then NAFTA, 1992; “Tequila crisis” of 1994-95 affecting Mexico
- Ruble-Real currency crisis of late 1990s
- Argentinian currency policy
- China/European/US trade patterns with Brazil, Argentina, Venezuela, Mexico
 - Soja, gas/oil, agricultural goods, industrial goods

So the idea of a common “Latin American pattern” dissolves.

Neoclassical Design Mechanisms: “Micro-level” Market Arbitrage

At the micro-strategic level, the lesson learned by corporations and firms in the neoliberal era is that liquidity rules and arbitrage-seeking activities are most rewarded.

Long-term investment in plant, capacity, or systems of suppliers simply reduces flexibility in a global competitive playing field that demands it.

You have to arbitrage exchange rates, arbitrage workers' wages, arbitrage rates of return on financial instruments, and above all retain the ability to switch.

Neoclassical Design Mechanisms: “Micro-level” Market Arbitrage

The arbitrage idea is now deeply embedded.

- The original meaning of arbitrage was of the exploitation of implicit price differences that appeared momentarily at a point in time. The transactions involved did not need to be ‘spot’, but the profit was locked in instantly.
- So this arbitrage was riskless, and would occur if the return to the play exceeded the transaction cost.
- Another characteristic of arbitrage was, in turn, that it involved financial instruments and financial trading.

Neoclassical Design Mechanisms: “Micro-level” Market Arbitrage

Now, however, arbitrage takes place across time as well, in production as well as finance

- Mobility of production
- Arbitrage through time – asset acquisition supported via securitization, especially home-purchase loans
- Income through time – payday loans.

The idea is that the decision-making unit takes the risk – for example, that wages in China will be less than in Mexico or Vietnam; or that housing prices will continue to rise; and so on.

But ...

Neoclassical Design Mechanisms: “Micro-level” Market Arbitrage

- ... there are many spillovers and dependencies:
 - Mobility of production: depends on ability of states in off-shore labor-suppliers to provide for their population’s needs and security (“safety nets”)
 - Arbitrage through time: depends on availability of liquid markets to support off-balance-sheet positions
 - Income through time: depends on regularity of employment

Many of these strategies were predatory, and remain predatory:

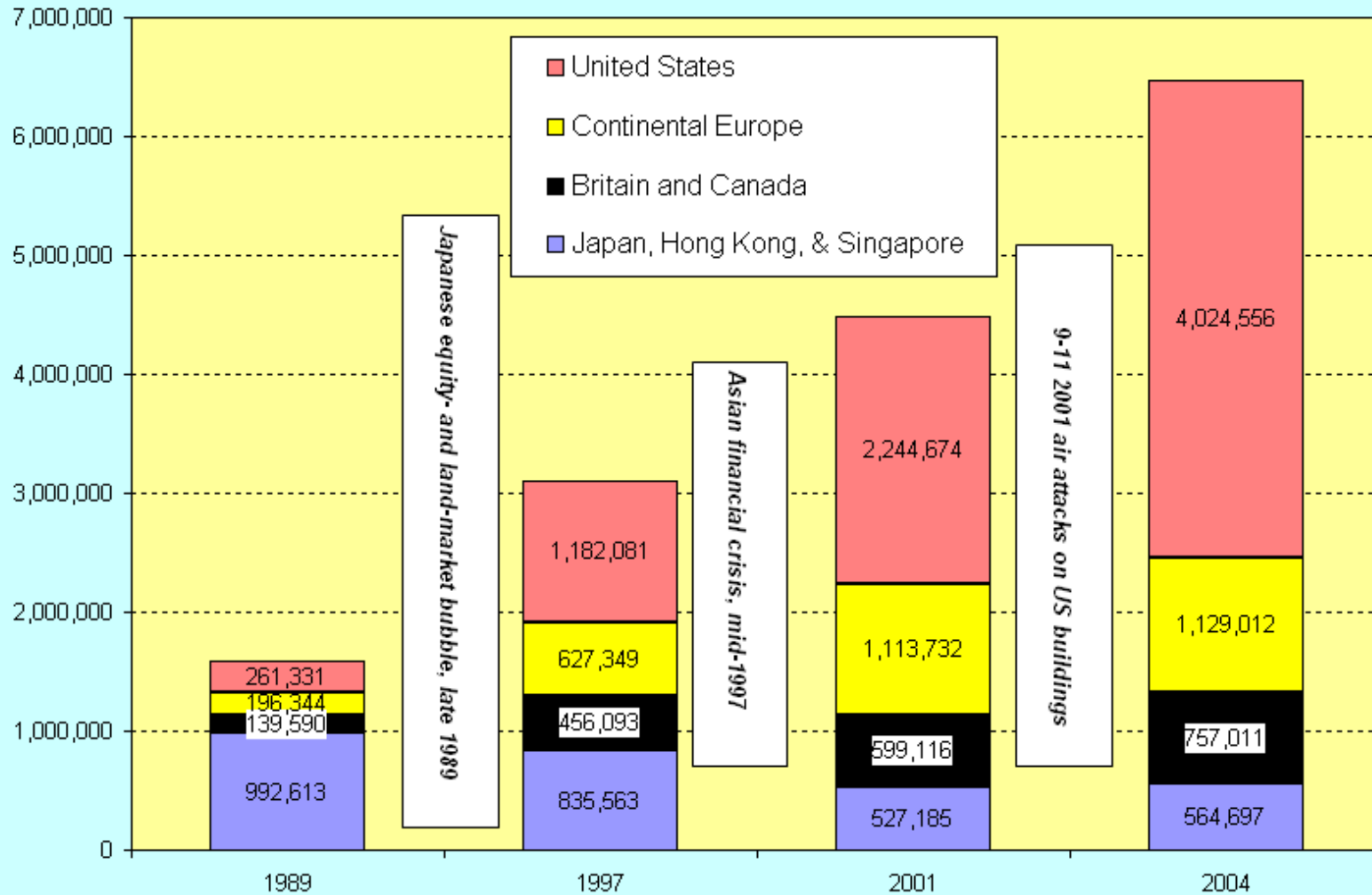
- They exploit unequal market power (do you have an alternative?)
- They extract short-term gains without considering long-term consequences for sustainability or solvency

Neoclassical Design Mechanisms: “Micro-level” Market Arbitrage

And these micro-level strategies depend on macro-aggregate conditions that reflect structural disequilibria.

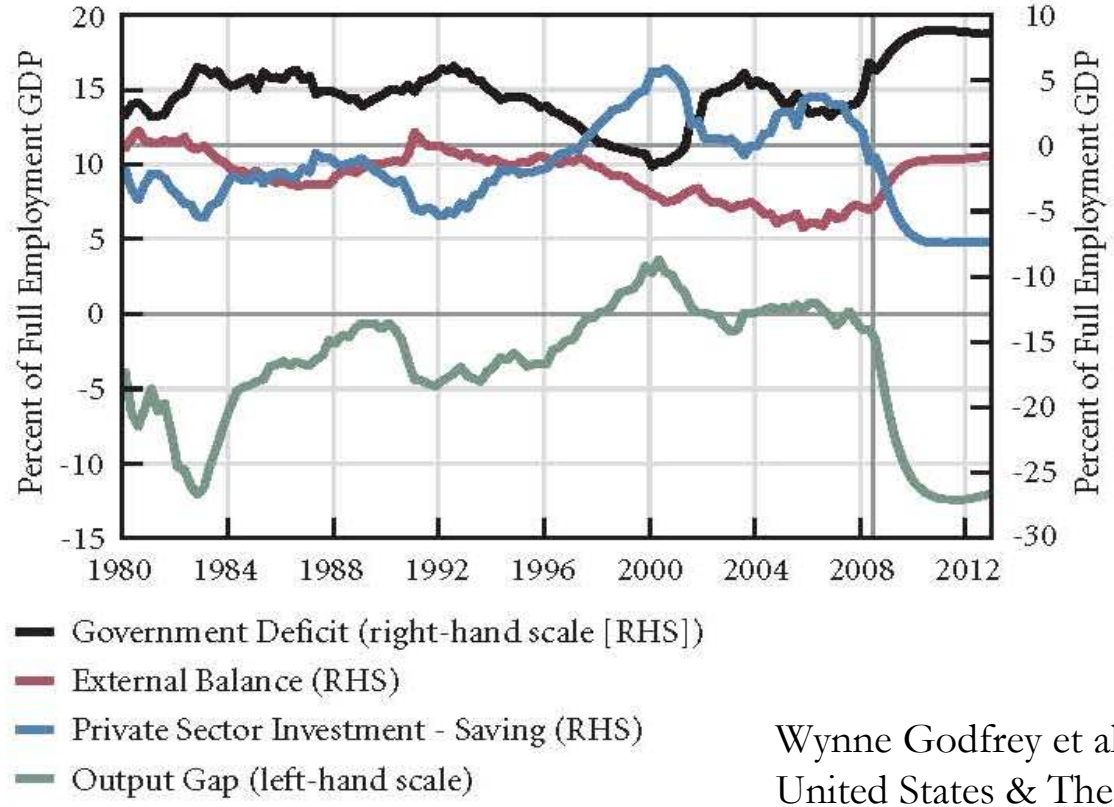
- It leaves a very uneven “map” of “winners” and “losers” from the global competition
- Much of what we think we know about competitive advantage reflects and interacts with these aggregate disequilibria
 - Example: The US “Competitive advantage in finance” .. is linked closely to the US’s current/capital account positions.

