

A Violent World

Jean-Hervé Lorenzi

Mickaël Berrebi

Modern Threats to Economic Stability



A Violent World

This page intentionally left blank

A Violent World

Modern Threats to Economic Stability

Jean-Hervé Lorenzi

*Professor of Economics, Paris-Dauphine University and President,
Le Cercle des Economiste, France*

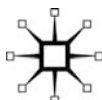
Mickaël Berrebi

Actuary, France

Translated by Josephine Bacon

Foreword by Anthony Giddens

palgrave
macmillan



© Jean-Hervé Lorenzi and Mickaël Berrebi 2016
Foreword © Anthony Giddens 2016
Softcover reprint of the hardcover 1st edition 2016 978-1-137-58992-7

All rights reserved. No reproduction, copy or transmission of this publication may be made without written permission.

No portion of this publication may be reproduced, copied or transmitted save with written permission or in accordance with the provisions of the Copyright, Designs and Patents Act 1988, or under the terms of any licence permitting limited copying issued by the Copyright Licensing Agency, Saffron House, 6–10 Kirby Street, London EC1N 8TS.

Any person who does any unauthorized act in relation to this publication may be liable to criminal prosecution and civil claims for damages.

The authors have asserted their rights to be identified as the authors of this work in accordance with the Copyright, Designs and Patents Act 1988.

Originally published in French 2014 as *Un Monde de Violences: L'économie mondiale 2015–2030*, by Groupe Eyrolles, ISBN: 978–2–212–56001–5 (www.editions-eyrolles.com)

This edition first published 2016 by
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC,
175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

Palgrave® and Macmillan® are registered trademarks in the United States, the United Kingdom, Europe and other countries.

ISBN 978-1-349-88782-8 ISBN 978-1-137-58993-4 (eBook)
DOI 10.1007/978-1-137-58993-4

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

Library of Congress Cataloging-in-Publication Data

Names: Lorenzi, Jean-Hervé, author. | Berrebi, Mickaël, author.

Title: A violent world : modern threats to economic stability / Jean-Hervé Lorenzi, Executive Board Member, Compagnie Financière Edmond de Rothschild, France, Mickaël Berrebi, Actuary, France.

Other titles: Monde de violences. English

Description: New York : Palgrave Macmillan, 2016. | Includes index.

Identifiers: LCCN 2015035441

Subjects: LCSH: Economic forecasting. | Economic history – 1990– | International economic relations. | International finance. | Economic history – 21st century – Forecasting. | BISAC: BUSINESS & ECONOMICS / Economic Conditions. | BUSINESS & ECONOMICS / Economic History. | BUSINESS & ECONOMICS / Economics / General. | BUSINESS & ECONOMICS / Economics / Theory.

Classification: LCC HB3730 .L6713 2016 | DDC 330.9001/12—dc23

LC record available at <http://lccn.loc.gov/2015035441>

This book could never have seen the light of day without the intelligent, friendly and talented assistance of Isabelle Albaret

This page intentionally left blank

Contents

<i>List of Figures</i>	ix
<i>List of Tables</i>	xi
<i>Foreword</i>	xii
Anthony Giddens	
Introduction	1
1 The Major Breakdown in Technical Progress	6
Innovation, a disruptive phenomenon	7
The major part played by technical progress in promoting growth	12
Slowdown: the great debate	16
Increasingly rare resources	21
The war of intelligence	26
2 The Curse of Ageing	30
The weight of demographics in history	32
The three impacts of ageing	36
A blessing in disguise?	40
Towards intergenerational conflict	44
3 The Irresistible Explosion of Inequalities	50
Inequalities and growth: a return to the old controversy	51
The end of the egalitarian myth	58
The patrimonial society against the middle classes	66
Inequality lies at the heart of a new conflict	71
4 The Impact of Deindustrialization	74
1995–2005: deindustrialization, offshoring, outsourcing	76
The London temptation	83
The American hope	87
Terrible uncertainty over globalization	93
5 The Illusion of Definancialization	102
The explosion of liquidity	103
The dismemberment of the financial system	107
The utopia of regulation	112

