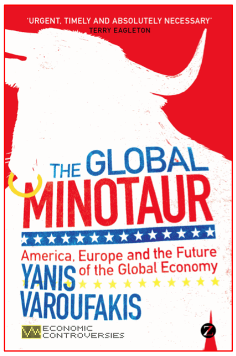
CHAPTER 9 (2nd Edition, 2013)
A world without the Minotaur



Almost two years have passed since the first edition of this book was written. Its prognosis for our tormented beast was not good. Have events since confirmed that the Global Minotaur's wounds were too deep to allow it to continue to perform its miraculous global surplus recycling? Is this still the best explanation available as to why the American, the European and, indeed, the global economies are stuttering, and why generalized insecurity has become the 'new norm'?

To be worthy of serious consideration, a theory of what went wrong with the global economy must not only offer a logical explanation of the past but must also describe the future developments that would *falsify* it. Would the argument that was the kernel of this book's first edition pass such a test in the light of the last two years? Before addressing the question, it may be helpful to restate clearly (and with the help of a diagram) the book's overarching 'Global Minotaur Hypothesis'. Once the reader is reminded of the hypothesis, a series of 'facts' that would have falsified it will follow. As I hope to show in the remainder of the chapter, the original explanatory thrust, the Global Minotaur Hypothesis, survives the empirical test of falsifiability rather well. And, in so doing, it illuminates usefully the current policy debates unfolding on the drama's three parallel stages: America, Europe and China.

The Global Minotaur Hypothesis: a summary

Since the 1970s, the United States began absorbing a large portion of the rest of the world's surplus industrial products. America's net imports were, naturally, the net exports of surplus countries like Germany, Japan and China; their main source of demand. In turn, the profits earned by the surplus nations' entrepreneurs were returned, daily, to Wall Street, in search of a higher pay-off. Wall Street would then use this influx of foreign capital for three purposes: (a) to provide credit to American consumers, (b) as direct investment into US corporations and, of course, (c) to buy US Treasury Bills (i.e. to fund American government deficits).

Central to this global surplus recycling mechanism (GSRM), which I have likened to a Global Minotaur, were the two gargantuan deficits of the United States: the *trade deficit* and the federal government *budget deficit.* Without them, the book argues, the global circular flow of goods and capital (seediagram below) would not have 'closed', destabilizing the global economy.

This recycling system broke down because Wall Street took advantage of its central position in it to build colossal pyramids of *private money* on the back of the net profits flowing into the United States from the rest of the world. The process of private money minting by Wall Street's banks, also known as *financialisation,* added much energy to the recycling scheme, as it oozed oodles of new financial vitality, thus fuelling an ever-accelerating level of demand within the United States, in Europe (whose banks soon jumped onto the private money-minting bandwagon) and Asia. Alas, it also brought about its demise.

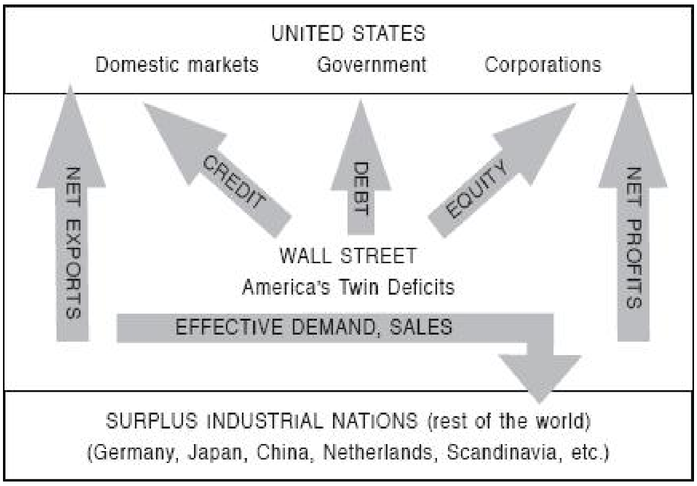


Figure 9.1. The Global Minotaur's global surplus recycling mechanism

When, in the fall of 2008, Wall Street's pyramids of private money auto-combusted, and turned into ashes, Wall Street's capacity to continue 'closing' the global recycling loop vanished. America's banking sector could no longer harness the United States' twin (trade and budget) deficits for the purposes of financing enough demand within America to keep the net exports of the rest of the world going (a financing process that, until the autumn of 2008, tapped the rest of the world's surplus profits which these net exports produced). From that dark moment onwards, the world economy would find it impossible to regain its poise at least not without an alternative global surplus recycling mechanism that replaces the wounded Global Minotaur.

