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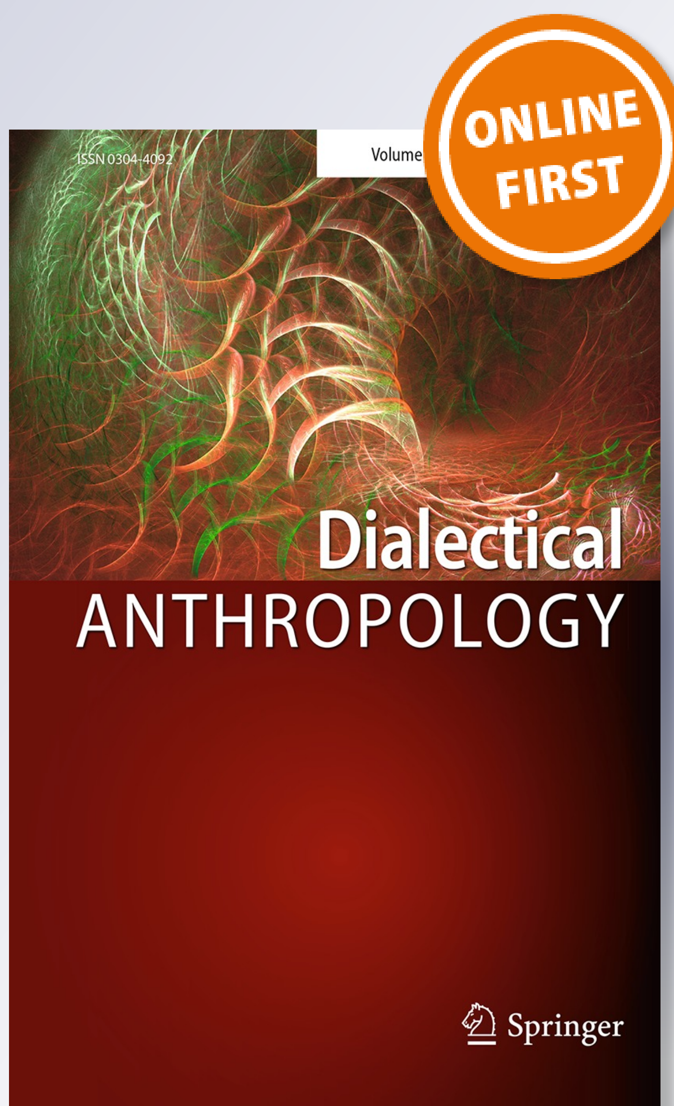

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Profiting from financialization, secular stagnation and wage anchors: a commentary on Lapavitsas (2013)

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> The share, then, may be defined as a title to income, a creditor's claim upon future production, or claim upon profit. Since the profit is capitalized, and the capitalized sum constitutes the price of the share, the price of the share seems to contain a second capital. But this is an illusion. What really exists is the industrial capital and its profit.
> Rudolph Hilferding, *Finance Capital*, 1985:110–111.

According to the World Bank (2001:75), there were 112 systemic banking crises in 93 countries between the late 1970s and the end of the twentieth century. A similar estimate is given by Eichengreen and Bordo (2002), who counted 139 currency and/or banking crises worldwide during 1973–1997. Indeed, the world economy has been in a state of incessant turmoil since the collapse of the dollar-based Bretton Woods international monetary and financial system in the early 1970s.

Yet, the widespread sense that a deep-rooted change had taken place in the real economy so that we were in need of a major rethinking of received economic theory was catapulted only by the aftermath of the financialization crisis that erupted in the US subprime market in 2007. As the financial crisis went global through the interconnectedness of global financial firms, the big investment bank Lehman Brothers collapsed; balance sheets trembled around the world… and, with them, crumbled the methodological consensus built around the dynamic stochastic general equilibrium (DSGE) theory that informed macroeconomic policy during the Great Moderation. In reaction, two new approaches aimed at rethinking the functioning of the economy are now available: In the mainstream camp, Summers (2014) put forth his "new secular stagnation hypothesis," whereas in the Marxian tradition,

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Lapavitsas's (2013) *Profiting without Producing* offers a critical analysis of the crisis of financialization.