Figure 9: Market value of financial firms listed in Business Week 1000, by global areas, 1989-2004 (US \$M)



An example: The US “Competitive advantage in finance”

Figure 1 U.S. Main Sector Balances and Output Gap



Sources: Federal Reserve and authors' calculations

Wynne Godfrey et al, Prospects For the United States & The World: A Crisis that Conventional Remedies cannot Resolve, December 2008.

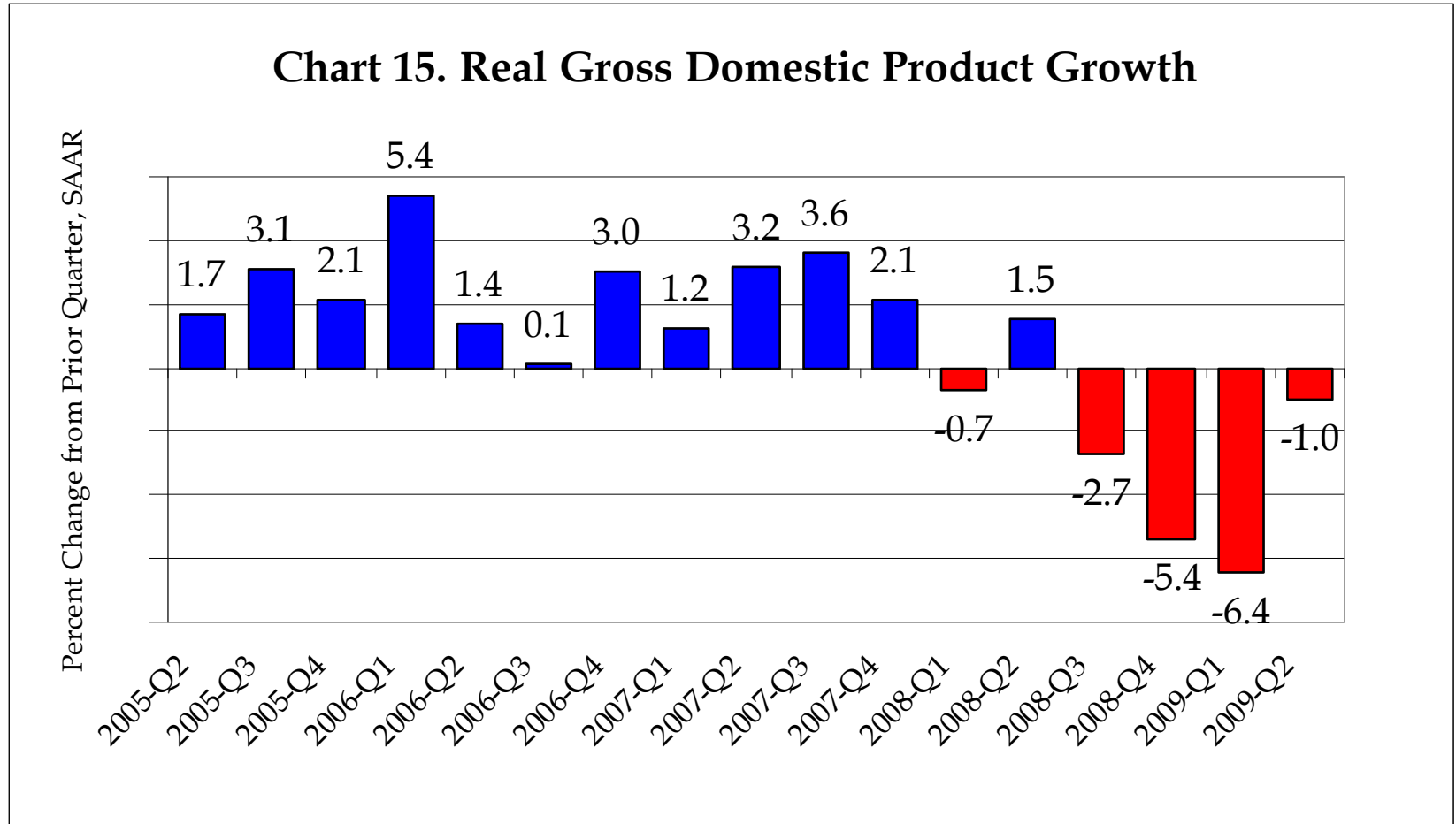
US Futures – The situation as we have it

A “snapshot”:

- (1) Dollar-global structural imbalance
- (2) Jobless recovery, if recovery
- (2) Bank dysfunctionality and megabank gigantism as a matter of policy
- (3) Housing market crisis: subprime loans, prime loans, foreclosures
- (4) Predatory micro-capitalism still in place, with financial fragility pushed down to the household level.
- (5) We aren't sure where we are in our macro-cycle, and are not even looking for new “Engines of Growth”