This was, in brief, the central hypothesis of the book's first edition. Did it stand the test of history?

The Minotaur is dead! Long live America's deficits!

Had the global economy found its feet without some GSRM to replace the Minotaur, there would have been no new edition of this book (since an apology for the first one would have sufficed). Similarly, if the eurozone had bounced back, on the strength of its austerian policies, or if China had discovered some inner force by which to arrest the declining rate at which its people consumed, the book's central pillar would have lain in ruins. Sadly, this is not what transpired: the world continues its journey in the uncharted waters of a dark ocean whipped up continually by the evil winds of dread and fear.

The fact that recovery has not spread its soothing wings over us is, of course, no proof that the 'Global Minotaur Hypothesis' holds. To reach the conclusion that the last two years have kept it alive and potentially insightful, we need to state carefully and in some detail its predictions and then to compare those with the facts. So, let us begin: what observations would we have to make regarding the past two years or so to conclude that the Global Minotaur Hypothesis was flawed?[3]??Suppose we observed that, despite the Crisis, Suppose we observed that, despite the Crisis, America's deficits remain high but that they continue to absorb the net exports of both goods and capital from the rest of the world, and at a pace not too dissimilar to that of the pre-2008 era. If this is what we observed in 2009 and beyond, then the Global Minotaur Hypothesis would be refuted: for it would then be impossible to claim (a) that the Global Minotaur is kaput, and (b) that its demise must be blamed for the world's economic continuing woes.

So, let's look at the facts: The first observation worth noting is that America's twin deficits are alive and kicking. At the height of the Minotaur's reign, in 2005, the US federal government posted a deficit of $574 billion. In the same year American consumers and firms absorbed a staggering $781 billion of net imports from the rest of the world. Almost 70 per cent of the profits that the non-American producers of these goods made returned to Wall Street. Once in the bankers' hands, they were turbocharged (through so-called 'financial engineering') and, thereby, financed the US deficits, with the residual being exported to the four corners of the globe (where it helped build a variety of bubbles).

Following the 2008 catastrophe, America's deficits diverged massively. As all sorts of incomes (from labour, capital and rent) collapsed, asset values fell through the floor, home foreclosures and the ranks of the unemployed burgeoned, it was inevitable that Americans would reduce drastically their consumption of imported goods. Indeed, in 2009 the trade deficit fell from $781 billion in 2005 to $506 billion. However, in the same year, the US federal deficit shot up (from $574 billion in 2005) to $1,400 billion, as government strove to prop up Wall Street and stimulate Main Street. By 2011 the trade deficit had recovered to, more or less, its 2005 level (reaching $738 billion) while the budget deficit stabilised at the historically gigantic $1,228 billion mark.

Granted that the Crisis did not dent America's deficits (indeed, it boosted their sum), the pertinent question is this: did the United States manage, post-2008, to continue recycling other people's surplus goods and profits at a pace that, judging from the pre-2008 period, is necessary to keep world total demand for produced goods buoyant? The answer that surfaces upon close inspection of official statistics is unambiguously negative. In brief, the facts confirm the hypothesis that the Global Minotaur is now defunct. Two pieces of data confirm this.

First, America has lost its capacity to recycle the rest of the world's net exports at the pre-2008 pace. More precisely, in 2011 America was generating *23.7 per cent less demand* for the rest of the world's net exports than it would have been without the Crash of 2008. (SeeFigure 9.2 where it is evident that in 2011 the United States was absorbing almost 24 per cent less of the main exporters' net exports than their underlying trend value.)

Secondly, and at the same time, America was failing to attract (through Wall Street) the level of capital flows necessary to maintain the pre-2008 pace of investment into its private sector. In particular, by 2011 the United States had lost *56.48 per cent of the assets held by foreigners* compared to the (trend) level that would have been had the Crash of 2008 not happened (seeFigure 9.3). The main, and indeed crucial, reason for this precipitous decline was that foreign net capital flows ending up as loans to US corporations fell drastically from around $500 billion in 2006 to$50 billion in 2011 (seeFigure 9.4).

