



# The Real Causes of the Recent Economic Crisis and Current Economic Turmoil

Howard Nicholas

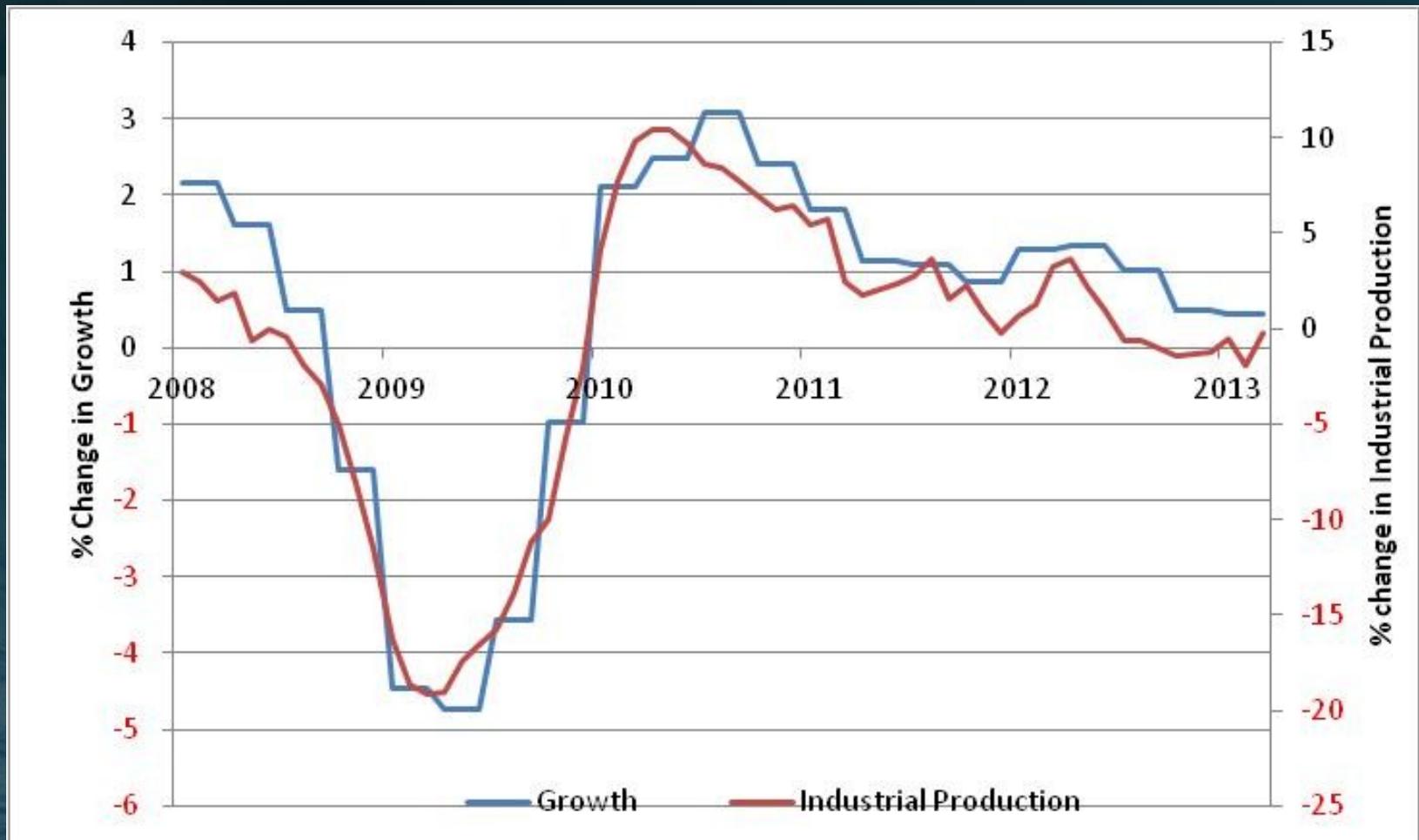
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CREA lecture 24 June 2013

# The Global Economic Problems

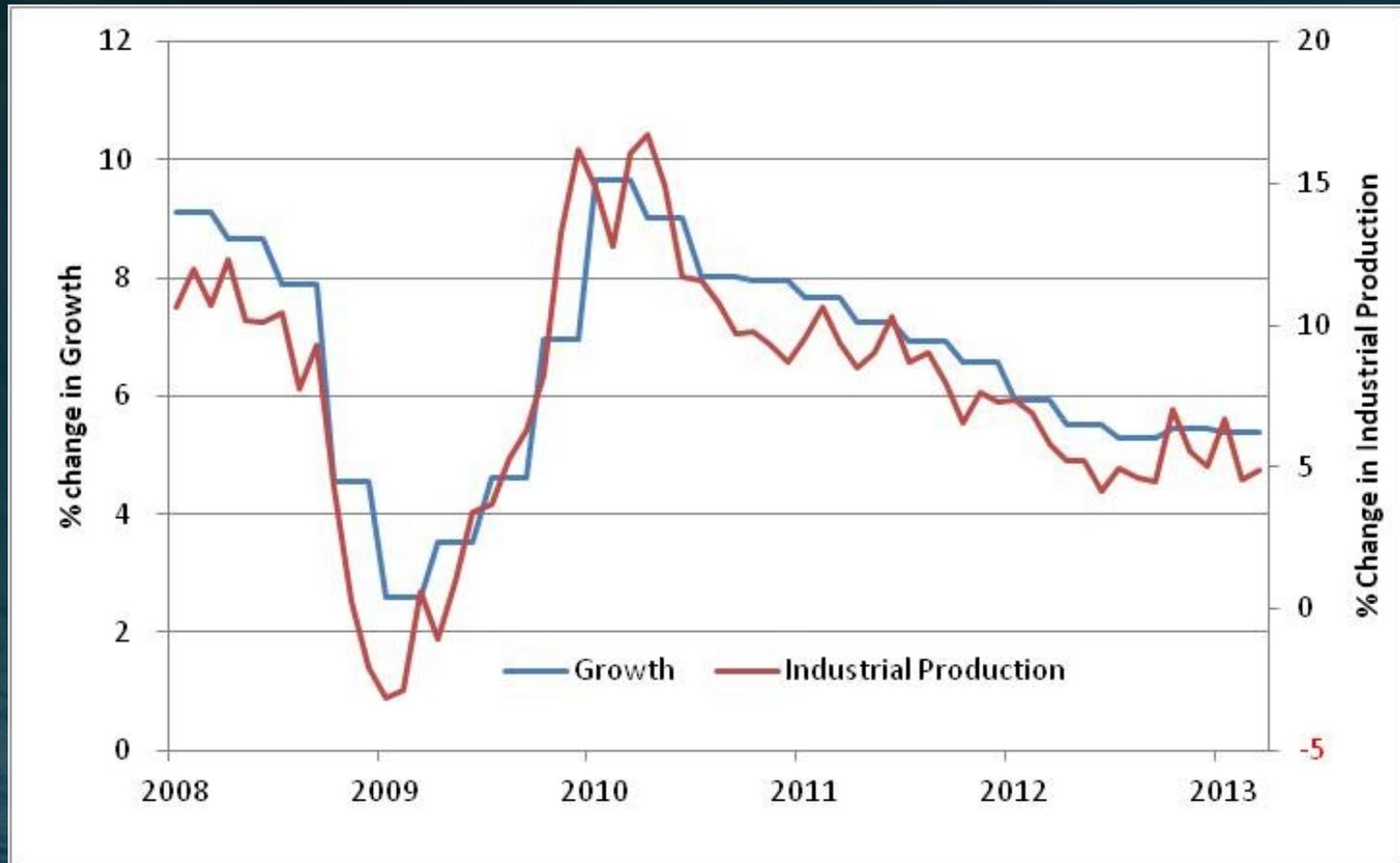
- Severe economic and financial **crises** in period 2007-9
- Renewed **weakness** in the global economy from mid-2010 onwards
  - Falling GDP and industrial production growth
  - Continuing high unemployment
  - Loss of confidence in countries with excessive debts – the Eurozone crisis
  - Considerable volatility in global financial markets