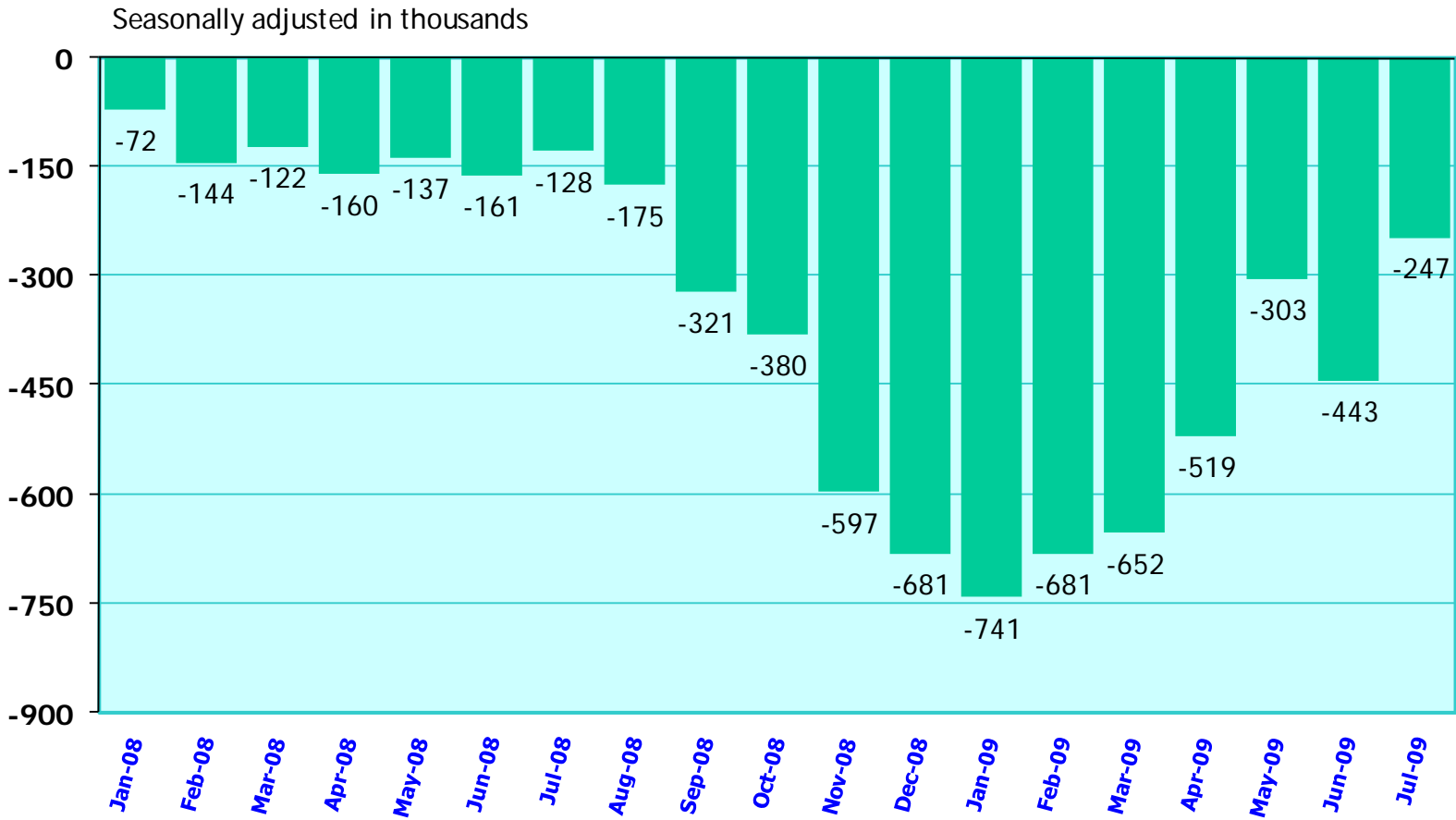


Real GDP



Employment in total nonfarm

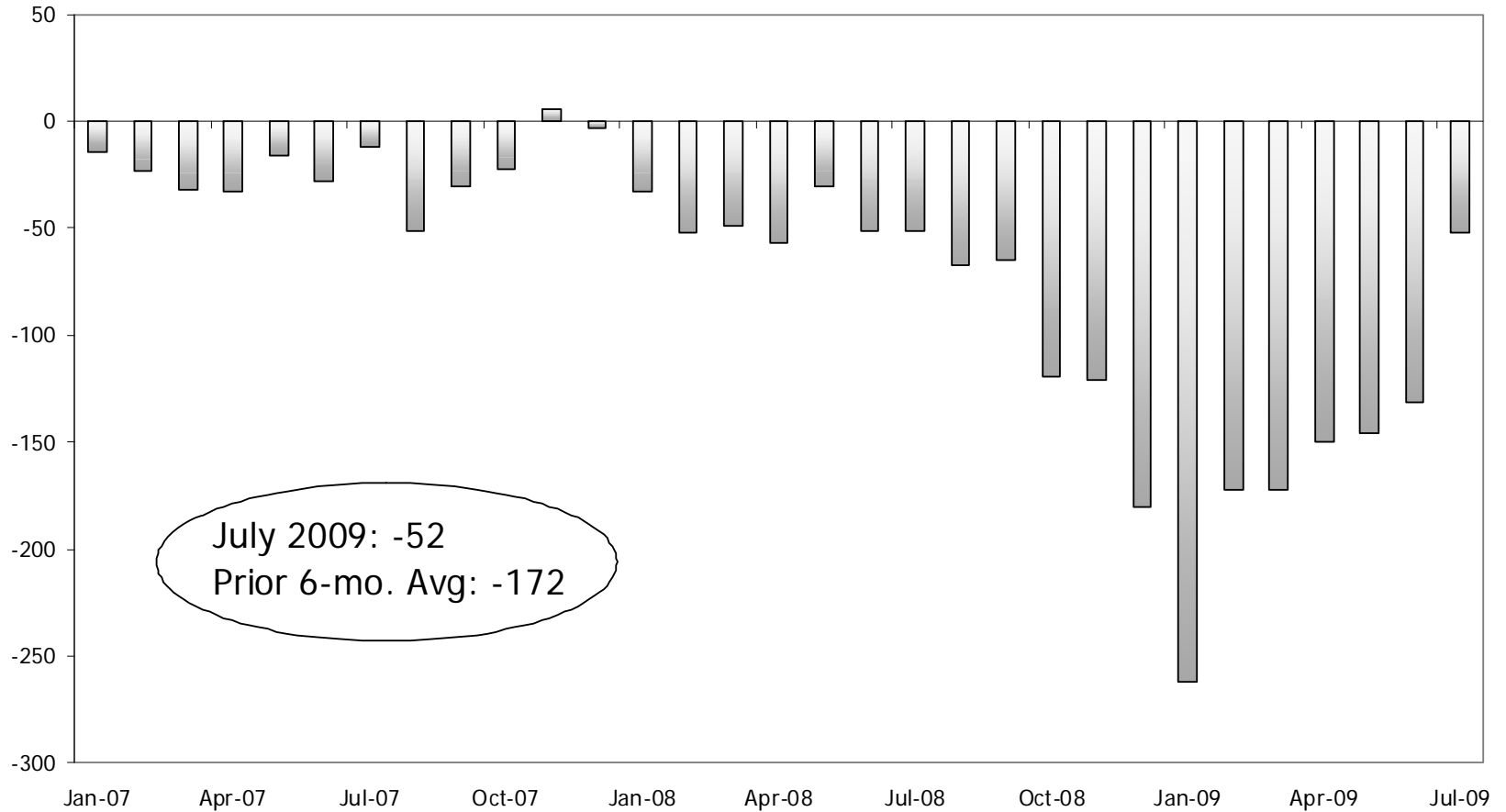
Over-the-month change, 2008-09



Source: Bureau of Labor Statistics, Current Employment Statistics survey, August 7, 2009.

Note: Most recent 2 months of data are preliminary.

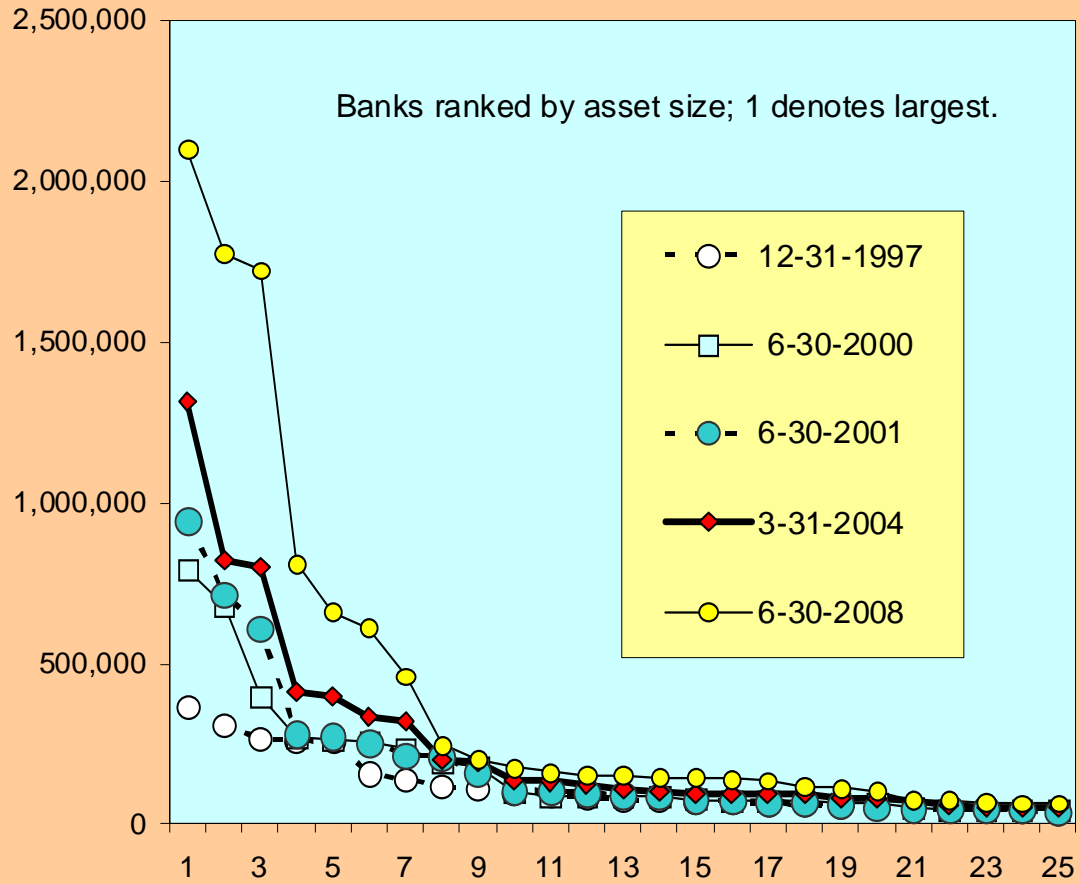
**Manufacturing over-the-month employment changes,
seasonally adjusted, in thousands,
January 2007 - July 2009**



Division of Current Employment Statistics, National Estimates Branch, Release Date: August 7, 2009.

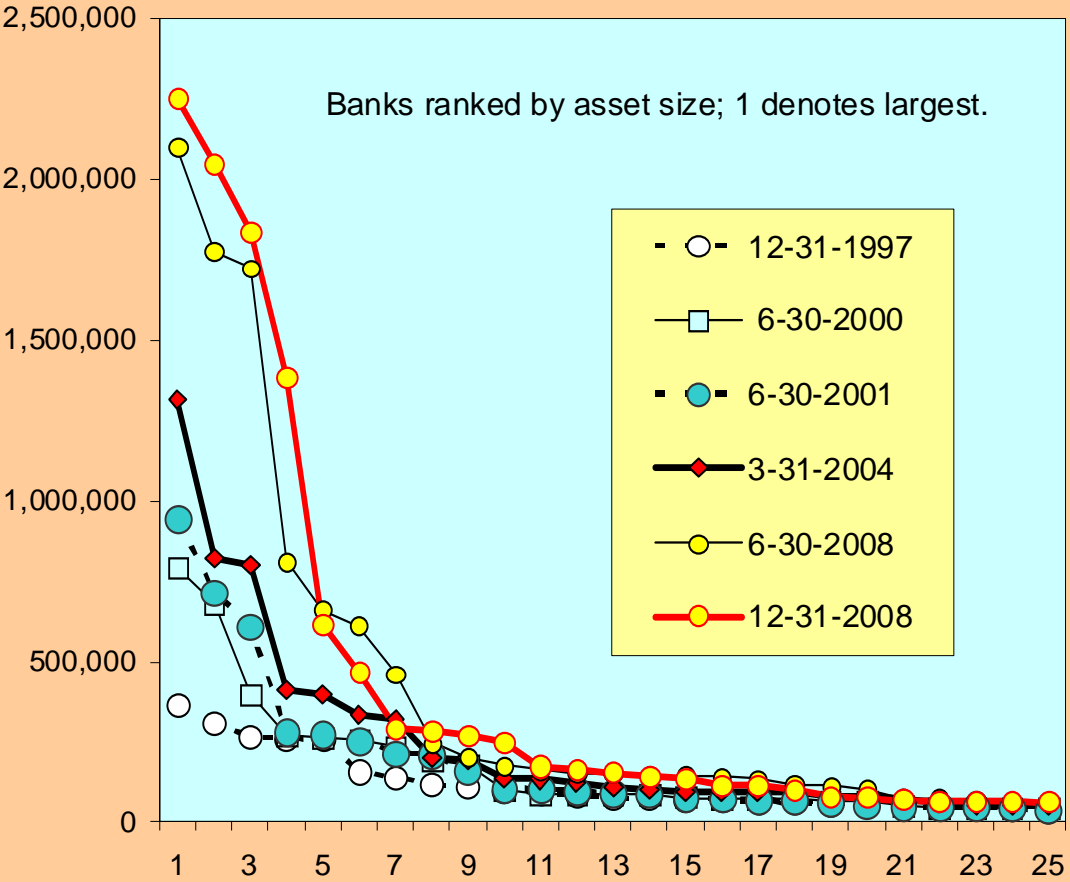
Created by: *Steve Mance X15484, Ryan Davis X6542, and John Eddlemon X7894* Supervisor: *Laura Kelter X16549*