This paper confronts Summers's new secular stagnation hypothesis with Lapavitsas's (2013) key insight into the financialization crisis. Further, the paper glances at the chief feature which, in our view, explains the *raison d'être* of subordinate financialization in various developing countries, namely the role of wages in the predominant macroeconomic policy of peripheral financialized capitalism. This feature receives no attention whatsoever in Summers's hypothesis, and very little in Lapavitsas's book.

Is secular stagnation or financialization to blame?

The failure of the dominant economic theory to foresee the current financial crisis, alas, now has been extended to the problem of explaining why, despite long-lasting zero interest rates and massive QEs (quantitative easing) interventions,[1] the length of the crisis just keeps extending in the Eurozone, while recovery is both anemic and jobless in the USA, the UK, Japan and the Eurozone, and soaring unemployment, near-deflation and risk of new financial bubbles still plague industrial countries.

Summers (2014), in an attempt to bridge the gap, sets out to explain why "secular stagnation" is to blame. He acknowledges that unsustainable finances have camouflaged the permanent loss of potential output affecting industrial economies over the past decades. Furthermore, as long-term interest rates have been on a downward trend since the 1980s, secular stagnation and liquidity trap appear to be "the new normal" in the industrial world (IMF 2014; Summers 2014; Krugman 2014). A variety of structural factors such as slower population growth, faster technological progress (information technology, biotech and new materials), rising inequality, disinflation, debt overhangs, deleveraging behavior of households and corporations and increasing demand for safe assets have combined to increase saving and reduce spending. For this reason, Summers argues, it is safe to assume that the full-employment real interest rate (FERIR) has declined significantly. Under low FERIR, Summers maintains, negative real interest rates are required to equilibrate saving and investment at full employment output. Alas, the full employment (low) interest rate may not be consistent with financial stability.

According to Summers, we live in a liquidity-trap-prone economy[2] characterized by secular stagnation; in such conditions, it is difficult to simultaneously attain full employment, low stable inflation and financial stability. He recommends two solutions: higher inflation targets to reduce real interest rates and fiscal policy to raise demand and address balance-sheet recessions. Clearly, financialization and the pervasive role of financial markets do not appear to be a fundamental problem for Summers. The fundamental forces of secular stagnation engender the risks of financial instability (not the other way around), of saving and investment imbalances and less than full employment levels of output.

[1] Expansions of the money supply through large-scale asset purchases.

[2] Note that, instead, Lapavitsas (2013) affirms we live in a financialized capitalist economy.

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Lapavitsas (2013), in turn, digs deeper into both the causes of the current crisis and the dreadful role of financial markets in the extraction-of-profits process of the finance-driven world. Here, neither liquidity trap nor secular stagnation plays any significant role. Actually, Lapavitsas appears to reverse the direction of causality: Financialization does not arise from secular stagnation; financialization is not a by-product of capital escaping from secular stagnation only to seek refuge in "the realm of finance," as some Marxian authors have maintained (for example, Brenner 2002, 2006; Foster and Magdoff 2009). Nor is it the outcome of the shareholder ideology, or of the ascendance of the rentier due to neoliberal economic policies (Post-Keynesians) or the demise of Fordism (School of Regulation).

Lapavitsas envisions the current dominance of finance capital as an expression of a systemic metamorphosis of capitalism starting in the 1970s, a complex historical phenomenon involving changes in the spheres of production and circulation: "The theoretical and empirical point of departure is that financialization represents a structural transformation of advanced capitalist economies, and its roots must therefore be sought in the fundamental relations of non-financial enterprises, financial enterprises and workers" (ibid., p. 36). This epochal transmutation, he argues, is characterized by the financialization of monopoly capital, banks and households; the nature and the source of the "enormous" financial profit is to be found in this new dynamics between productive capital, loanable capital (the banking sector, financial markets) and the working class in the intertwining evolution of the spheres of production and circulation of capital.