# Weakening industrial production and real GDP growth in advanced countries, 2008 (Jan) – present (Mar 2013)



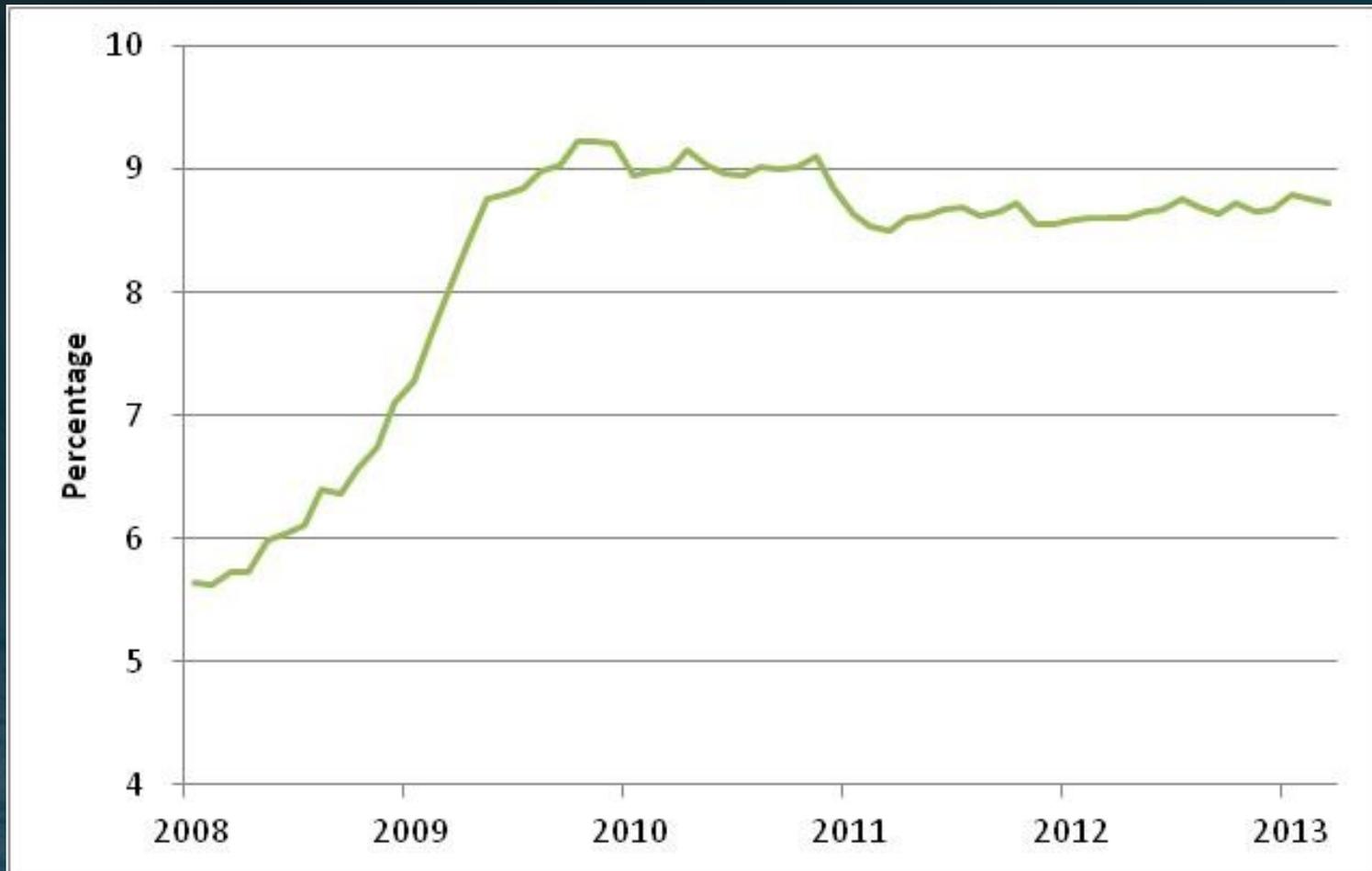
(Data Source: Economist, Calculated by author)

# Weakening industrial production and real GDP growth in developing countries, 2008 (Jan) – present (Mar 2013)



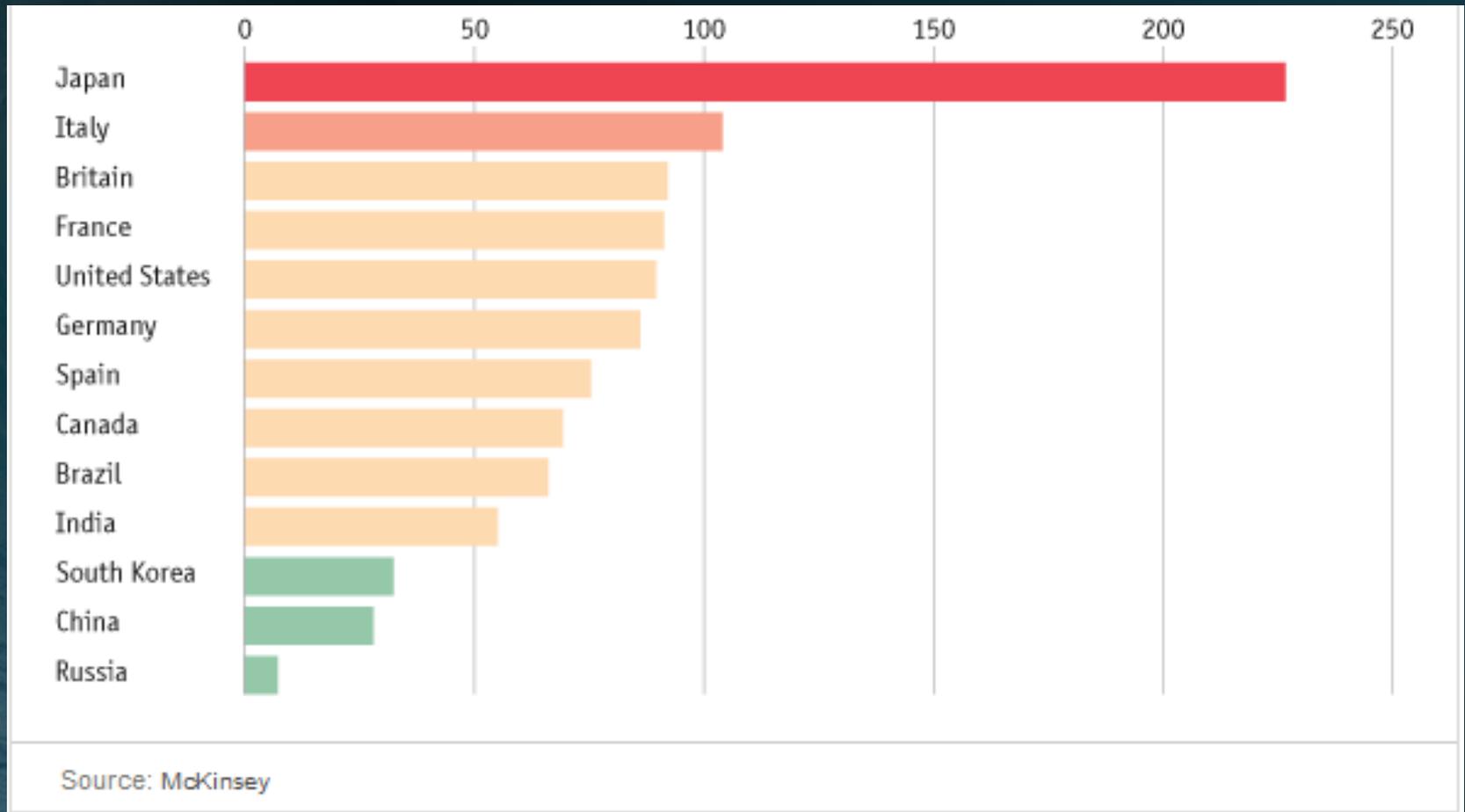
(Data Source: Economist, Calculated by the author)

# Unemployment still high in advanced countries, 2008 (Jan) – present (Mar 2013)



(Data Source: Economist, Calculated by the author)

# Government debt, 2012





# Major policy responses to 2007-9 crisis

- Injections of **liquidity** in system along with lower short-term interest rates
- **Budget deficits**
- **Bail-outs of banks (1)**
  - Purchase of “toxic assets”
  - Nationalisations and capital infusions
  - Guarantees of deposits

# Major policy responses to current turmoil

- Reductions in **budget deficits** in advanced countries because of fear of debt
- Loose **monetary policies** in advanced countries (1)
- Continuing **bailouts** of banks (2)
- More financial market **regulation** (3)
- Tight monetary policies in developing countries to curtail inflation
- **Capital controls** and **currency interventions** in a number of countries

# Standard explanations for the global economic problems

- **Government** monetary and fiscal irresponsibility in the advanced countries coupled with exchange manipulation by the Chinese.
- Speculative excesses by **the financial sector** in the advanced countries coupled with mercantilist policies of the Chinese and other Asian economies.