Figure 7: Asset Size of Top-25 Bank Holding Companies, Dec. 1997 to June 2008 (US \$000)



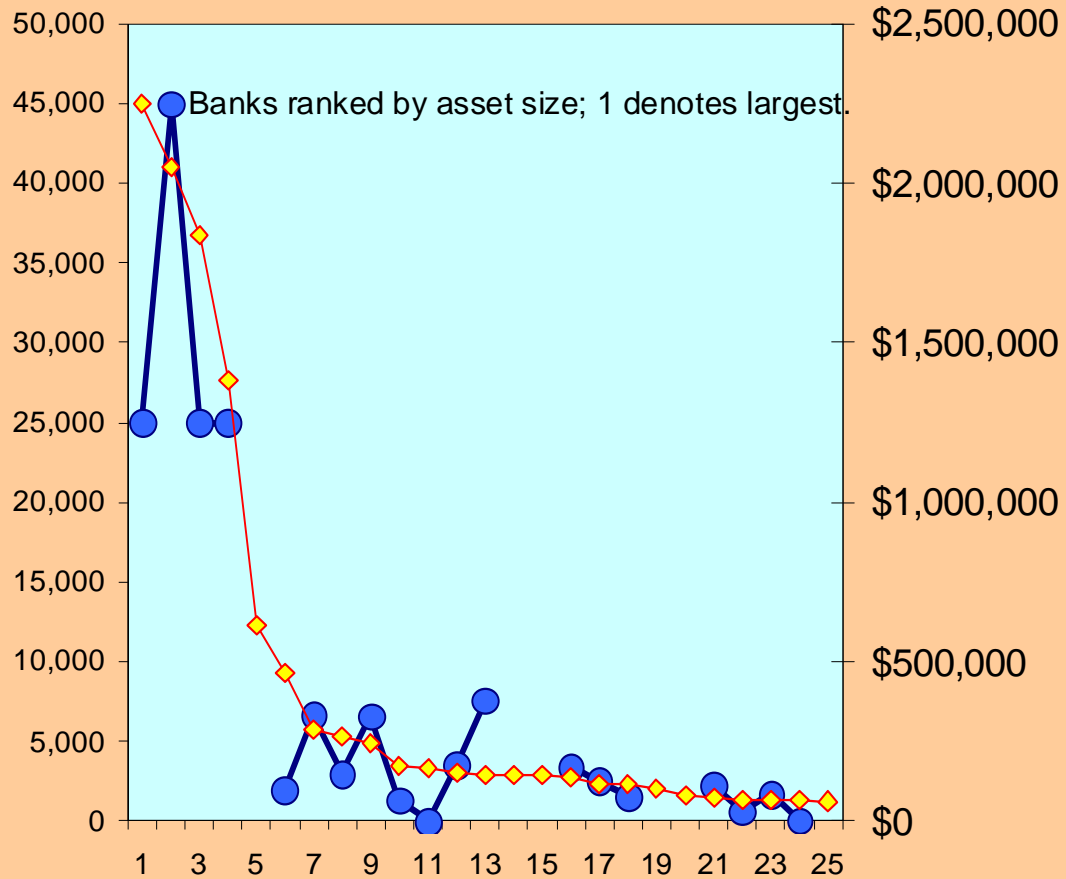
Source: National Information Center, FFIEC; FDIC.

Figure 7: Asset Size of Top-25 Bank Holding Companies, Dec. 1997 to Dec. 2008 (US \$000)

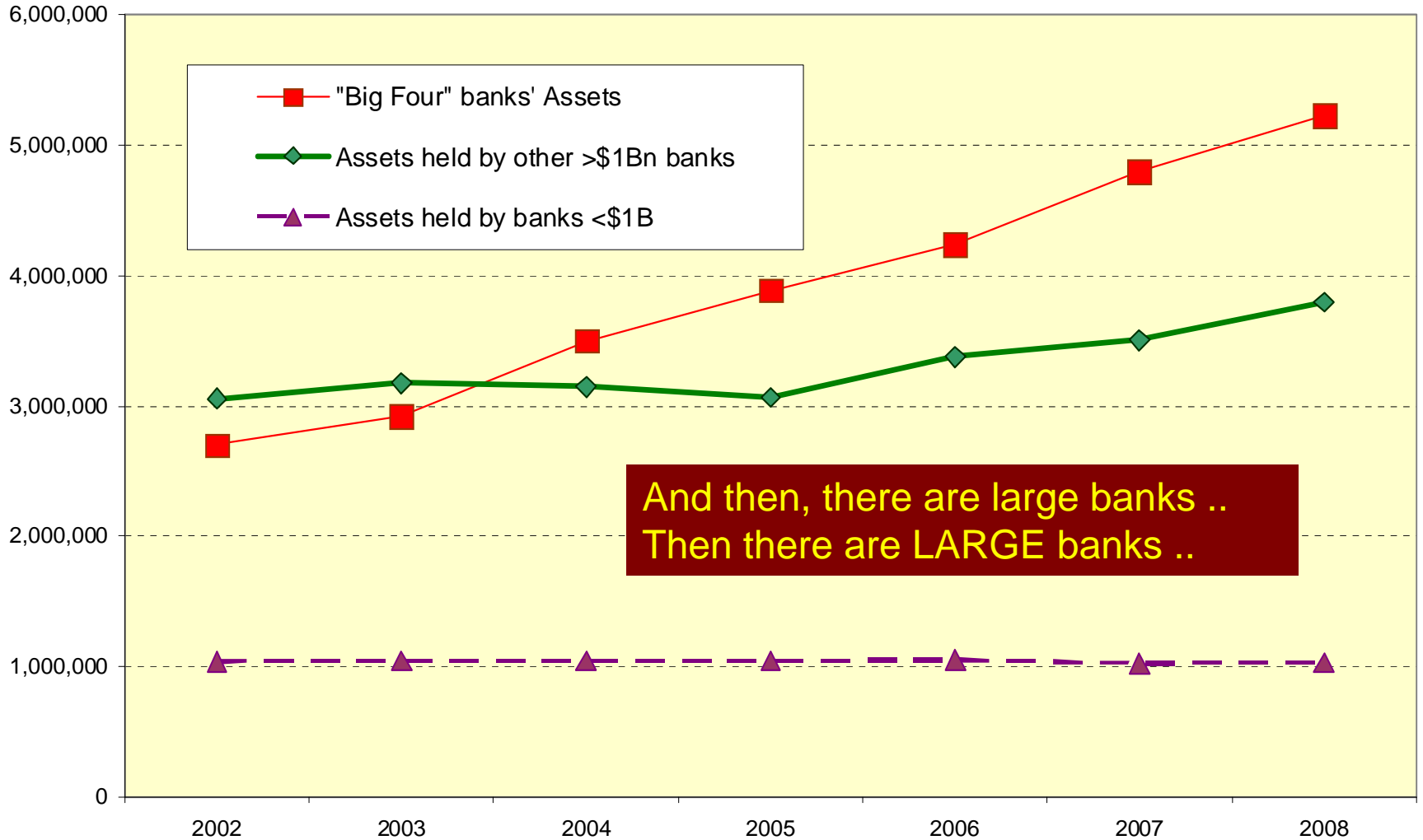


Source: National Information Center, FFIEC; FDIC.

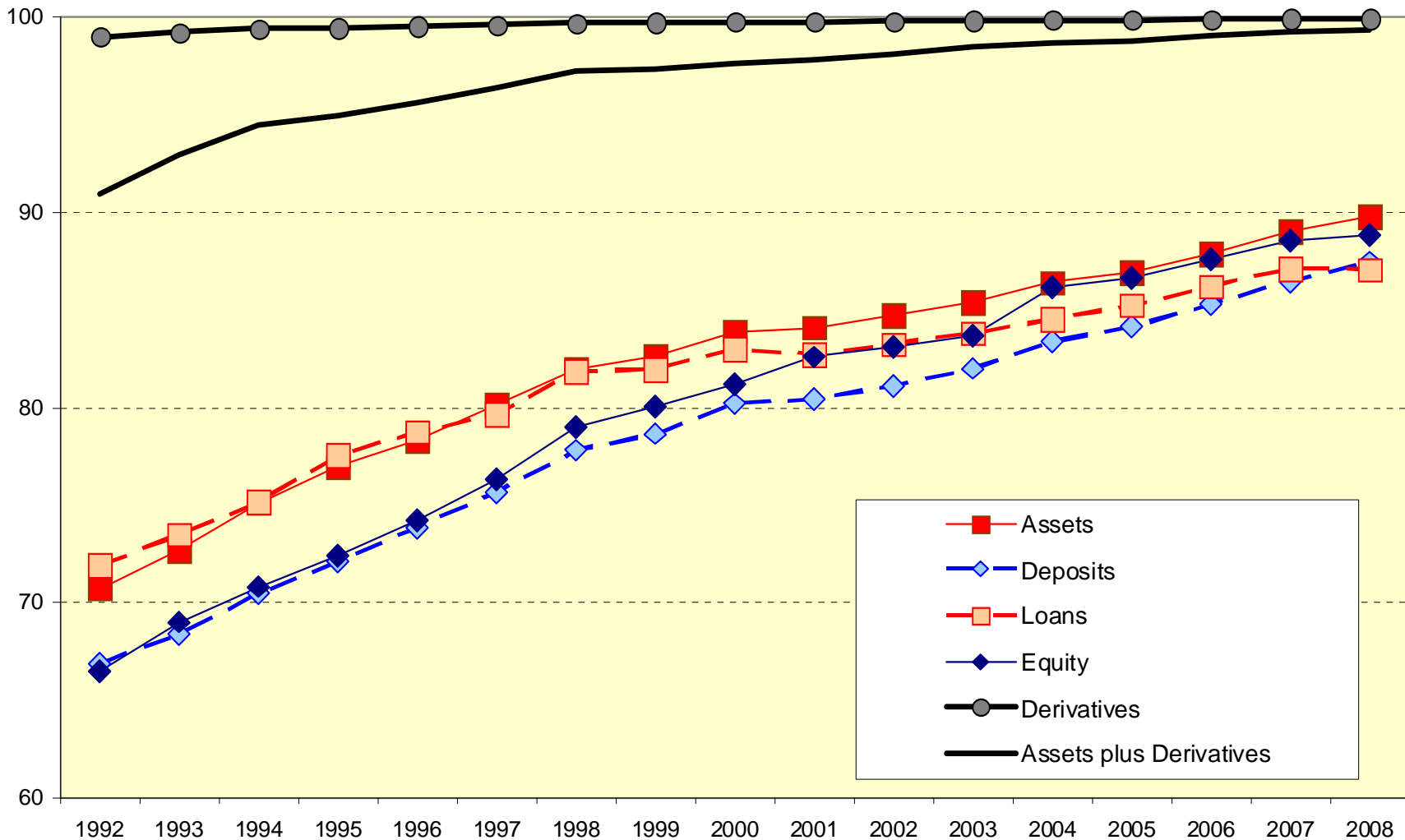
Figure 7: Capital Injections for Top-25 Bank Holding Companies from TARP, January 10, 2009 (\$000)