The impossible debt equation	115
Finance versus the real economy	119
6 Savings, the Ultimate Rare Resource	125
The enigma of the balance between savings and investment	126
Three decades of an over-abundance of savings	129
The world is changing, savings are decreasing	133
The world is changing, investment is increasing	136
Towards a major imbalance	138
7 Avoiding the Major Crisis of the Twenty-First Century	143
Refocusing the world on youth	146
Socializing rare resources	149
Taming pensions	151
A new Bretton Woods?	155
Risk-sharing	156
 <i>Notes</i>	 160
 <i>Index</i>	 175

List of Figures

4.1	Industry's share of added value on a world scale (developed countries and emerging nations)	78
4.2	Industry's share of added value on a world scale (Germany, France, the United Kingdom, Japan, the United States, China)	78
4.3	Share of exports of goods on a world scale	79
4.4	Outflows of capital and stock in foreign direct investments (FDIs) in billions of U.S. dollars at current prices and current rates of exchange	80
4.5	Share of jobs in industry as a proportion of all jobs	82
4.6	Manufacturing jobs (in thousands) and wages costs in industry and corporations (2009 = 100)	88
4.7	Manufacturing jobs (in thousands) and cost of gas in the United States and in the euro zone (2009 = 100)	89
4.8	Trend in U.S. dollar-based exchange rates	100
5.1	Monetary base of the central banks as a percentage of GDP	104
5.2	Notional amounts outstanding in OTC derivatives in billions of U.S. dollars	105
5.3	Total bank credit in the United States, the euro zone and in Japan, in billions of dollars	106
5.4	Development of shadow banking's financial assets in comparison with the financial institutions in thousands of billions of dollars	109
5.5	Projection for 2015–2030 of private debt from non-financial entities and overall debt as a percentage of GDP	117
6.1	Current account balances as a percentage of GDP	130
6.2	Rate of savings as a percentage of GDP	130
6.3	Investment levels as a percentage of GDP	131
6.4	Interest rates and ten-year swap rates as percentages	132
6.5	Savings rate forecast as a percentage of GDP for China and Japan	135
6.6	Provisions of world savings and investment rates as a percentage of GDP	137

6.7	Projections of the rates of savings as a percentage of GDP	139
6.8	Projections of the rates of investment as a percentage of GDP	140
6.9	Forecasts of the world rate of savings and investment as a percentage of GDP	141

List of Tables

1.1	Percentage growth of GDP per hour worked (average annual growth rate)	13
1.2	Rate of GDP as percentages (1500–2012) and potential growth rate of GDP as percentages (2012–2060) (annual average growth rate)	17
1.3	Total factor productivity growth rate of factors as percentages	19
1.4	Technology ranking on the world scale	27
2.1	Unemployment by age group, 2000 and 2013	46
4.1	Number of technological inventions recorded	85
5.1	Profitability of physical capital as percentages (after-tax profits, before interest and dividends/net capital in value)	120
5.2	Annual performance of a few hedge fund strategies as percentages	121
5.3	Annual performance of certain stock exchange indices as percentages	121
5.4	Estimates of the profitability of retail banking equity in 2010	122
5.5	Profitability of equity from market trading for the world's 13 largest merchant banks in 2010	122
6.1	'Savings–investment' differential	141

Foreword

This is an extraordinary book, which deserves to reach a wide audience across the world. It is clear that the opening period of the twenty-first century will be in some core respects very different from the closing decades of the twentieth. I do not agree with everything the authors have to say. For example, they speak of a 'slow down in technical progress', while I think we are in a period of accelerating technological innovation, driven by the digital revolution, whose outcomes at the moment are quite unknown. Yet I know of no other work that attempts such an ambitious, and enlightening, analysis of the dislocated period of history that we have now entered. The authors identify a series of master trends that are shaping the contemporary world – we cannot be sure where any of them will lead, let alone be able to say at this point how they will connect with each other. Nor do we know whether, as collective humanity, we will be able to control and shape the forces we have unleashed to positive social and economic ends.

One such force is the vast expansion in financial capital, creating levels of global liquidity way beyond anything ever observed before. I would relate this precisely to the digital revolution, because for the first time ever almost all money has become electronic – the role of cash is today relatively marginal. The authors are right to say that this process of the creation of liquid capital has become an unstoppable flood. A second is the acceleration of economic inequality at the very top. Overlapping with each of these is the large-scale transfer of industrial production from the richer countries to the emerging economies – the process of the de-industrialization of the West.