In conclusion, a crystal clear picture is emerging: the Crisis did not alter the deficit position of the United States. The federal budget deficit more or less doubled while America's trade deficit, after an initial fall, stabilised at the same level. *However, the US deficits are no longer capable of maintaining the mechanism that keeps the global flows of goods and profits balanced at a planetary level.* Whereas until 2008 America was able to draw into the country mountains of net imports of goods, and a similar volume of capital flows (so that the two balanced out), this is no longer happening post-2008. American markets are sucking 24 per cent fewer net imports (thus generating only 66 per cent of the demand that the rest of the world was used to before the Crash) and are attracting into the American private sector 57% less capital than they would have had Wall Street not collapsed in 2008.

In short, of the mighty Global Minotaur, the only reminder that remains is the still accelerating flow of foreign capital into America's public debt (seeFigure 9.5), evidence that the world is in disarray and money is desperately seeking safe haven in the bosom of the reserve currency in this age of tumult. But as long as the Rest of the World is reducing its injection of capital into America's corporate sector and real estate, while America is reducing its imports of their net exports, we can be certain that the beast is dead and nothing has taken its place with a capacity to re-start the essential process of surplus recycling. Thus the sad cry: *The Global Minotaur is dead! Long live America's deficits!*

The Minotaur's death in pictures

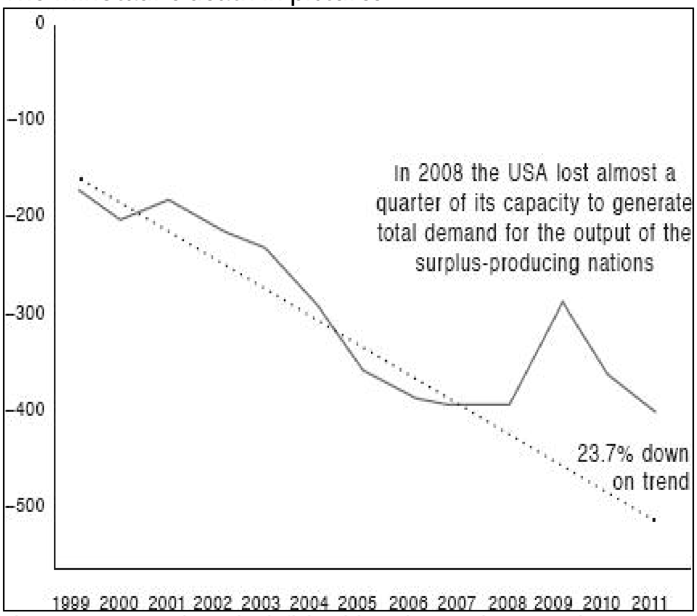


Figure 9.2 US goods trade deficit with major surplus countries, including the eurozone's surplus member states, China, Hong Kong, Japan and Korea (US$ bn)
Source: US Bureau of Economic Analysis.

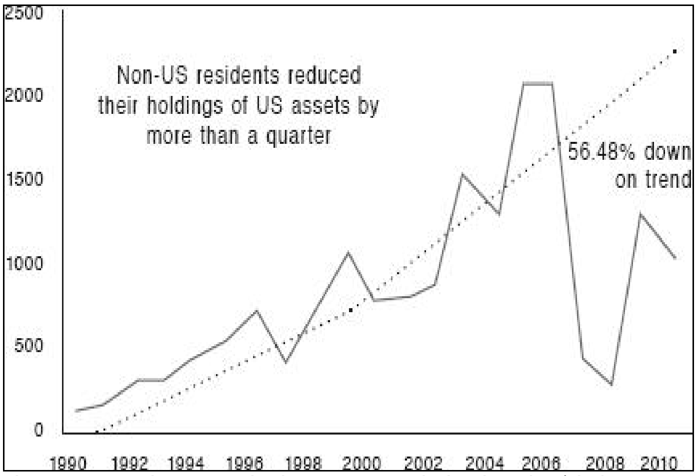


Figure 9.3 Foreign assets in the US except derivatives (US$ bn)
Source: US Bureau of Economic Analysis.