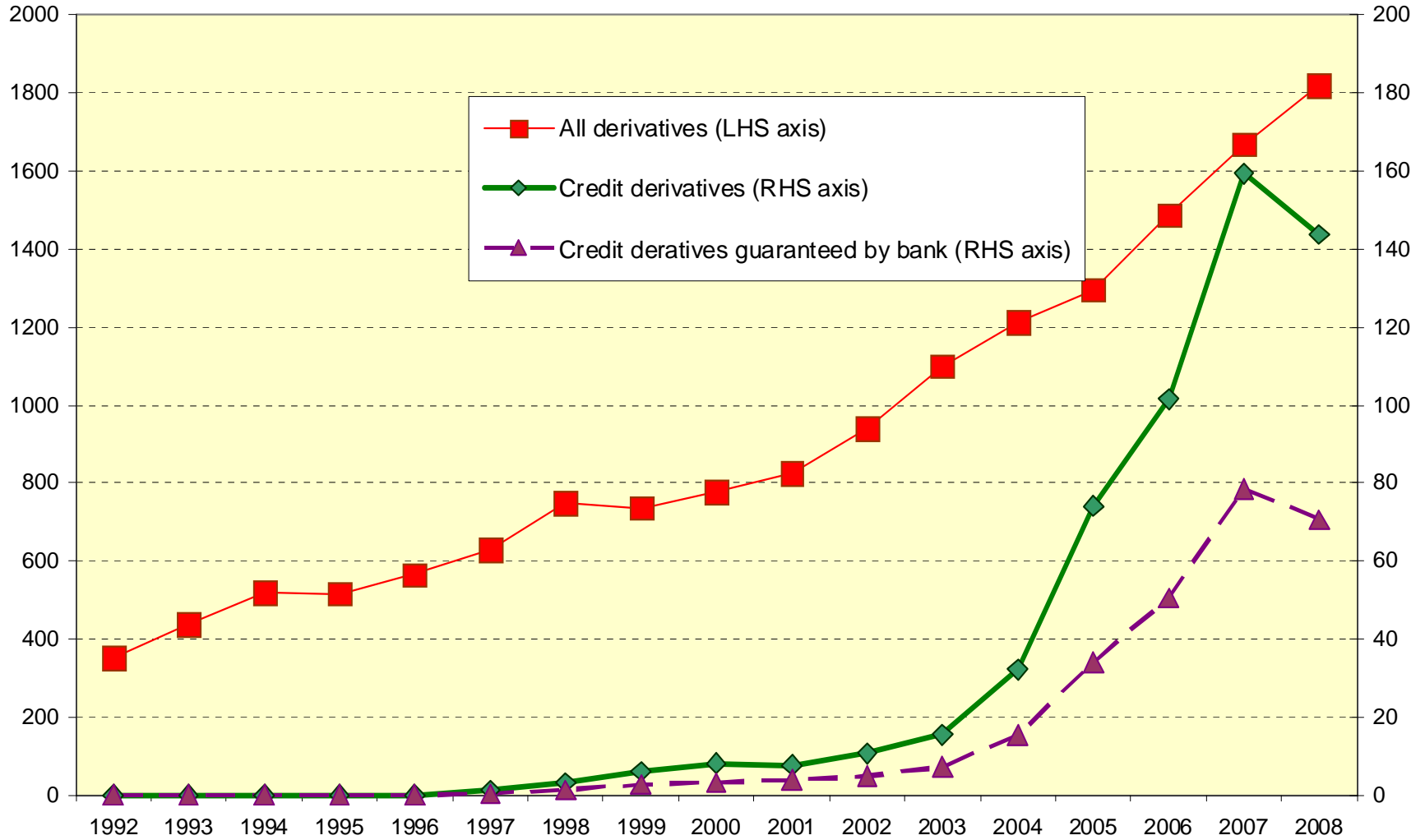
**"Big Four" banks' assets (BofA, Chase, Citi, Wells) versus other banks' assets,
2002-2008 (in constant dollars, with 2000=100)**



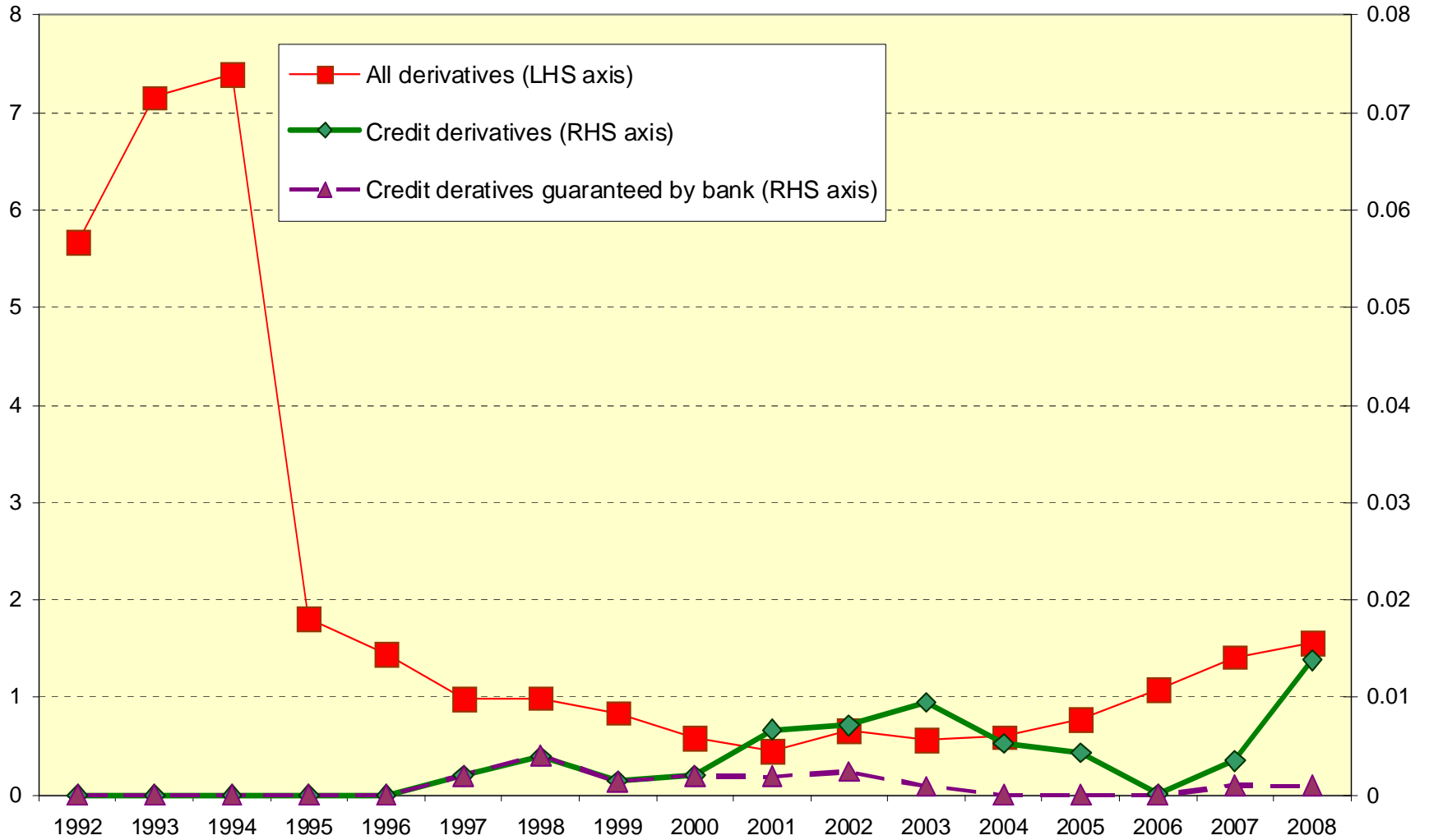
Share of Bank Markets held by Banks over \$1Bn, 1992-2008



