No significant recovery in world economy, says US Fed official

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Almost six years after the financial crisis that began with the collapse of the US investment firm Lehman Brothers in September 2008, triggering the deepest recession since the 1930s, the world economy is showing no sign of significant recovery.

Unable to advance any policies that might begin to alleviate the situation, financial and economic policymakers are warning that present conditions, characterised by low growth and even stagnation, are looking increasingly permanent.

Following in the path of former US Treasury Secretary Lawrence Summers, who last year warned of "secular stagnation," the vice chairman of the US Federal Reserve, Stanley Fischer, delivered a speech in Sweden on Monday pointing to structural changes in the economic environment.

Fischer said global recovery from the recession had been "disappointing," adding, "year after year we have had to explain from mid-year on why the global growth rate has been lower than predicted as little as two quarters back."

The Fed vice chairman noted that "recoveries" in the advanced economies had been "well below average." The recent pace of growth in "emerging market economies" had also been "disappointing" after an initial upturn more in line with historical experience. Chinese growth had fallen "to rates significantly below the average pace in the decade before the crisis."

"These disappointments in output performance," Fischer continued, "have not only led to repeated downward revisions of forecasts for short-term growth, but also to a general reassessment of longer-run growth."

Fischer asked whether restoring growth was even possible. While the lower growth rates might be the aftermath of the financial crisis, he said, "it is also possible that the underperformance reflects a more structural, longer-term shift in the global economy."

In fact, the two phenomena are inseparably connected. The financial crisis of 2008 was not a cyclical downturn in the business cycle, from which there would be a "normal" recovery. It signified a fundamental breakdown in the process of capitalist profit accumulation.

In the years leading up to the financial collapse, with large sections of industry having been destroyed, profits in the US economy increasingly came to depend on speculation and parasitism in financial markets, sustained by cheap money from the Fed. By 2007, the share of finance in corporate profits rose to some 40 percent, from its level of 10 percent or less in 1980.

Financial speculation grew in importance from the late 1990s, when the rate of profit in the US economy started to turn down. This was reflected in the growth of the so-called tech bubble that burst in 2001, leading to a recession and the loss of some 1.7 million jobs, the second highest level in 50 years. At that point, this recession was eclipsed only by that of 1981-82, when almost 3 million jobs were destroyed.

The "recovery" after the end of the recession in November 2001 was sustained by low official interest rates that fuelled a housing bubble. This gave rise to the speculation and outright criminal activity that characterised the growth of the mortgage-backed securities industry, increasingly resting on sub-prime loans.

The collapse of the bubble in 2008 led to the destruction of more than 7 million jobs in the deepest recession since the 1930s. While the outright collapse of the US economy was prevented by the maintenance of near-zero interest rates and the pumping of some $4 trillion by the Fed into the financial system, the underlying conditions in the real economy that led to the 2008 crisis remain.

Ultra cheap money has again created a bubble, this time in the stock market. There has been no recovery in investment. This is of considerable importance because investment, in the final analysis, is the chief driving force of real economic growth, as opposed to profits gained through financial speculation.

High profit levels are being recorded in some areas of the US economy but they are being achieved chiefly through cost cutting, not by the expansion of sales and markets. The money accumulated is not being invested in new plant and equipment but in financial activities, such as mergers, acquisitions and share buy-backs.

In his speech, Fischer pointed to “important signs of a slowdown in the productive capacity of the economy” in three key areas—labour participation rates, capital investment and productivity.

The proportion of Americans in the workforce has markedly declined since the beginning of the century. From 67 percent in 2000, it has dropped to 62.9 percent. Large numbers of workers have dropped out of the labour market because there are no jobs.

Another factor contributing to the growth slowdown has been the drop in the rate of investment. While it was to be expected that investment would fall sharply in the immediate wake of the crisis, Fischer said, “in the United States, and in many other countries as well, the growth rate of capital stock has yet to bounce back appreciably.” This was despite historically low interest rates, increased profits and cash.

Productivity growth was also down from its long-run trend. Averaging around 1.5 percent in the years 1964 to 2003, it was now 1 percent. While not sharing their views, Fischer cited economists who maintain that the rapid productivity growth spurred by earlier technological developments, such as electrification and mass production, was over and that, except for a brief period in the mid-1990s, would not be replicated by the “information technology revolution.”

As a leading member of the US financial establishment, Fischer is politically obliged to remain officially upbeat. So, while acknowledging the possibility of slower productivity growth, he indicated his faith in the potential of the IT explosion to improve the quality of lives of most people in the world. However, while the IT revolution has created a number of high-paying jobs, its main impact has been to enable cost-cutting and impose labour force downsizing.

Underscoring Fischer’s warnings, some of the latest data show that there is no recovery in sight, and world economic growth may well be slowing.

According to estimates by Bloomberg, German gross domestic product (GDP) fell by 0.1 percent in the three months to June. Germany has been the mainstay of the euro zone economy since the onset of recession, but its growth rate has now fallen below that of Spain, which recorded a 0.6 percent increase for the second quarter of 2014.

In Japan, the world’s third largest economy after China and the US, GDP contracted at an annual rate of 6.8 percent during the second quarter. A large contraction was expected because GDP numbers were boosted in the first quarter by advance purchases, aimed at beating the 3 percentage point increase in the national sales tax that came into effect on April 1.

Statistical anomalies aside, however, the figures point to a worsening situation. Not long ago, economists were predicting that Japan’s second quarter contraction would be only 3 percent.