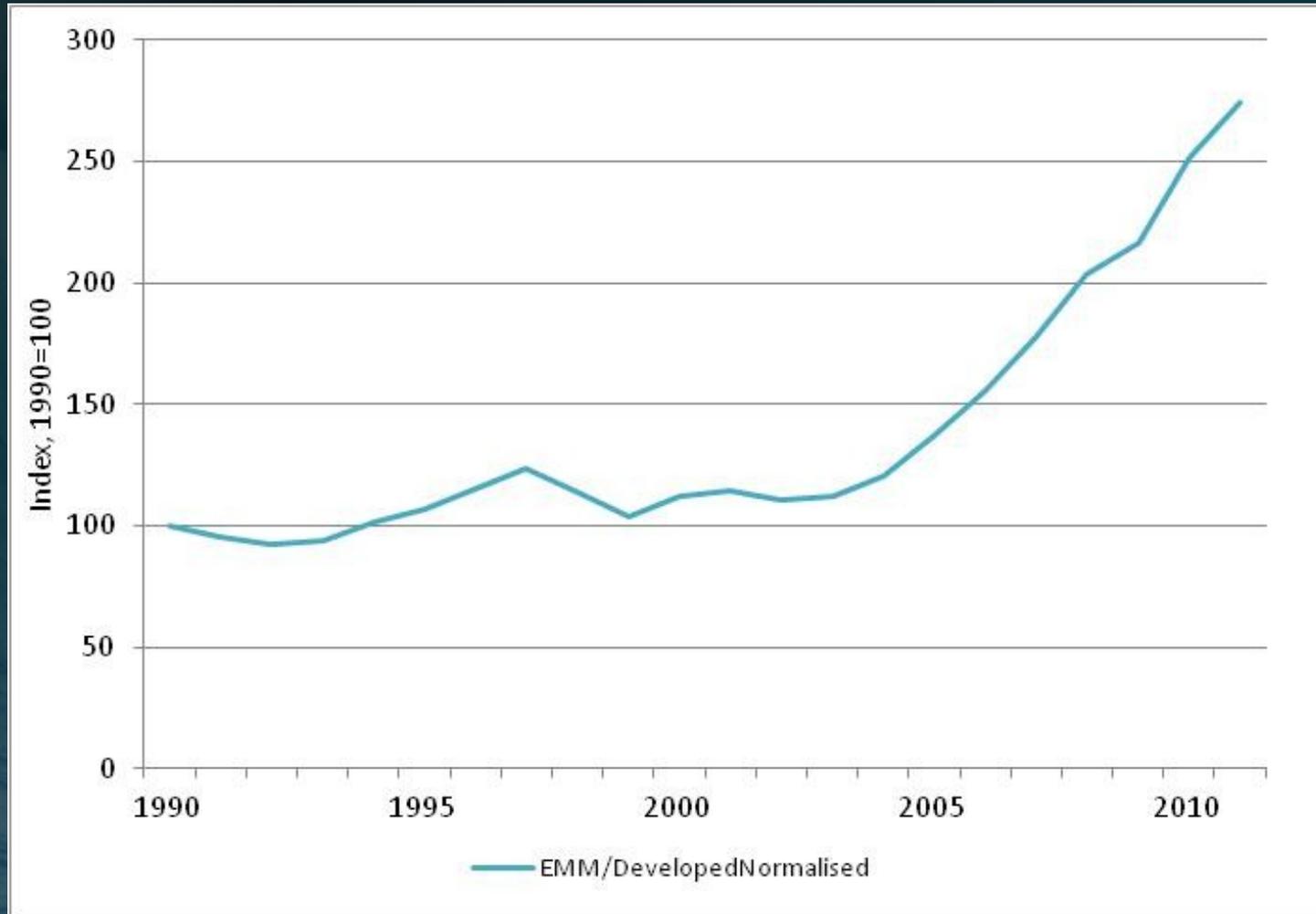
**THE REAL REASONS  
FOR THE CRISIS AND  
THE CONTINUING  
TURMOIL**

# Real causes

- Shift in **balance of global economic power** away from the U.S. and towards Europe and Developing countries.
- Workings of cycles, especially the **long cycle** – end of phase in which financial sector becomes too big
- Fall or stagnation in **real wage** levels in the U.S. (and other advanced countries) hidden by an excessive expansion of credit (1)
- **Misguided policies** and data manipulation in the advanced countries have aggravated problems.

# THE SHIFT IN GLOBAL ECONOMIC POWER

# Shift in global production from Advanced to Developing countries, 1990-2011



(Source: World Bank)

## Shift in global investment (% of Total) – 1990, 2000, 2010

		1990	2000	2010
Developed		86.8	85.2	60.5
	US	24.3	35.0	26.8
	Japan	24.1	21.0	14.2
	EC	34.8	27.1	32.5
	Other OECD	16.8	16.8	26.5
EMM		13.2	14.8	39.5
	South East Asia	29.3	51.7	61.4
	China	14.7	41.4	53.5
	South Asia	14.6	13.7	11.3
	India	12.4	11.0	10.1
	Latin America	21.5	21.1	13.6
	Brazil	15.2	11.0	8.2
	Africa	4.1	2.6	1.8
	Russia	23.6	4.4	6.4
	Eastern Europe	1.2	0.8	1.2

(Source: World Bank, Calculated by author)

## Global balance

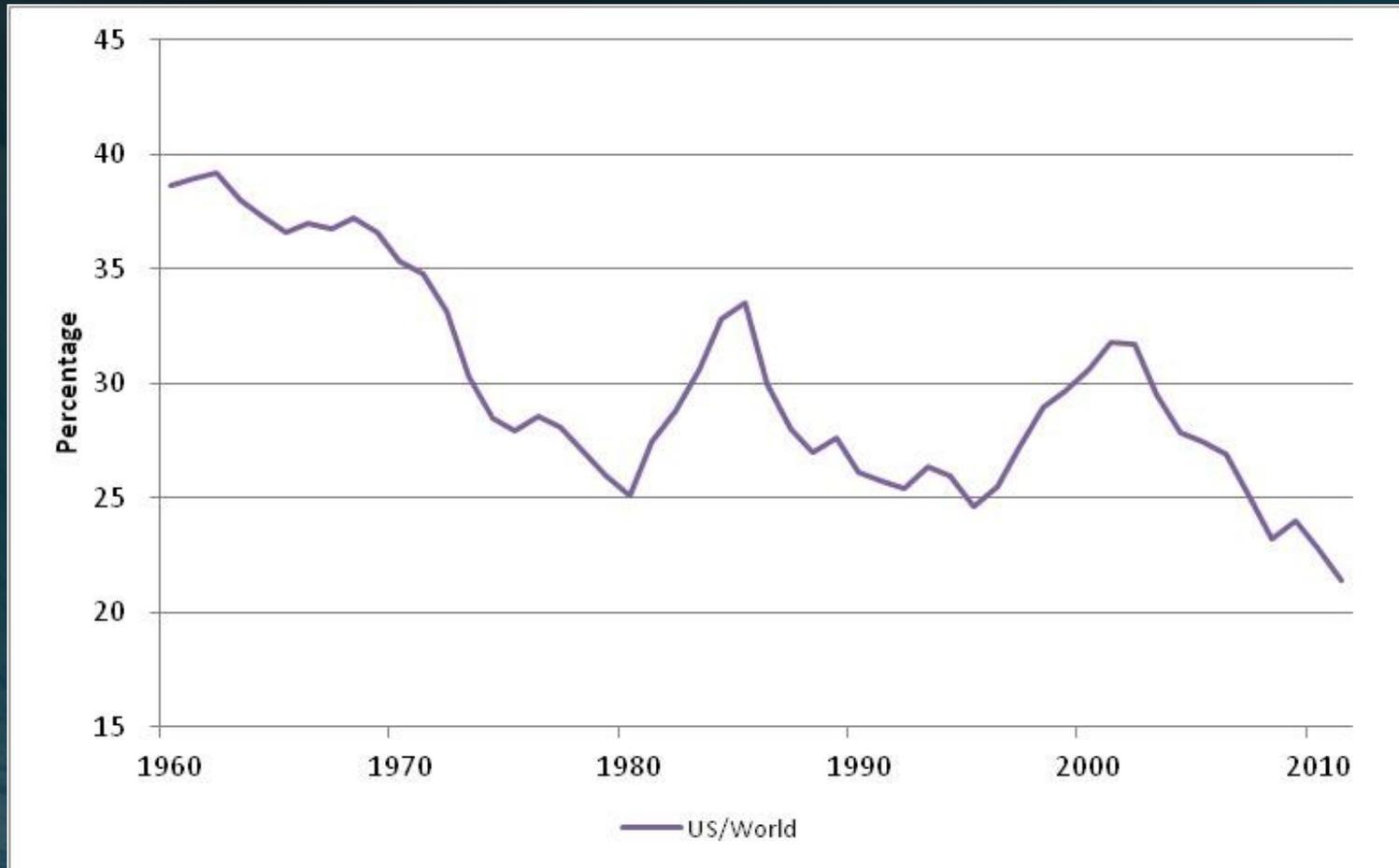
Economies' share of world GDP, %

At market exchange rates



Sources: AT Kearney; Bloomberg; BP; dotMobi; Fortune; IMF; UBS; UN; World Bank; World Steel Association; WTO

## Decline of the US relative to the World economy, 1960-2011



(Source: World Bank, Calculated by author)