These are operating against the backdrop of further deep structural trends, affecting many if not yet all societies in the world. Such trends include the ageing population in the developed countries – a trend that reflects advances in diet and medicine, and obviously embodies many positives, but creates a host of problems of its own. The strain this situation will produce in welfare systems is already evident: it overlaps with a final source of deep worry – where will investment come from, when all of the industrial countries, and many others besides, have run up huge levels of debt? To all of these one can add a further factor: the fact that, if left unchecked, climate change, even in the short term, will exacerbate all of these problems.

As the authors emphasize, some of the core ideas that were prominent twenty years or so ago today seem naive or simply erroneous. For instance, it was widely thought that accelerating global interdependence would bring transnational collaboration on the large scale. The European Union appeared to many to be a model for other parts of the globe. One author, Mark Leonard, even proclaimed that the EU ‘would run the twenty-first century’. Today, the Union is fighting its way through no less than five or six concurrent crises and the press – at least for the moment – is full of articles suggesting that it may even collapse.

Two decades ago, many authors were predicting the demise of the nation-state in the face of accelerating global interdependence – Keniche Ohmae, for example, spoke of the emergence of a ‘borderless world’. Today, national identity looms as large as ever, as do conflicts originating in sectional divisions and forms of identity politics. The most significant powers in the world once again seem to be nations and groups of nations. It is a sobering situation indeed, since the capability of even clusters of nations to create effective global governance is limited, given the level of interdependence in the world economy. It is matched by the emergence of new forms of terrorism, possibly capable of much greater impact than was true of previous eras. Thus Islamic State mixes barbarism with cutting-edge digital technology in a way that has no analogue previously.

As the authors quite rightly point out, we should beware of over-generalizing from these trends. We cannot say with any certainty at the moment how far they will prove enduring, or lead to serious world conflicts, even large-scale breakdown, in the social and economic order. Marx said many years ago that ‘human beings only set themselves such problems as they can resolve’, and he might turn out to be right. To me the correct way to interpret the world today is as a huge mixture of opportunity and risk, in which it is not possible to use stochastic methods to identify how that balance will play out. This is because, at least in some core respects – well identified in the book – we are living in a world ‘off the edge of history’. That is to say, we have opportunities, but we also face risks that simply did not exist for preceding civilizations. Take, for example, global interdependence itself, now dramatically accelerating as we move further into the digital age – no one has ever lived in such a world in previous periods of history and therefore we can only learn from the past to a limited degree in interpreting its likely consequences.

Most of this book is about diagnosis. Lorenzi and Berrebi only offer a short discussion of the policy implications of the trends they dissect so

acutely. They see no hope in the possibility of reversing deindustrialization in the developed countries. (I don't wholly agree. We just don't know at the current time what the implications of current advances – such as 3D printing and other technological developments – might be.) Nor can we hold back the tide of financialization. However, the authors say we can and must seek to reshape it, and in so doing turn away from unfettered consumption towards investment both in people and in infrastructure.

There has to be an active rebalancing between the generations. Older people have long been thought of as those most in need. Today the balance has to shift back towards the young. The most difficult task will be to encourage population migration at just the time when nations are starting again to consolidate their borders. The tensions involved are very evident when we look at the vast influx of refugees into Europe today, or the movements of population from Latin America into the United States. And then there is the issue of debt. Perhaps, the authors conclude by saying, we should seek to live with it rather than imposing new regimes of austerity. 'Perpetual debt' has in fact a long historical lineage, albeit in much smaller contexts than is the case today. Innovative thinking in this area, however, will be absolutely crucial. My own belief is that the idea that we can run the world as an unfettered marketplace has reached its end point. A retrieval of the public domain – not all necessarily the same thing as the state – will be a key task. Since the policy prescriptions with which this magisterial book ends are so brief perhaps the authors will consider developing them further in a companion volume to this one?

Anthony Giddens

Introduction

Economists are overfond of the word 'crisis'. They tirelessly explore history in an attempt to find explanations, analyses and opinions that might throw light on our vision of the current situation.