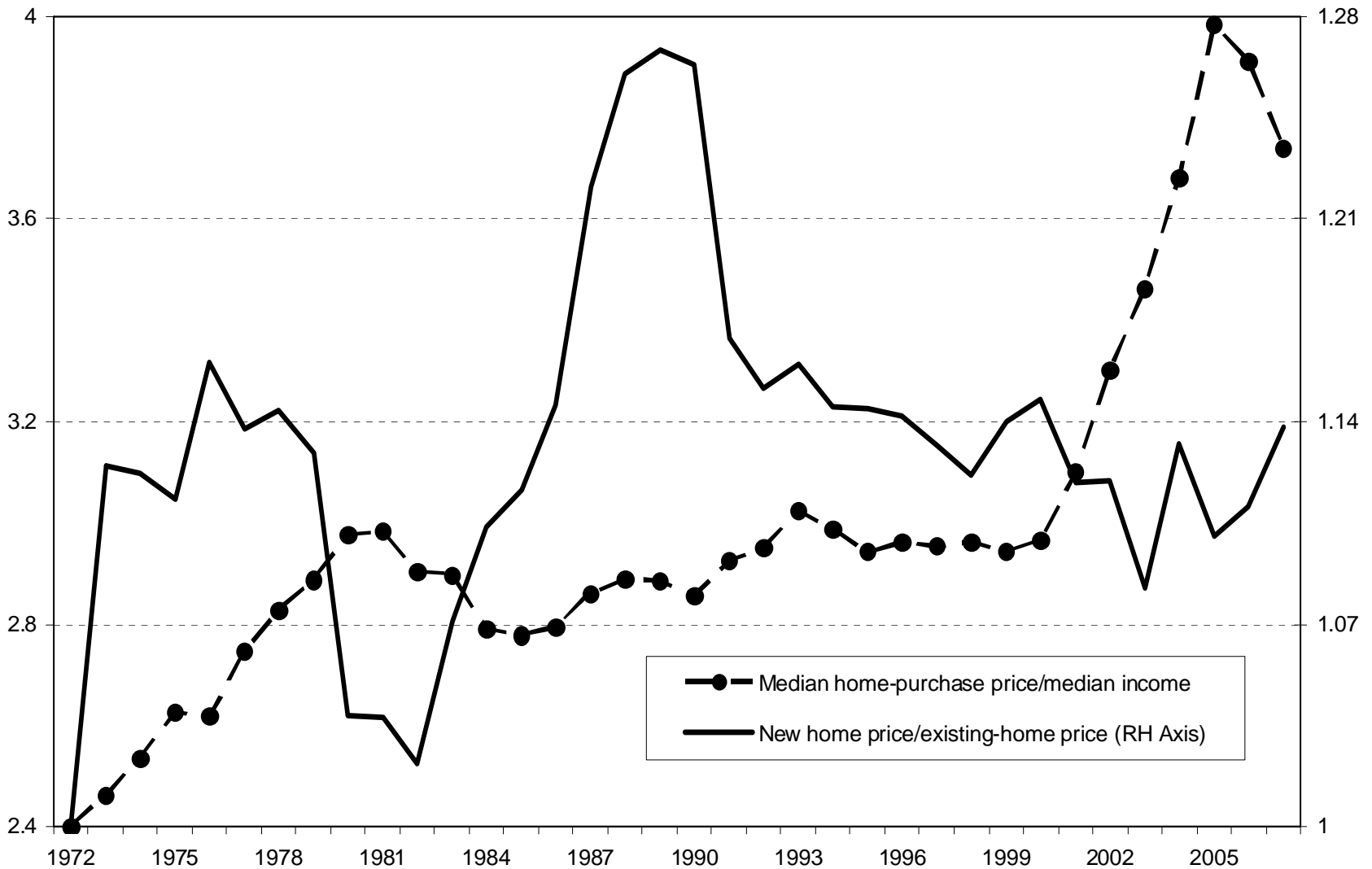
**Derivatives as % of Assets, 1992-2008:
Detail for Big banks (>\$1Bn Assets)**



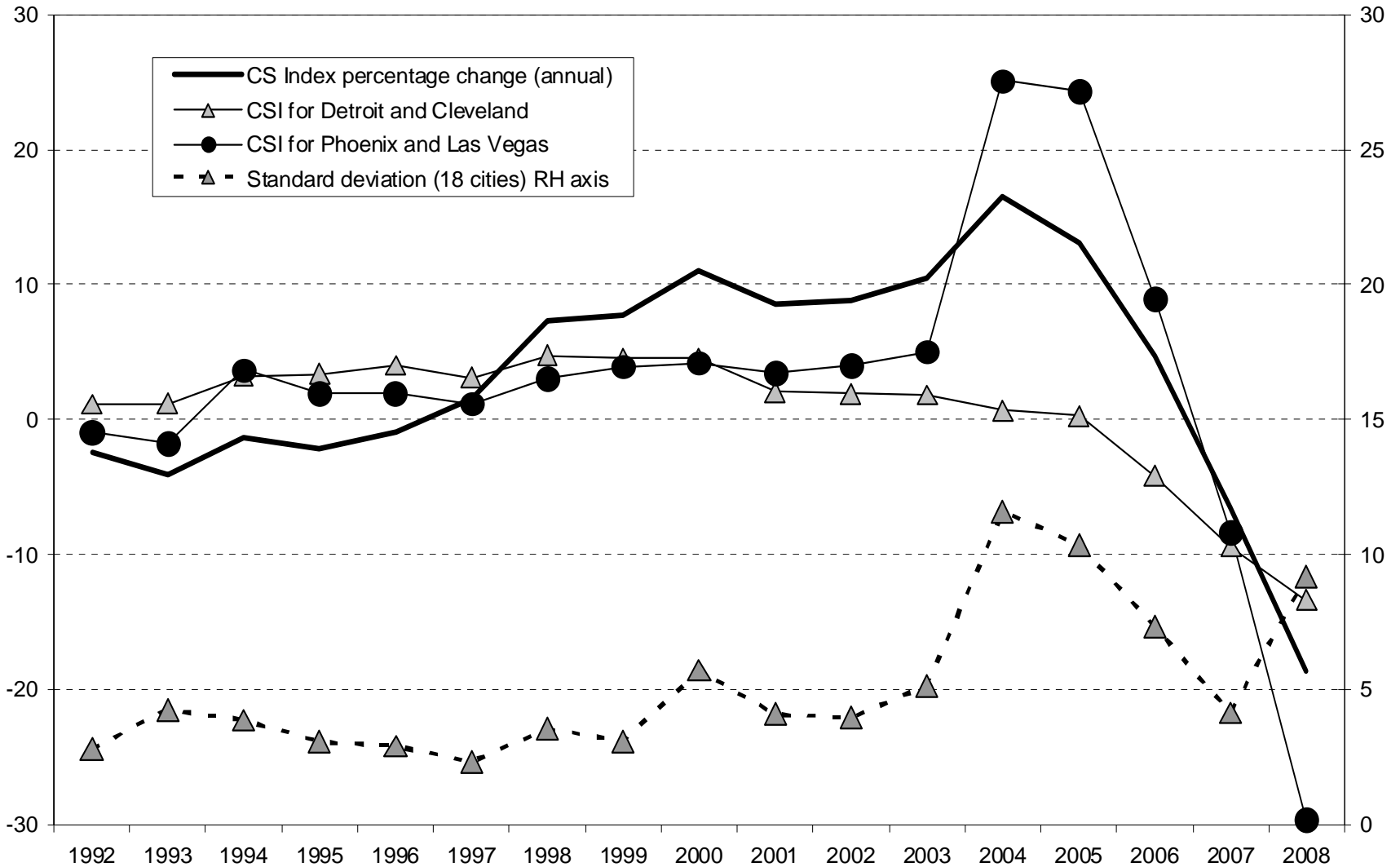
**Derivatives as % of Assets, 1992-2008:
Detail for Small banks (<\$1Bn Assets)**