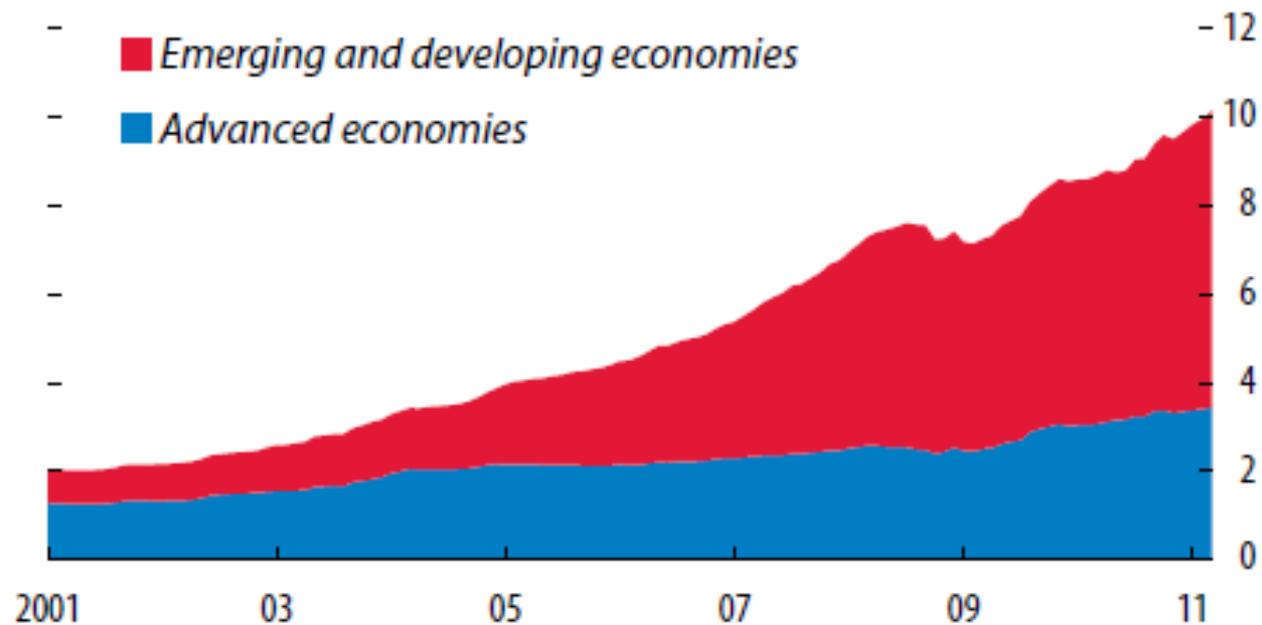
# The rise of China

“Many analysts are predicting a power shift in the financial arena quite soon, since according to International Monetary Fund projections, China could leapfrog the United States to become the world's largest economy by 2016”

(Source: RT, 10 Aug 2011)

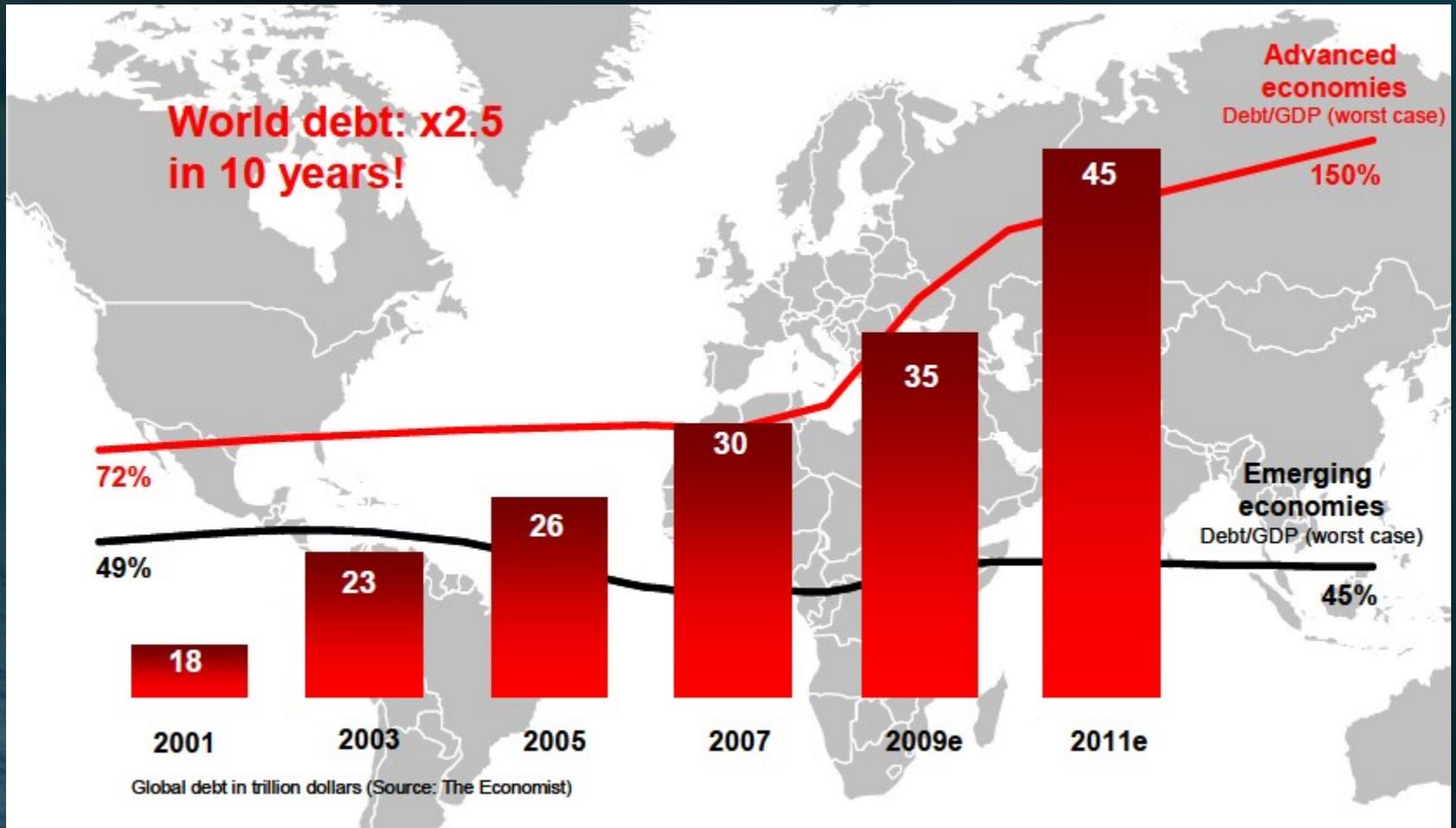
# Developing country reserves growing rapidly

**Figure 2.6. Foreign Exchange Reserves, Excluding Gold**  
(In trillions of U.S. dollars)



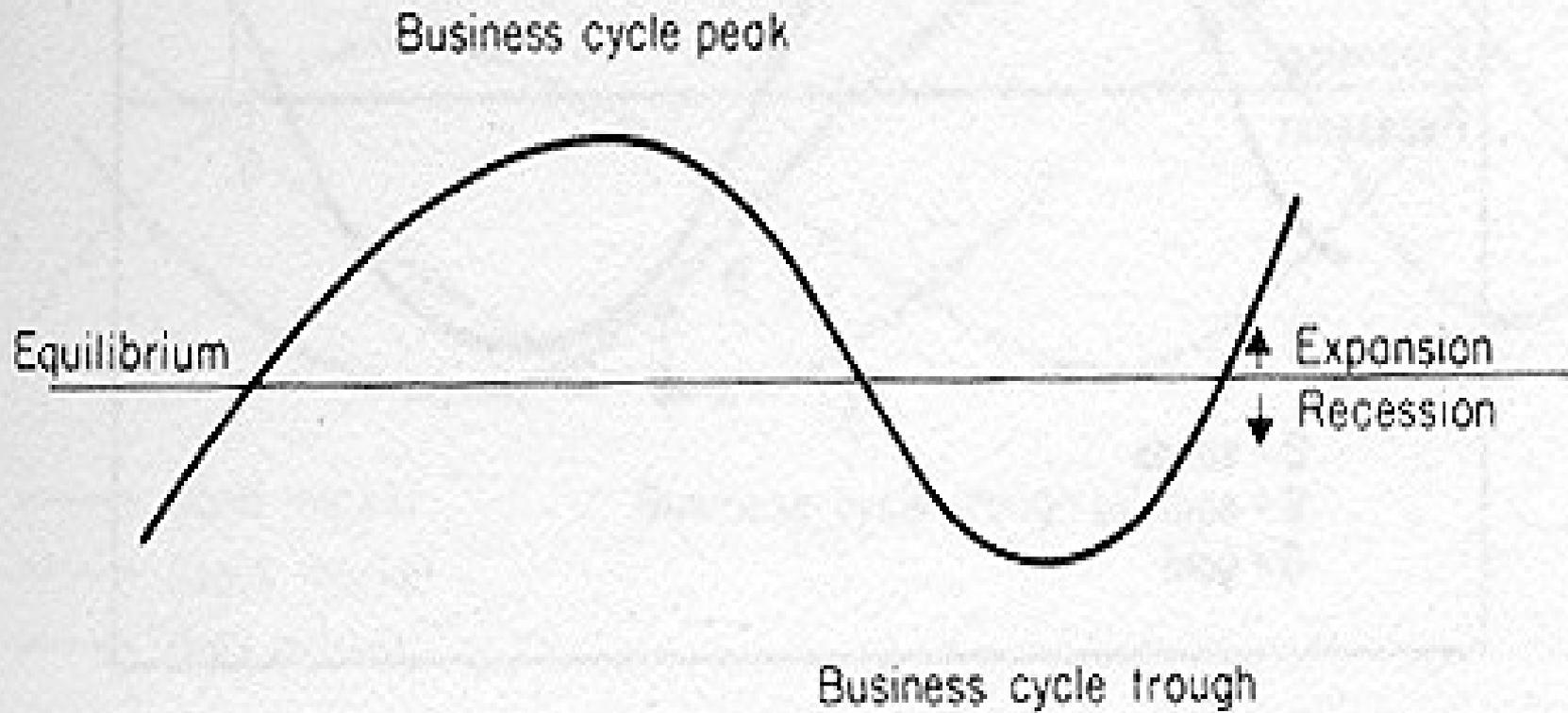
Source: IMF, International Financial Statistics.