Drawing on Marx's (and Hilferding's) monetary theory of credit, Lapavitsas solves what he calls "the conundrum of financial profit." By and large, the various forms of financial profits accruing to lenders, shareholders, state bondholders and other agents trading in bubbly financial assets, such as derivatives and financial securities, ultimately represent shares of surplus value or of personal income, "profit upon alienation or expropriation." Financialized capitalism allows the sphere of circulation to appear as an immediate source of profit arising from particular forms of loanable capital. The circuits of productive and loanable capital configure a sort of "generate-and-distribute" model of sharing into surplus value.[3] From this perspective, Lapavitsas emphasizes the importance of the role of (quasi-) world money in the world market for the materialization of financialization (pp. 101–105, passim). Thus, the current crisis is the very product of financialized capitalism, rather than a liquidity-trap phenomenon associated with central bank's monetary policy.

Contrary to Summers, Lapavitsas's solution to financial instability relies on the socialization of the supply of credit and, above all, on the introduction of public banking and the control of finance. He adamantly re-asserts the priority of the public interest, with full and democratic representation in the world of finance (pp. 323–327). It goes without saying that, if money is a public good, public interest should rule over private (financial) interests. And the same should be true of central banks, once it is acknowledged that monetary policy affects the supply and demand

[3] The "generate-and-distribute" model to be found in conventional finance literature belongs to the realm of speculative activities in capital markets.

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for capital as well as the ways in which wealth is created, allocated and accumulated in a modern society.

Peripheral financialization and the role of wage anchors

Lapavitsas (2013, pp. 37, 42–43, 245–255) distinguishes between core financialization and subordinate financialization. His analysis of subordinate financialization (I will call it peripheral financialization henceforth) can be summarized as follows: The subordinate character of peripheral financialization has been driven by the subjugating role of quasi-world money (the US dollar); world money imposes huge costs on developing countries that fall in the orbit of core finance capital; financialized capitalism in leading industrial economies has led to enormous indebtedness among peripheral countries, thus giving a particular shape to peripheral financialization; the set of structural reforms of the Washington Consensus policy framework (financial liberalization in the first place) and the accumulation of foreign exchange reserves have been paramount for the subordinate dimension of peripheral financialization.

It goes without saying that I agree with the gist of the above description of peripheral financialization. Yet, such panorama of subordinate financialization misses one of the true cornerstones of the macroeconomy of developing economies, a *conditio sine qua non* which gives peripheral financialization its peculiar morphology, namely the role of wage deflation as the main anchor for inflation targeting.

Wage deflation happens to be the cornerstone of both slow growth and peripheral financialization, at least in a number of developing economies. While the role of wage deflation in peripheral financialization is consistent with Lapavitsas's critique of financialized capitalism, it is hardly discussed in his book. Needless to say, wage deflation is utterly neglected by Summers's new secular stagnation hypothesis.[4] In the remainder of this commentary, I would like to briefly shed light on the *modus operandi* of wage deflation anchors in a peripheral financialization environment.

Macroeconomic policy in peripheral financialized capitalism is, broadly speaking, composed of two models: a model of export-led growth and a model of inflation targeting. There is a fundamental trade-off in the functioning of these two models. Success in the inflation frontage depends on real exchange rate appreciation, whereas success in growth performance requires a competitive real exchange rate. Given that a finance-driven peripheral economy must comply with the inflation target, the real exchange rate must appreciate almost constantly, as Penn World Table data readily confirm for most developing countries since the inception of the two aforementioned models of growth and inflation. Central banks in developing inflation targeting countries follow an asymmetric exchange rate policy; they allow

[4] Incidentally, the role of wage deflation as the main anchor for inflation targeting and financialization in peripheral countries has gone unnoticed in the heterodox literature. While the rate of interest is the anchor of inflation in the new macroeconomic consensus model of monetary policy, Post-Keynesian and Neo-Structuralist theorists have emphasized nominal exchange rate anchors (Cf. Ball 1999; Svensson 1998; Galindo and Ros 2008; García and Perrotini 2014).