Is the world really in crisis? Nothing is less certain; although the year 2009 could rightly be considered as having been a disastrous one, 2010 and 2011 saw a soon-aborted attempt to create a world government. Since 2012 each country has gone its own way. This has been brilliant for some, average for others, but a subject for despair in a third group of nations.

This book is based on a paradox. Unlike other periods of global macroeconomic disruption, the future is not defined by eventually overcoming the current crisis. The crash of 1929 gave birth to Fordist mass production, simply as a consequence of the major imbalance between world supply and demand. The organization of the labour market and the social changes that occurred post-World War II made it possible to overcome difficulties of this kind. The period in which we live today will probably end in a few years' time once the major Western countries are able to settle their private and public debts.

Notwithstanding all this, the twenty-first century will not be able to discover a new balance through such simple restructuring. In reality, six new constraints will emerge, together with the policies used to control them at major world economic level. Conflict is bound to take over by default. In the best case scenario, this conflict will take the form of radical change, but it may also adopt a more bellicose manifestation. Regardless of the form adopted, these six limitations will structure the world of the future. Three of them already exist and will almost certainly affect the course of events as they have played out between 2007 and today. The world has experienced accelerated financialization,

an explosion of inequality and a massive, unprecedented transfer of business activity from the Organization for Economic Co-operation and Development (OECD) countries to the emerging nations. These three limitations may govern worldwide economic policy and national policy and they will probably be applied to consolidated geographical areas.

Three other constraints, newer, will take some time to emerge. They are those that could, to some extent, be extremely difficult to overcome, but they can be controlled and exploited, and their massive effects could be mitigated. All this is foreseeable, but the only certainty is that it will be impossible to avoid them. What are they? The first, an inevitable constraint, is the fact of an ageing population and the additional financial burden it places on social welfare, its aversion to structural risk and the major changes it introduces to patterns of consumption. The second is more ambiguous. It is currently the subject of a debate that is far from over. Beyond misleading appearances, hasn't there been a slowdown in technical progress over the last twenty years? This is an important point since technical progress has been the main factor for growth for two centuries and such a slowdown will mark a progressive form of decline. It will not be case for everyone nor will it be forever; this phenomenon will eventually come to an end. The countries that win the forthcoming economic war will be those that will have been able to catch the new wave of technological innovation. Yet no one knows how to encourage the emergence of such advances, reduce their time frames and ensure their wide distribution. In a word, all that counts is to be a country that, like Britain in the nineteenth century or Germany and France in the late nineteenth century, is capable of being the origin, source and beneficiary of such future technological revolutions.

Finally, there is a third constraint, linked to the first two. The future of the world has always been conditional upon the ability to balance world investment with available savings. Yet the long period of surplus savings is behind us. We are embarking on what could reveal itself to be a true tragedy, a period in which savings will become the rarest of resources *par excellence*.

The 1990s allowed Francis Fukuyama¹ to announce the end of history. The 2000s showed how delusional it was to imagine the world as being pacified, free of conflict, free of the immeasurable dark forces, before their terrible consequences could re-emerge. No one today can predict the future course of history except by being content to imagine a scenario tinged with narrow determinism. There is no doubt, however, that violence, whether explicit or implicit, has emerged unheralded from the deepest constraints that are currently tightening their grip on the world.

The searing brutality of the most recent economic, social and even environmental crises now seems to be setting the pace that is currently paralysing political action. To tell the truth, the third globalization has sketched the outlines of what is anything but a 'global village'; the truth is that this world lacks instructions for use, it rushes around extinguishing one conflagration after another, with no end in sight.

The breakdown in technical progress, the ageing population, the explosion of inequality, the massive transfer of business activity from one end of the world to the other, the limitless financialization of the economy, the impossibility of financing our investments – these are like tectonic plates, whose pressures will cause new disruptions that will be as unexpected in date as they will be in intensity. Are we capable of meeting the challenge of these future impacts, with all the subjective and objective violence that they will inevitably cause?

Humility is required, the humility of being capable of describing the cracks in our economic, social and political system that are liable to destroy it, a system that, despite its deficiencies, still inspires many populations throughout the world. What paths deserve to be retained or forged in order to mitigate the threat of the conflicts which are wars in all but name.