# Global debt



# THE BUSINESS CYCLE

# A Typical Cycle



# Types of Cycles

Cycle	Duration	Source
K-Wave	50-60 yrs	Major innovations
Juglar	7-11 yrs	Fixed capital investments
Kitchin	3-4 yrs	Inventory capital changes

# Long Waves

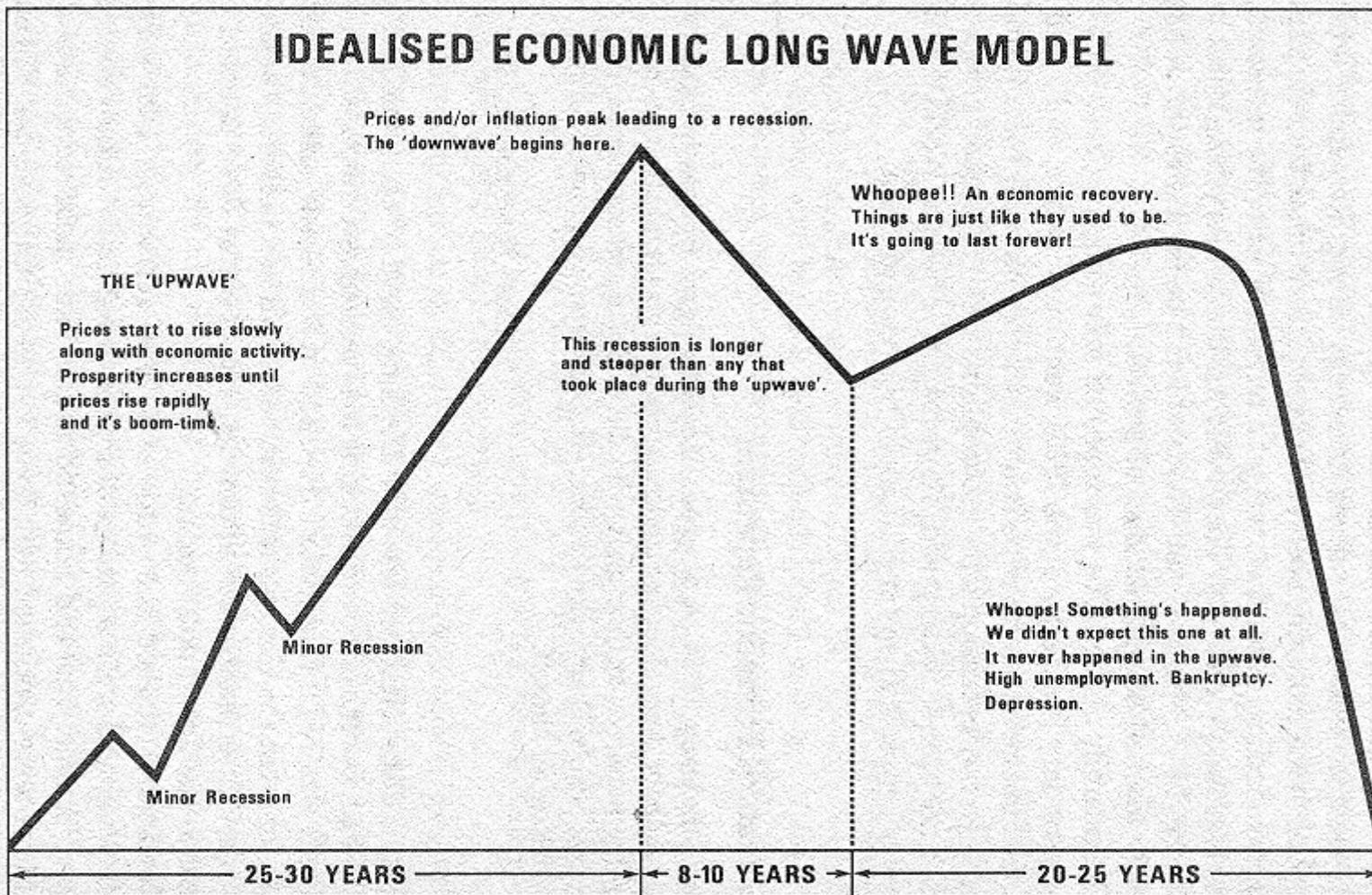


Figure 1 The Idealised Economic Long Wave Model

# Long Cycle Phases



- Major tech, innovations lead to rise in **profits**, investment and output
  - Prices rise towards end of phase (technological and production capacity limits are reached)
  - Economic policy is expansionary
- 
- Profits, investment and output growth fall
  - **Unemployment** rises and real wages and prices fall
  - Fiscal policy becomes contractionary and **monetary policy expansionary**

# Long Cycle Dating

Trough	Peak	Trough	Duration	Hegemonic Power	Technology
1790	1814	1848	58	Britain	Canals
1848	1872	1893	45	Britain	Railways, Steam (steam engine)
1893	1917	1940	47	Britain	Steel, Combustion engine, Electricity, Chemicals, Telephone
1940	1975	2000?	60	United States	Electronics, Plastics, Aerospace, Nuclear energy
2000	2030	2050	50	United States	Computers, Biotechnology, Robotics

(Source: Goldstein 1988 (modified))

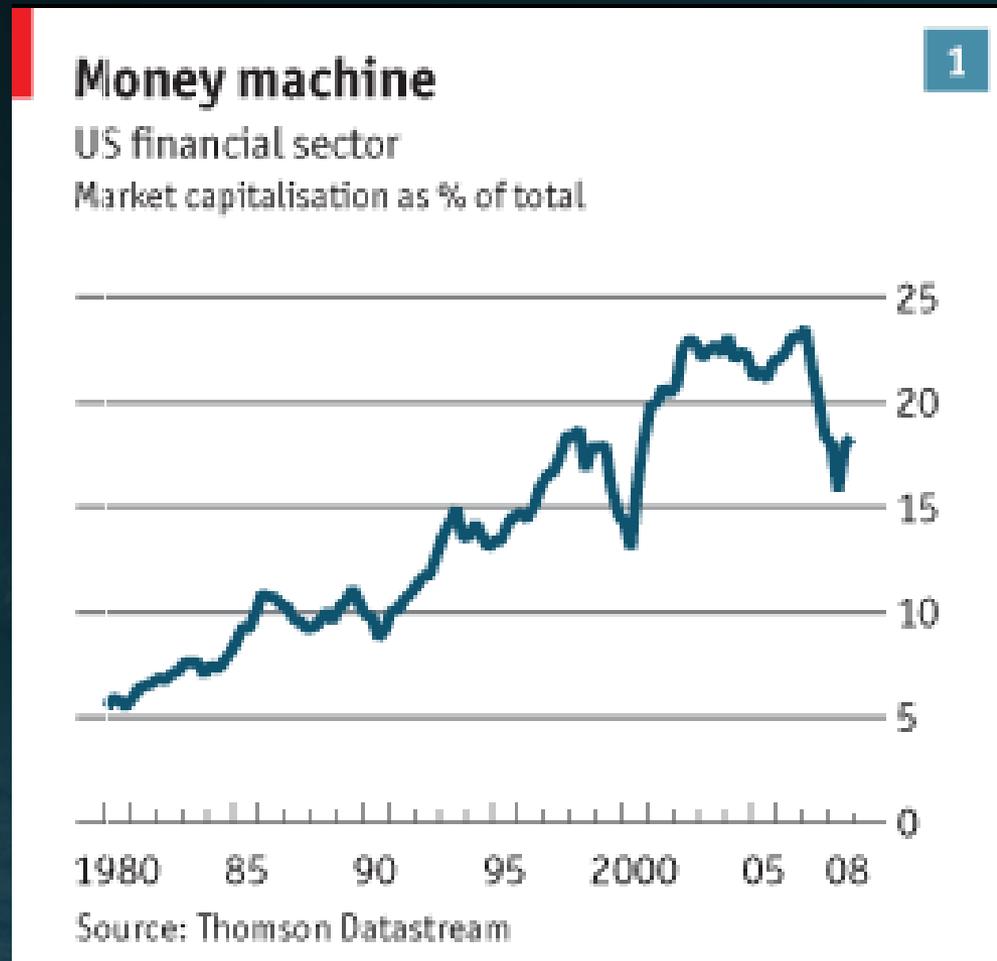
# Long Cycle Interest Rates, US 20 yr bonds, 1954 - 2012