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real exchange rate appreciation pressures to materialize and neutralize depreciation tendencies. For this purpose, central banks intervene in foreign exchange markets and accumulate international reserves (mainly US dollars), thus reflecting the hegemony of quasi-world money and the lesser nature of peripheral financialized capitalism. The more international reserves get accumulated, the more domestic credit gets reduced in order to stabilize the monetary base. This is how credit rationing adds to slow growth in peripheral financialized economies. Figures 1, 2 and 3 show this contradictory character of monetary policy in the era of inflation targeting in Brazil, Chile and Mexico: Central banks use sterilized interventions in the foreign exchange market (forex market) as an additional monetary policy instrument to achieve price stability; their actions in the forex market are reflected in their balance sheet in the form of an expansion of foreign exchange reserves and a contraction of domestic credit, countervailing sharp fluctuations in the monetary base. It is worth noting that the influence of world money on the balance sheet of peripheral central banks becomes strongest during the financialization crisis. So, inflation targeting is not just a new framework of monetary policy, but, most importantly, it also provides the monetary basis to financialization in peripheral capitalism: The accumulation of foreign exchange reserves by the central banks of Brazil, Chile and Mexico has reached a maximum in the aftermath of the crisis.

Peripheral financialized economies must transfer capital to core financialized capitalism; capital will not flow from rich to poor countries in financialized capitalism, as mainstream international economics has it. On the contrary, “capital flows have become strongly negative for developing countries on a net basis” (Lapavitsas 2013:246). Yet, if real exchange rates tend to appreciate so as to meet the inflation target, how is it that peripheral financialized countries manage to generate net export surpluses? Exchange rate appreciation involves a permanent loss of competitiveness. Here is where wage deflation enters the scenario: Real wages

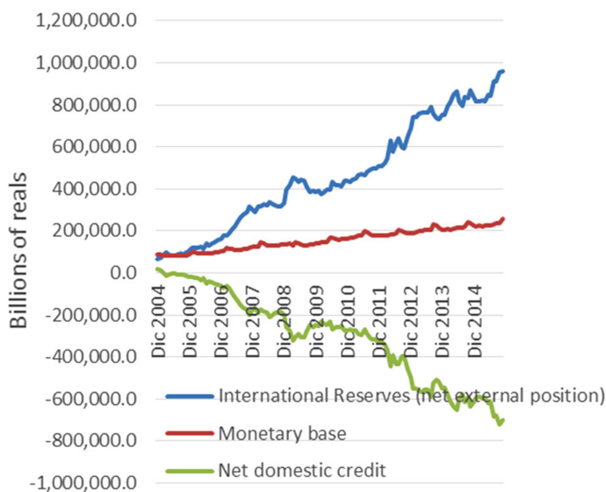

Fig. 1 Evolution of international reserves, monetary base and net domestic credit of the Central Bank of Brazil, December 2004–December 2014

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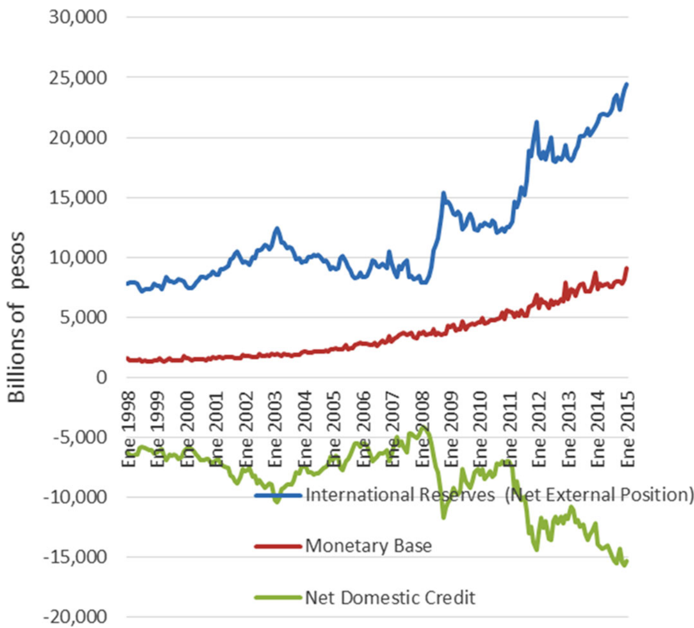

Fig. 2 Evolution of international reserves, monetary base and net domestic credit of the Central Bank of Chile, January 1998–January 2015