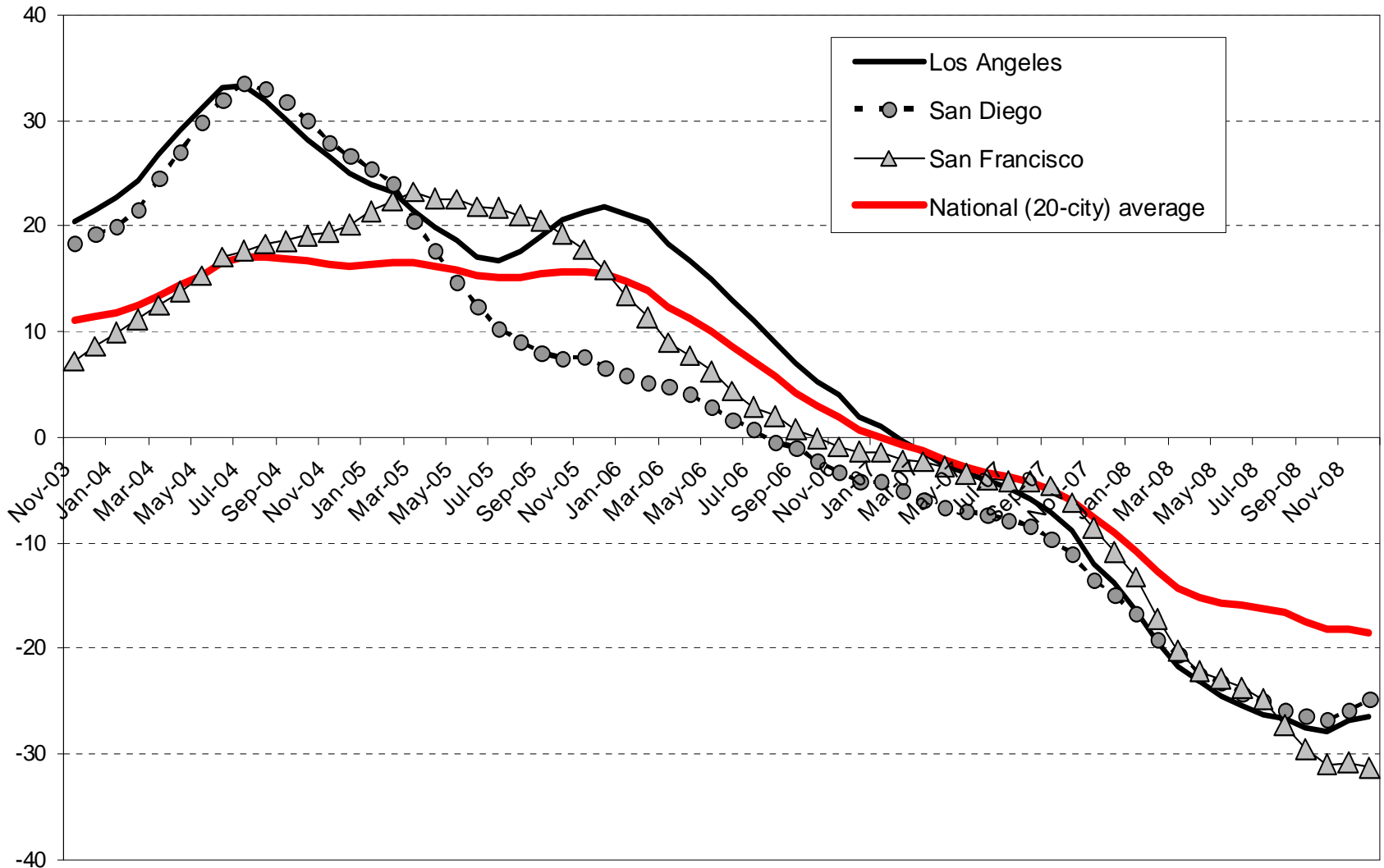
**Figure 5: Housing Price-to-Income Ratio and
New-Home/Existing-Home Price Ratio, 1972-2008**