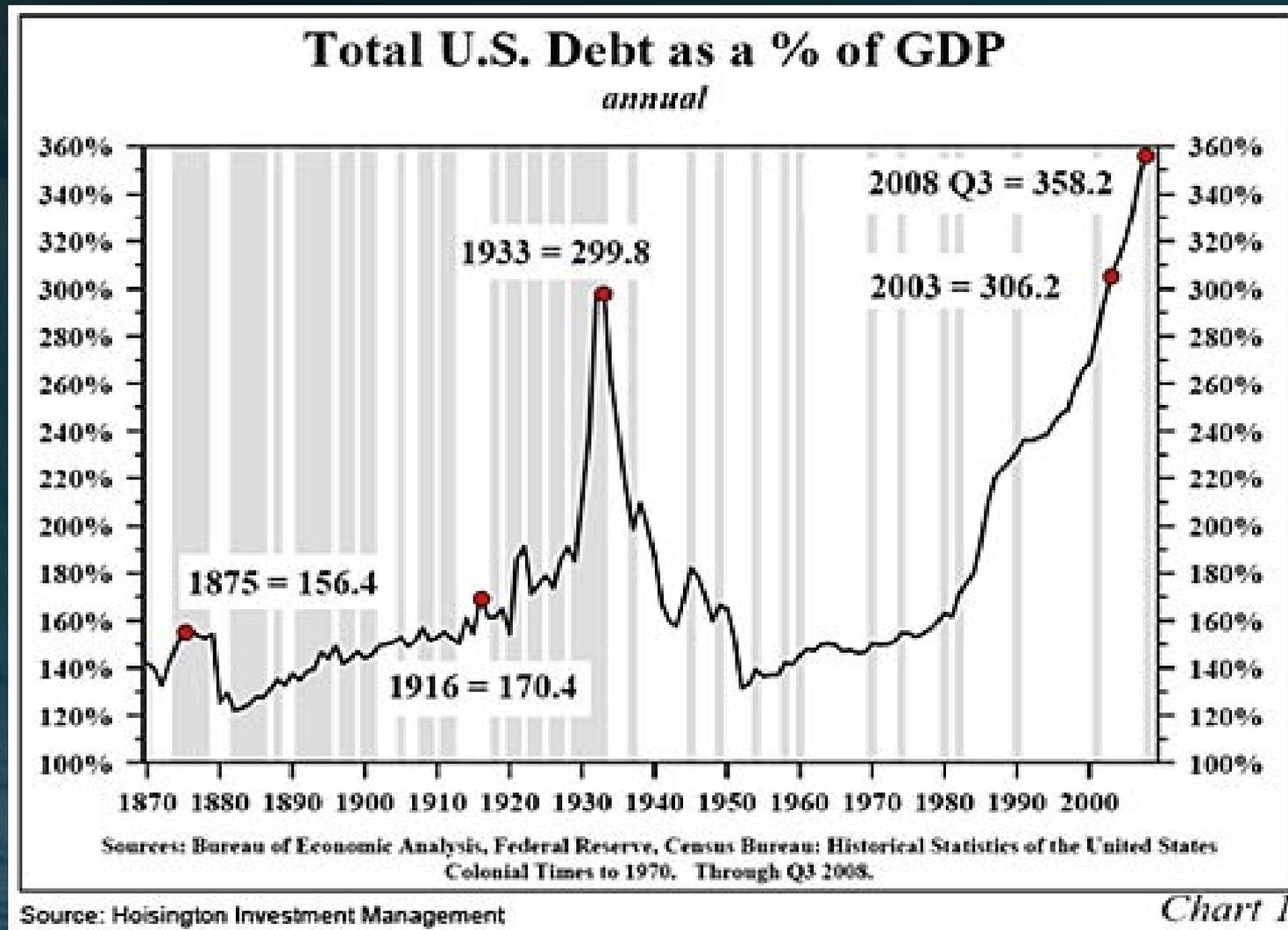
\* 1987-92 data is estimate

(Data Source: US Federal Reserve St.Louis)

# Overexpansion of the financial sector in the US



# Cyclical movement of US debt





# Juglar Dating - Troughs

1958

1970

1975 (oil shock)

1980

1991

2001

2008

2014?

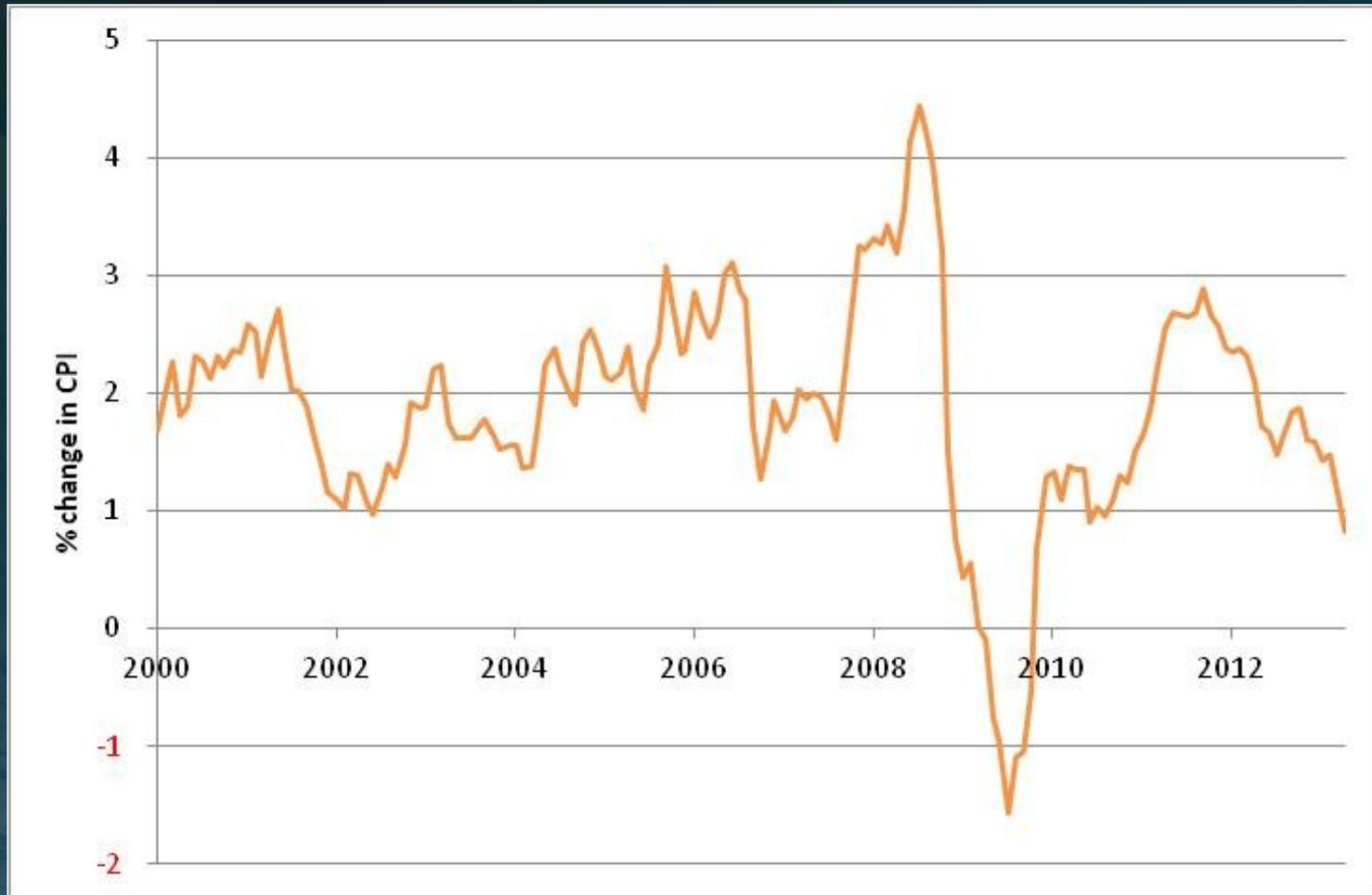
# **POLICY MISTAKES**

# Orthodoxy Mark 1

- **Printing** does not cause inflation – it leads to asset bubbles in the current context
- **Debt** is not the source of the stagnant growth in advanced countries it is a consequence of it
  - **Cutting expenditure** (to subsidize the financial sector) only worsen problems
- **Chinese currency** is not undervalued