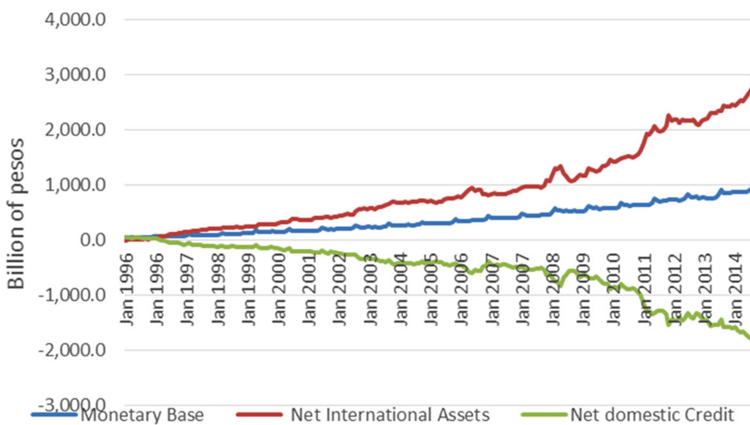

Fig. 3 Evolution of international reserves, monetary base and net domestic credit of the Central Bank of Mexico, January 1996–January 2015

lag *vis-à-vis* productivity to compensate for the loss of competitiveness, while an appreciated real exchange rate helps monetary policy to hit the inflation target. All in all, wage deflation becomes the real anchor for inflation in peripheral financialized capitalism. For example, in Mexico, the gap between total productivity and the real wage of industrial workers has increased sharply since the country

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Fig. 4 Total productivity and real wage, industrial sector, 1995–2013 (1995 = 100). *Source*: INEGI

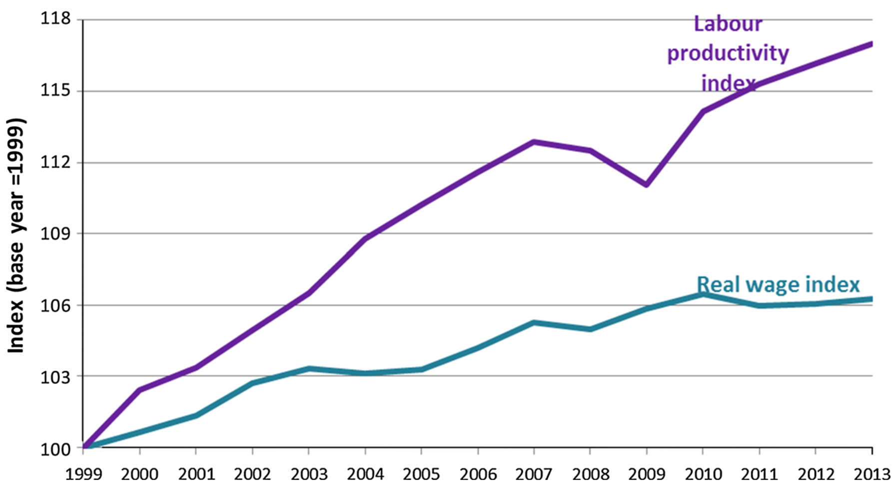

Fig. 5 Productivity and real wages in developed countries (1999 = 100). *Source*: International Labor Organization. *Note*: Wage growth is calculated as a weighted average of year-on-year growth in average monthly real wages in 36 economies (for a description of the methodology, see Appendix I). Index is based to 1999 because of data availability. *Source*: ILO Global Wage Report 2014/2015

adopted a full inflation targeting regime; inflation has been brought under control and on target precisely during the period (2003–2013) when the wage-productivity gap has reached a maximum (see Fig. 4). Hence, wage deflation has provided an anchor for price stability in Mexico.

Real wage anchors of inflation can be readily found in other developing economies as well. Yet, I am afraid the story may not be so different in some—if not all—core financialized capitalist economies. Some empirical evidence supporting

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such conjecture is as follows: The OECD (Organization for Economic Cooperation and Development) reports stagnant or declining real wages along with diminishing rates of inflation in Japan, the USA and the Eurozone since the early 1990s; the International Labor Organization report *World Employment and Social Outlook: Trends 2015* says that "the total number of jobseekers is 201 million today, over 1 million more than a year ago" (ILO 2015:16). Therefore, perhaps one can safely assume that wage deflation can be found too in core financialized capitalism, as shown in Fig. 5.

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