**Figure 3: Inflation-adjusted Case-Shiller Housing Index Values:
Annual percentage change, June 1992-June 2008**

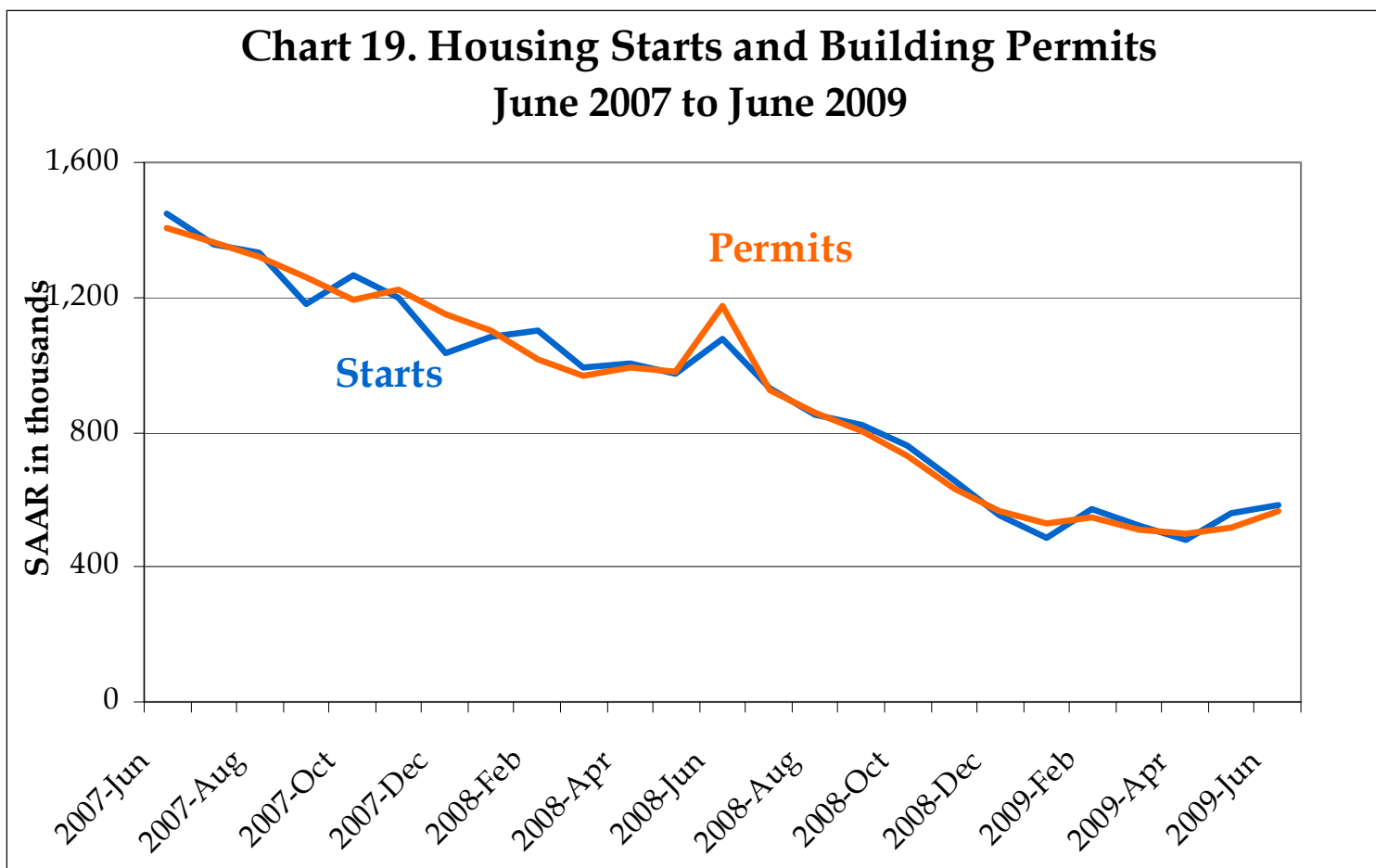


**Figure 1: Raw Case-Shiller Housing Index Values:
Month-to-month percentage change (annualized), Nov 2003-Dec 2008**





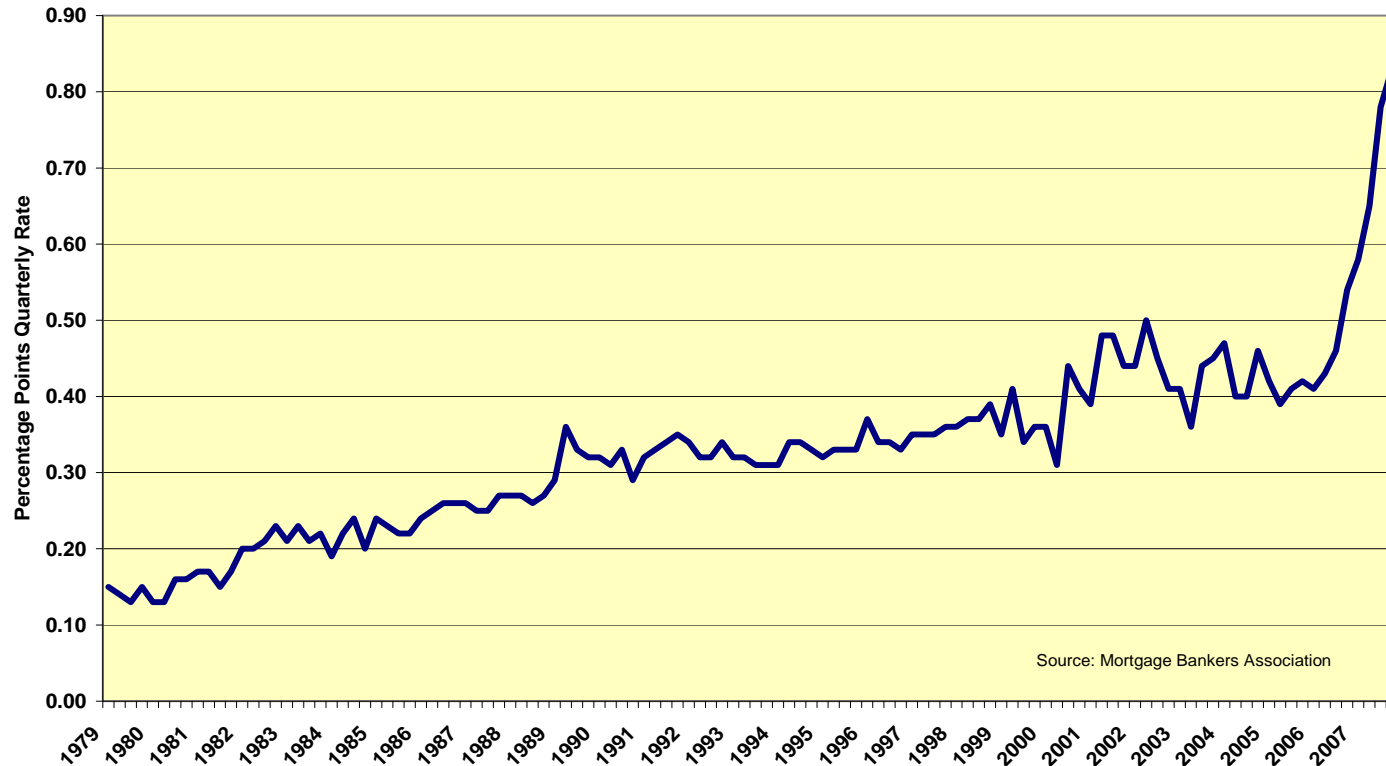
New Home Construction



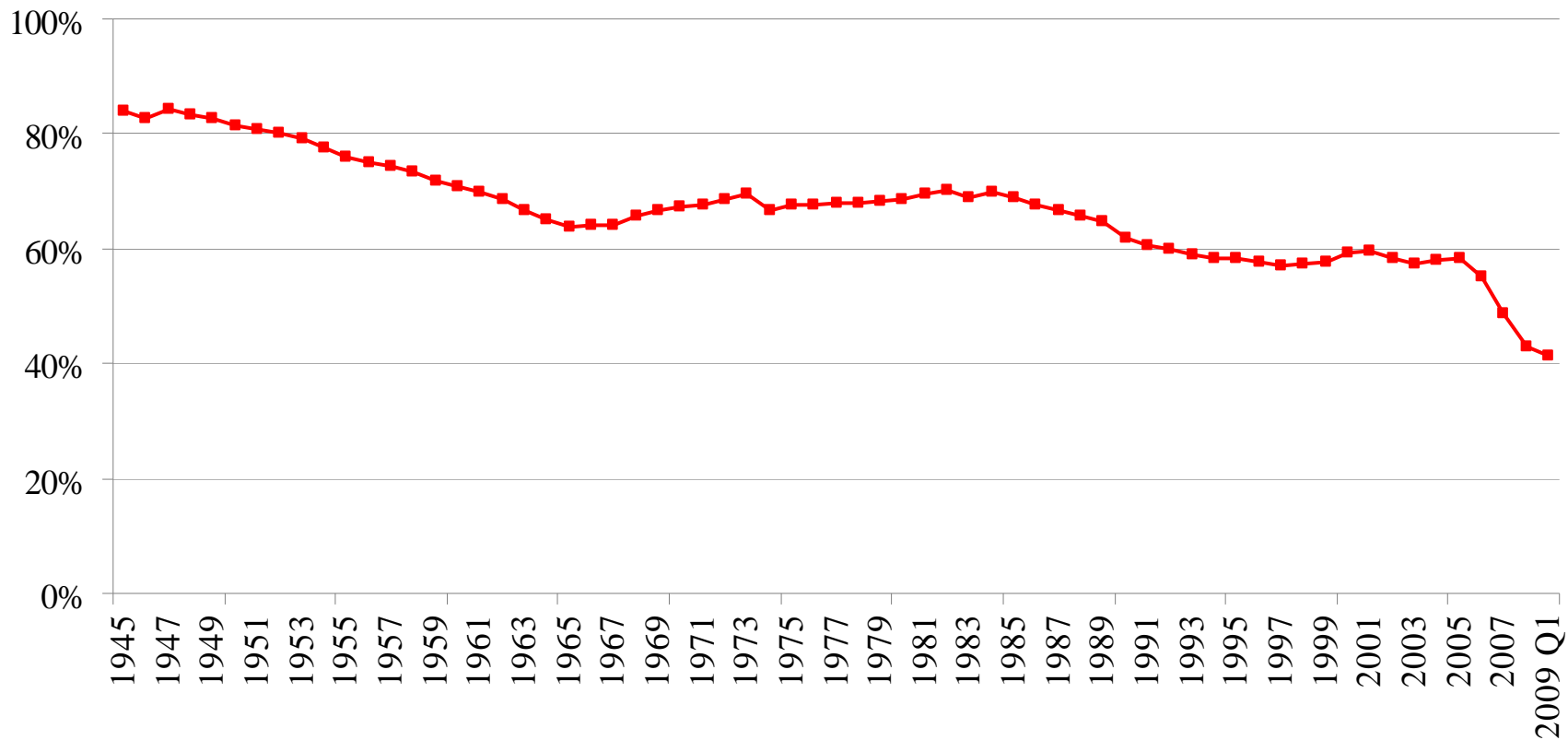
Foreclosure Rate Is Rising Rapidly

☐ Foreclosures started in the **fourth quarter 2007 represent 83 basis points** of all outstanding mortgages. This is a quarterly rate.

Foreclosures Started 2007Q4



Owners' Equity as a Percentage of Household Real Estate, 1945-2009 Q1



*Amounts outstanding end of period, not seasonally adjusted

Source: Table B.100 Balance Sheet of Households and Nonprofit Organizations

Z.1 Flow of Funds Account of the United States

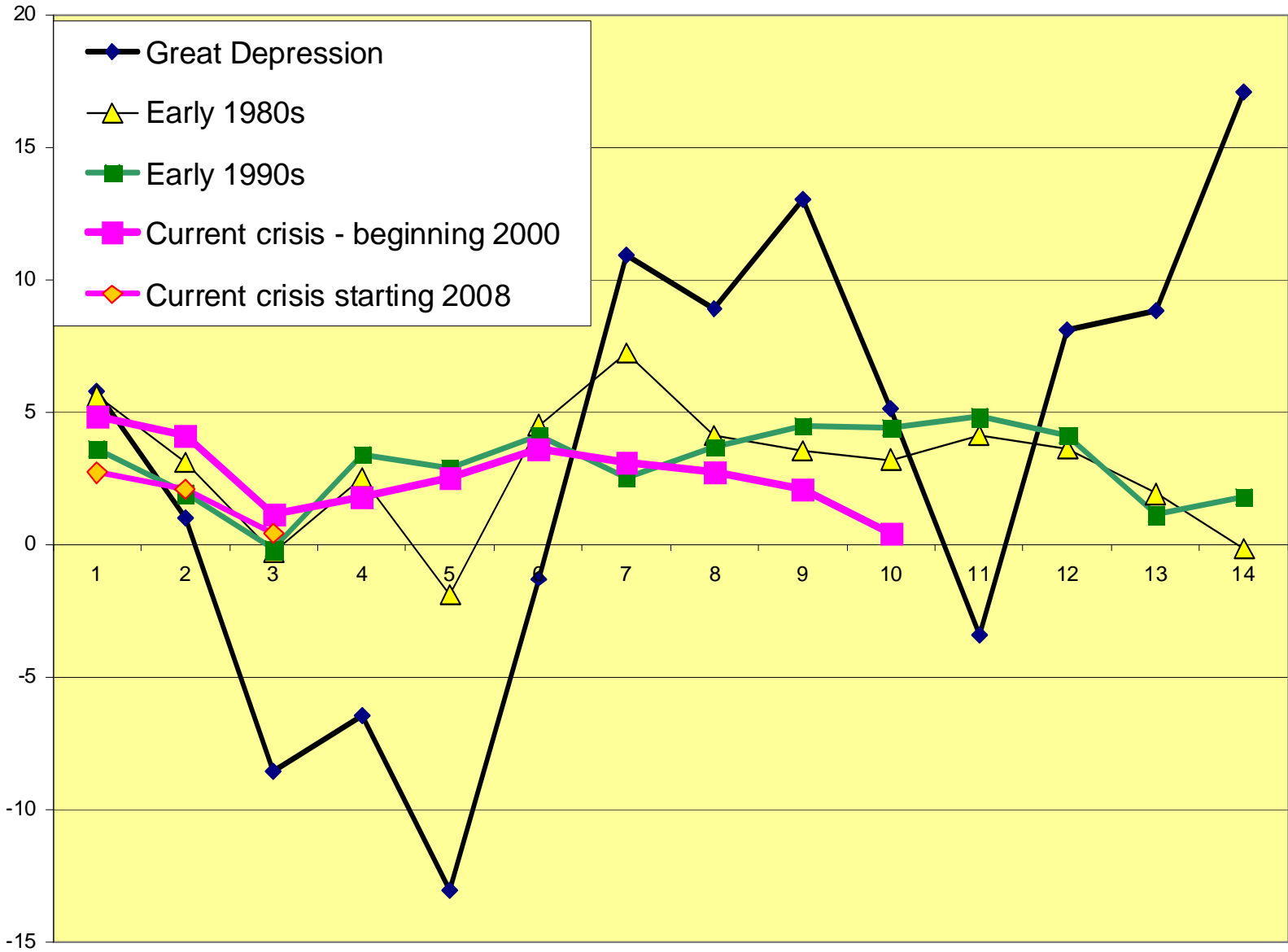
Federal Reserve Statistical Release

History Lessons

Economists are studying the double-dip contraction of the 1930s for clues on the path forward now. Real GDP, change from a year earlier:



Source: MeasuringWorth.org



Brazilian Futures – The situation as we have it

Questions:

- (1) “Pre-sal” – exactly! What is to be done with this, and how?
 - When, the post-petroleum world?
- (2) Amazonia – What is to be done?
- (3) China-Brazil – Move closer to China?
- (4) Europe-Brazil – Move closer to Europe?
- (5) What are the industrial strengths of the nation?
 - What is the role of national banks, planning, in this?
- (6) The coming of a middle-class Brazil...
 - How to avoid predatory micro behaviors that exploit people just as they earn and can have more?