This book is based on the description of the three constraints originating in the recent past that constitute the origins of our current difficulties and three future constraints that are harder to identify. It could easily be believed that the markets will find their own response – as they have always managed to do in the past – to these immense difficulties. Even the greatest pessimists, when asked how the market can be saved, believe that even though it may take some time, everything will nevertheless end happily. What a mistake, how naïve! We are entering a world in which these constraints have a name – that name is conflict. For each expression so typical of the language of economists, the confrontation between countries, between social groups and between generations is now so firmly entrenched that there is no knowing whether compromise is possible. What is exceptional in the present time in which we live is that we sense the massive difficulties ahead, though without much success in conceptualizing the threats, yet we hesitate to name them as threats, we hesitate to mention the unmentionable, of stating the explicit, dangerous, cruel conflict known as war. We are convinced that if nothing is done our inability to overcome the constraints will doubtless lead us into a conflict. While we still find it hard to put into words what the wars of the future will be like, we have been reduced to being inspired by what we are told by the futurists of the CIA² or the Ministry

of Defence³ in a country such as France. They are the only ones who dare to do so because it is their job. If today we tend to conceal from ourselves the cruel evidence that there will be conflicts in the future, they will eventually describe them.

This is how, with a certain degree of audacity, our 'experts' have traced the outlines of a world that tends to lack harmony by allowing the escape of the well-known *genie-out-of-the-bottle*.⁴ Consequently, the centre of conformity and world domination does not hesitate to imagine a world full of conflict, due to the massive inequalities between countries and especially within those very countries, as the United States progressively withdraws from its role as world leader. It is the world of Kishore Mahbubani,⁵ the Singaporean philosopher and diplomat who supports the idea of a de-westernized world and, in reality, of a world that is neither globalized nor multicentric. But, in a context still reeling from the financial crisis of 2008 and the loss of influence of the West, from the Arab revolutions whose outcome remains unknown, from the strategic turning of the US towards Asia or the Pacific regions in which tensions exist between countries, from the unsuitability of the instruments of world governance, in which the picture of risk, especially insidious risk, has increased, who knows? These risks are of a political nature, of course, with the threat of bellicose nationalisms as an outlet for disappointed populations, economic risk through the new dominance of China, risk relating to energy as competition increases for rare resources, and risks relating to information technology, public health and climate. There is another new element, that of the powerlessness of certain states that have become sanctuaries for criminal gangs or terrorists, transit points for various types of trafficking – the list is so long, so impressive, that it causes a more or less widespread feeling of insecurity and anxiety. The dialectic between fiction and fact is rebellious. It is because they are virtual that cyber-attacks are part of this bellicose reality and are therefore destructive.

The first signs of a new human folly emerged more than ten years ago. On either side of the West, there was talk of a 'just war', the 'clash of civilizations', ideological and religious systems that were bound to lead to victory, and thus the annihilation of one side or the other.

It has always been assumed that the world would become wiser following the fall of the Berlin Wall, that a generalized market economy would lead to a pacified and uniform world under the aegis of the great international institutions. This was the result of a very inadequate understanding of Samuel Huntington,⁶ but, above all, it created a new hysteria relating to a just war, making it possible to define, and even legitimize,

the killings that were to come. It is precisely here that Michael Walzer,⁷ and the very controversial Carl Schmitt, show the sombre way, one that is unfortunately so revelatory of our probable future. Our world is not that of diplomatic conflicts but of economy. The economists' initiatives are specific and reveal the uncertainty and limitations that are no doubt in danger of overwhelming us. Our anxieties are based on the difficulty of understanding and perceiving this new trajectory in a world economy which, unless rethought, will lead to the sort of conflicts that human history has always demonstrated.

The worst is never certain, however. Without repeating our own account of the often too naïve view of governance of the world economy, we intend to respond to the challenge of imagining and even offering solutions that are liable, while upsetting the current modes of regulation, to make the threat of such conflict more remote. If one manages to perceive the importance, the innovation and the impact of these six constraints, we consider that a future could be contemplated and, moving beyond the contradictions, compromises could be found and habits changed radically on a world scale, as well as on the scale of each country.