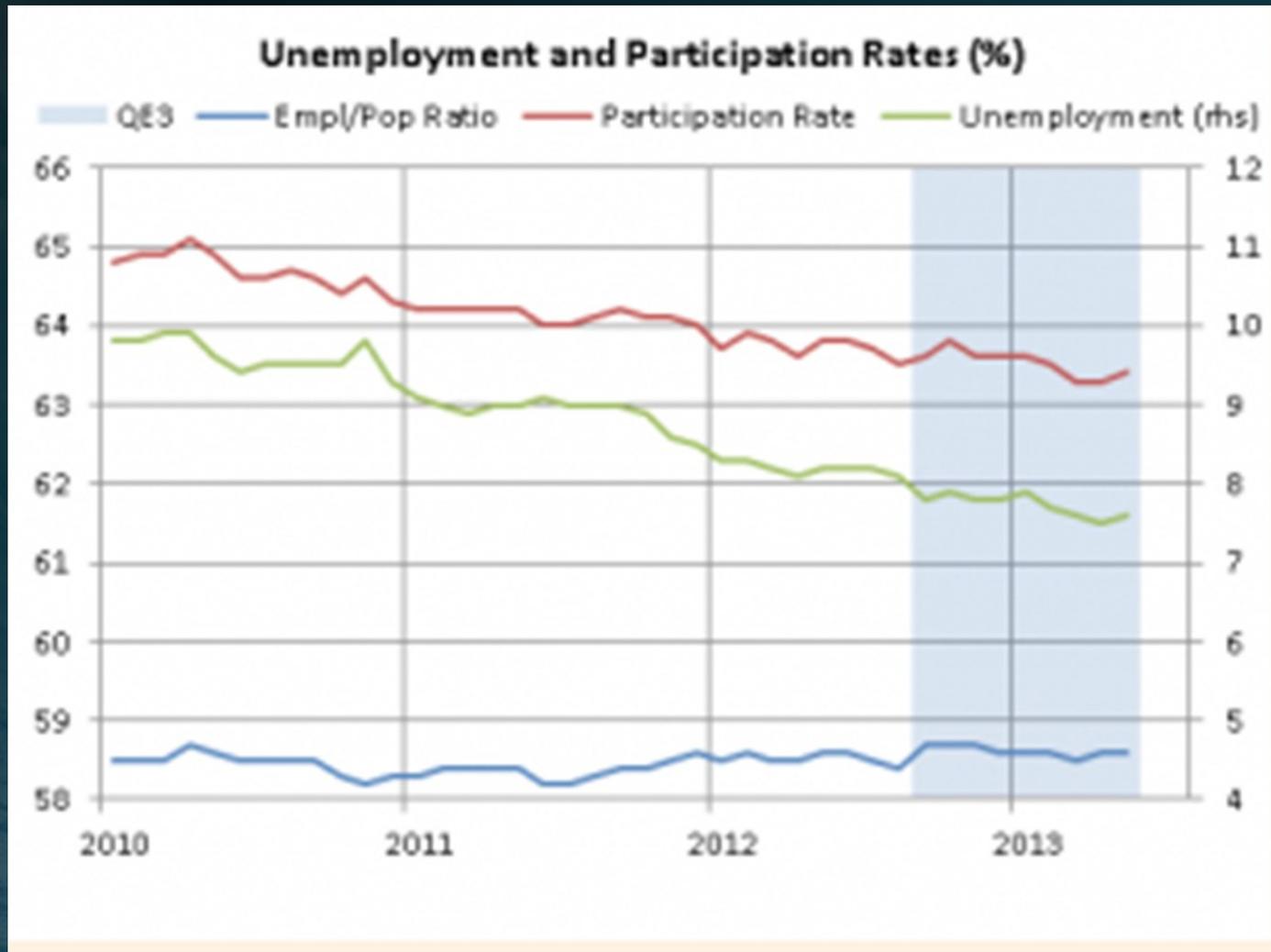
# US and Japanese printing holding up the markets

# Inflation of advanced economies, 2000 (Jan) – present (Apr 2013)



(Source: Economists, chart by author)

# Falling US unemployment?

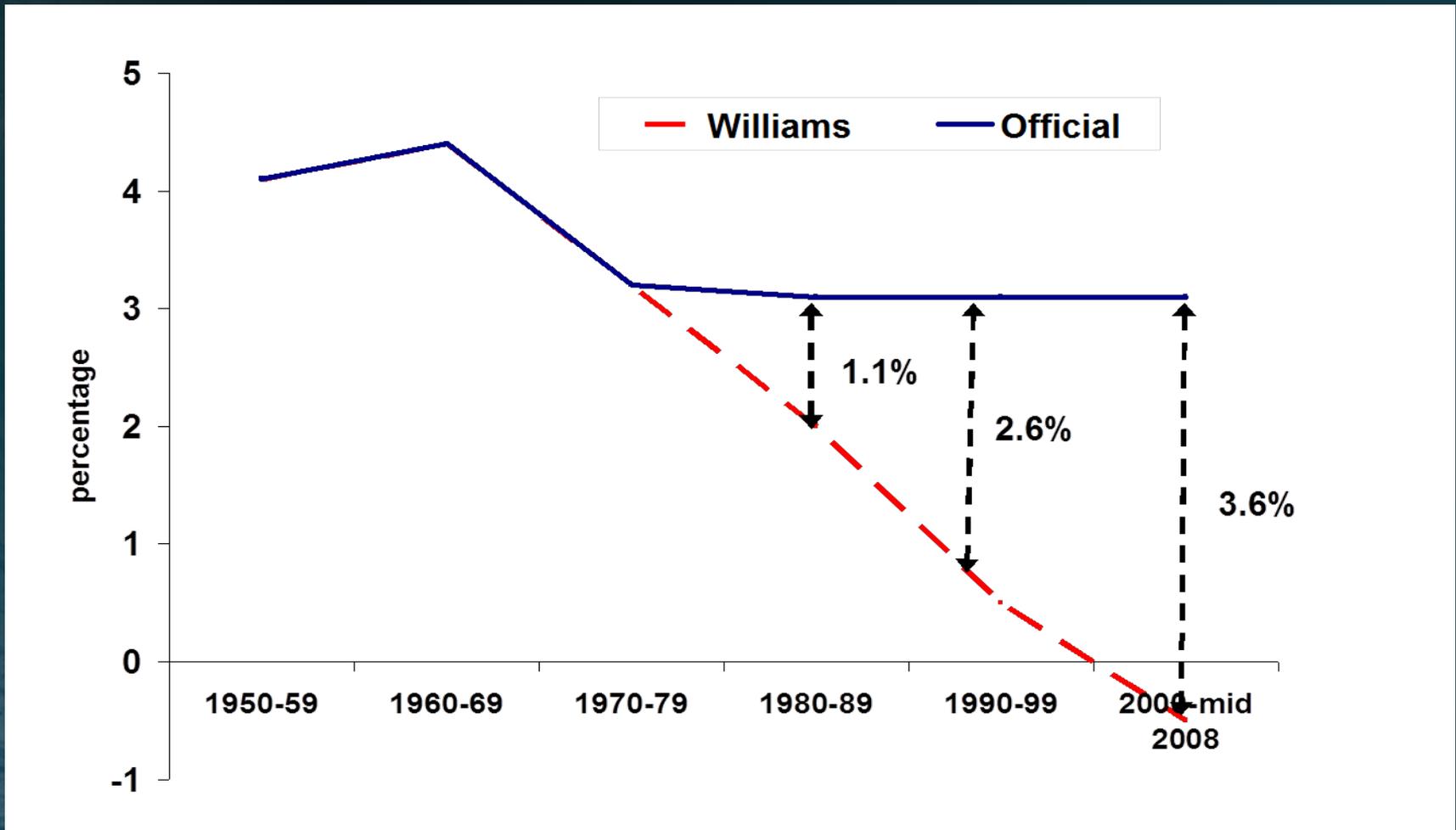


# Orthodoxy Mark 2

- **Budget deficits** *per se* not the answer
- **Raising wages** in the advanced countries will worsen matters and quite possibly lead to protection
- Mercantilist policies in **China** are not to blame.

# DATA MANIPULATION

# Official vs un-official US GDP data

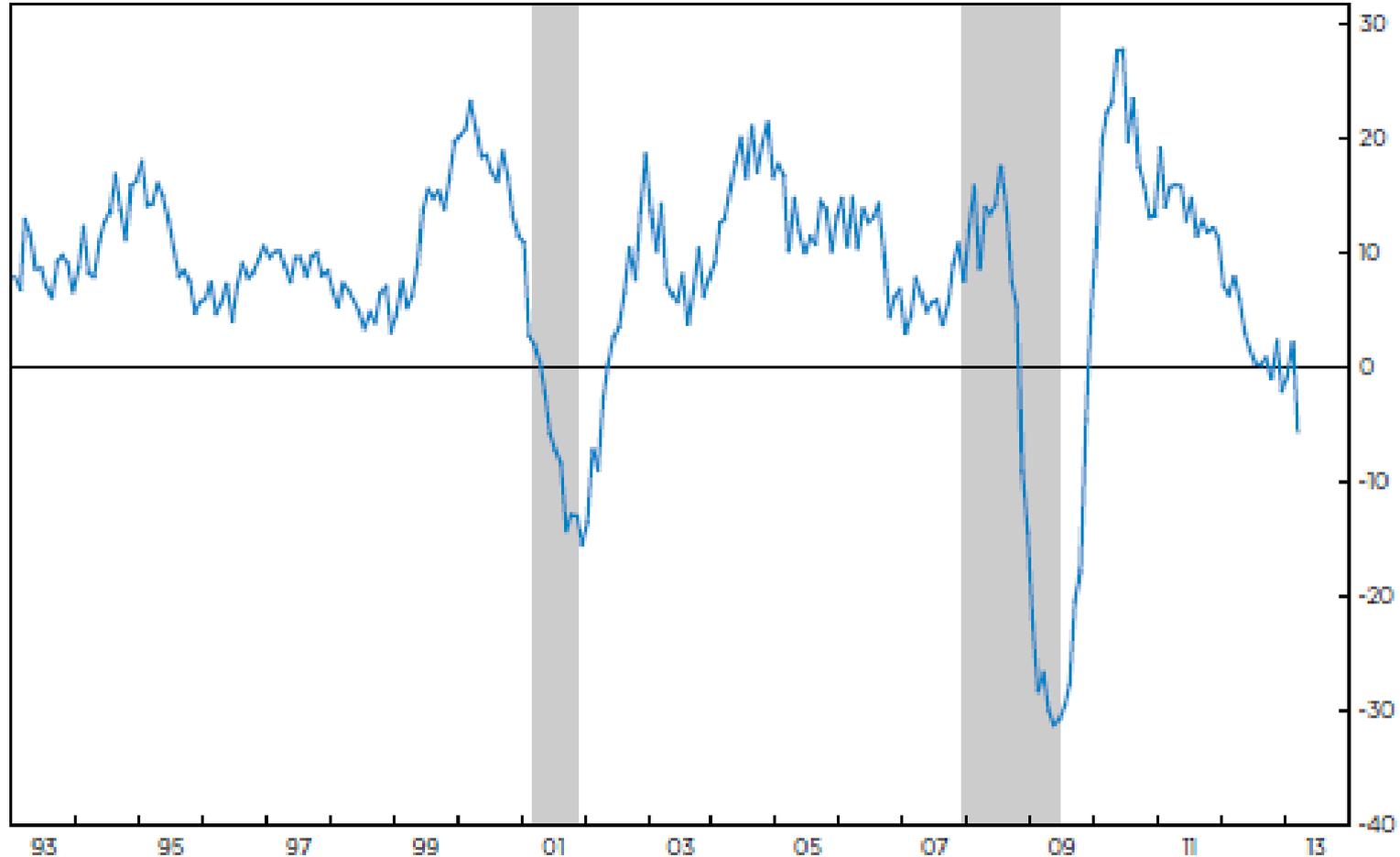


# **FUTURE PROSPECTS**

# Short-term

- Subsiding of the euro-crisis
- Recessionary forces gathering – should be another recession in US too by 2014 at the latest
- **Lower** global inflation
- Continuing **tightening of fiscal policies** in advanced countries and easing in developing countries
- Continuing **easy monetary policies** in the advanced countries and greater easing in developing countries

# U.S. Imports, growth rate 1993 - April 2013



Shaded areas represent U.S. business cycle recessions.

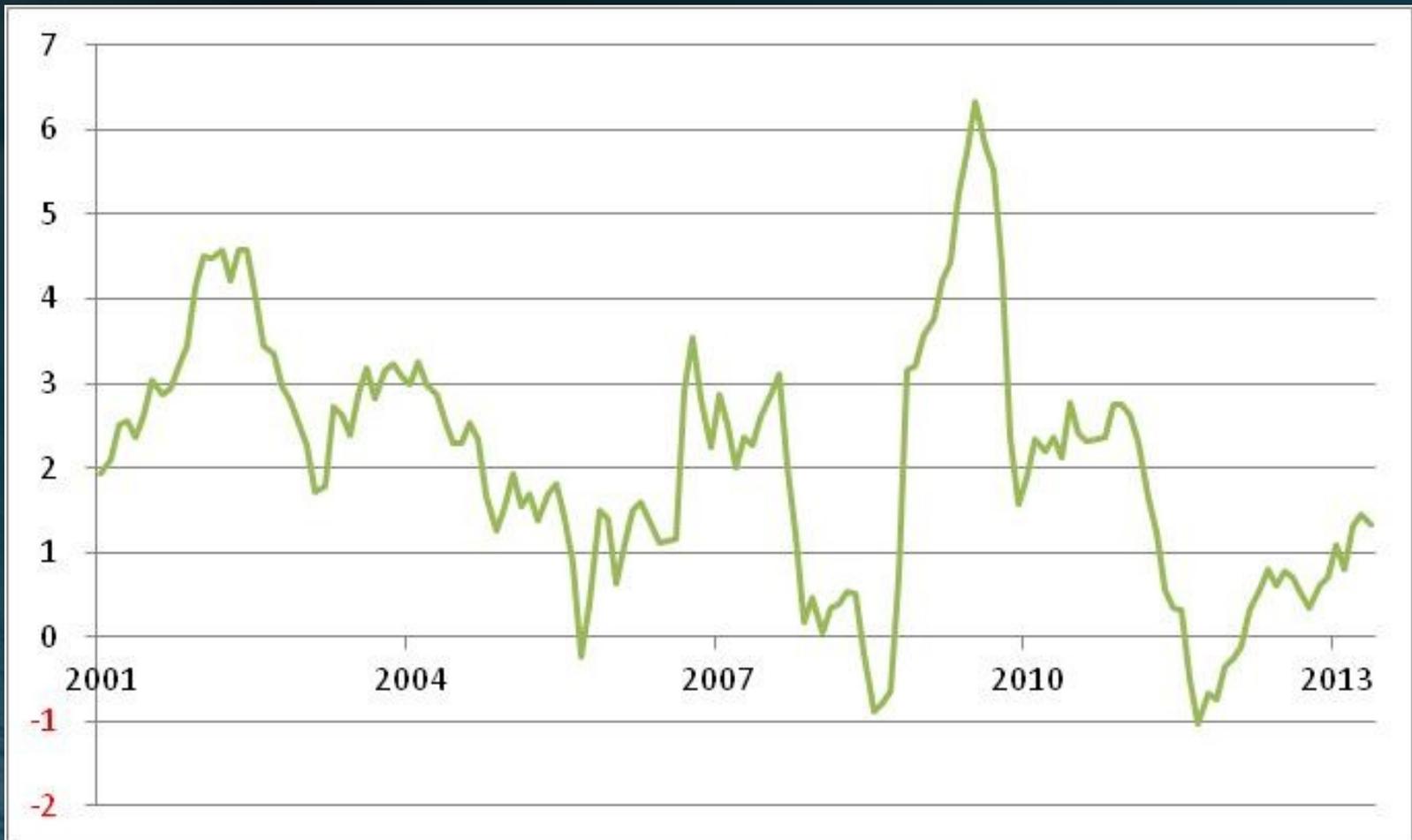
(Source: ECRI, 3rd June 2013)

# US industrial production and export growth, 2000 (Jan) – present (Apr 2013)



(Source: U.S. Federal Reserve St. Louis, chart by author)

# U.S. government 20year bond real interest rate, 2001 - present (May 2013)



(Source: U.S. Federal Reserve St. Louis, chart by author)

# Household debt

## Household debt

Households' gross debt as % of disposable income

● Pre-boom level 2000

● Pre-crisis level 2007

● 2012\*



Source: OECD

\*Or latest available quarter

(Source: Economist, 1st June 2013)

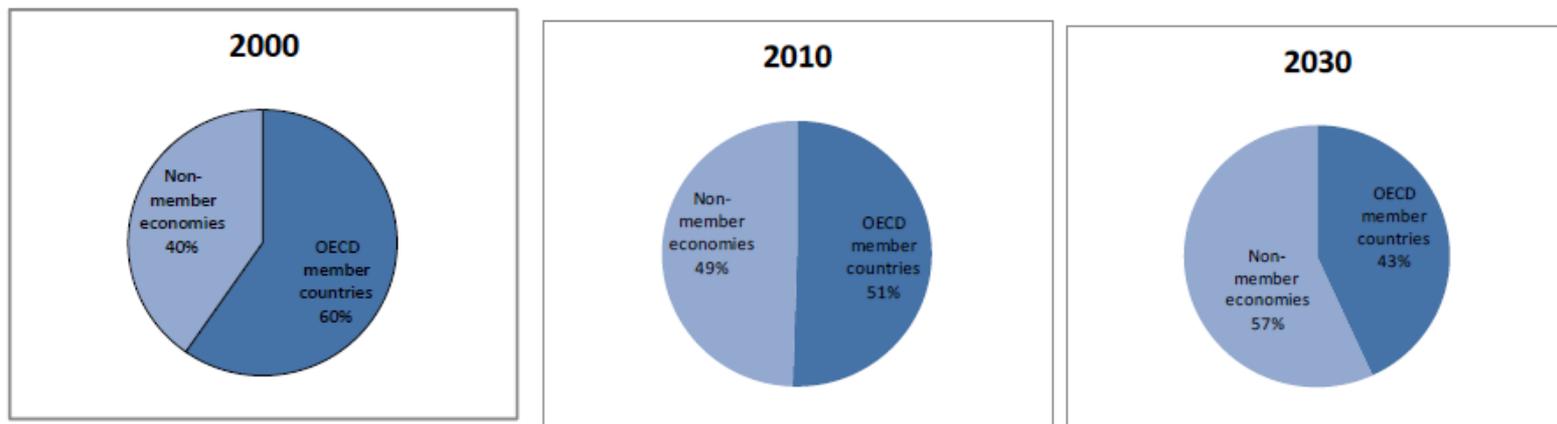
# Longer-term

- **Stagnation** in the advanced countries (1)
  - Weakening of the financial sector
  - Continuing high unemployment
  - Continuing high government debt and budget deficits
  - **Deflation** problems
- More **rapid growth** in the developing countries (2)
  - Rise of Latin America and Africa
  - Continuing growth of Asia – possible formation of a monetary union

# Shift in global wealth – 2000, 2010, 2030

**Figure 0.1: Share of the global economy in purchasing power parity terms**

% of global GDP, PPP basis



*Note:* These data apply Maddison's long-term growth projections to his historical PPP-based estimates for 29 OECD member countries and 129 non-member economies.

*Source:* Authors' calculations based on Maddison (2007) and Maddison (2010).

(Source: OECD Perspectives of Global Development 2010, Shifting Wealth)