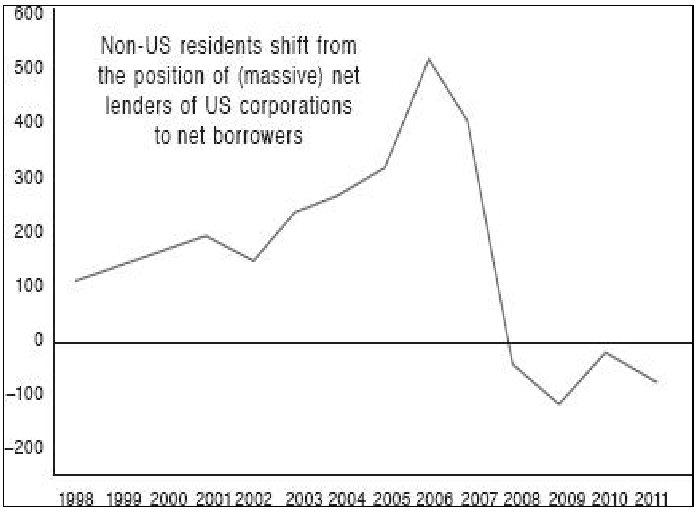


Figure 9.4 Corporate bond purchases (net) by non-US residents (US$ bn)
Source: US Bureau of Economic Analysis.

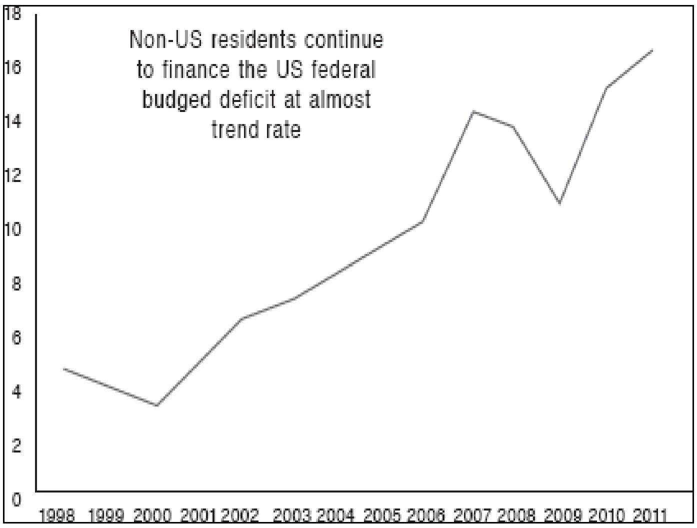


Figure 9.5 US Treasury bond purchases (net) by non-US residents (US$ tn)
Source: US Bureau of Economic Analysis.

America after the Minotaur

Once Wall Street lost its ability to harness America's twin deficits for the purposes of recycling the rest of the world's surplus goods and profits, the American economy had to settle at a much reduced level of economic activity. This would not be a bad thing per se if it were not for the fact that the accumulated debts (e.g. unpaid mortgages and many bad loans that one bank had made to another) remain as if nothing had happened.

A lower level of economic activity would have, indeed, been fine as long as employment had picked up quickly and the lower wages were able, in conjunction with lower prices, to preserve a level of consumption consistent with calm but steady recovery. Alas, the success of the banking sector in ensuring that monetary policy was tuned towards *their* interests, just like in the good old (pre-2008) times, guaranteed that endogenous growth was out of the reach of American society. When taken together with (a) Europe's suicidal dallying with Herbert Hoover-like austerity[4] (at a time when half of the continent is in the clasps of its own Great Depression), and (b) China's structural failure to stimulate domestic demand, it is no great wonder that the Crisis remains with us.

Chapters 7 and 8 described vividly the *rise of bankruptocracy,* the way in which bank failures armed the failed bankers with remarkable extractive, predatory political power, a power to extract a larger part of a shrinking national income at rates proportional to their banks' black holes. We have already seen (seeChapter 7) the manner in which the American public was betrayed and misled by the Geithner-Summers Plan; how the Fed's strategy was no more than an overt campaign unconditionally to refloat Wall Street;[5] the half-hearted stimulus package introduced by the Treasury which, when the rapid contraction of state spending is taken into account, amounted to no more than a trickle of funding entirely inadequate to arrest the fall in aggregate demand for goods and services within America.

Very quickly, the Obama administration lost political momentum. The obscene sight of those who had played a major role in setting the scene for the Crash (men like Larry Summers, Tim Geithner, Ben Bernanke) effectively returning to the scene of the crime as 'saviours', wielding trillions of freshly minted or borrowed dollars to lavish upon their banker 'mates', was enough to turn off even the hardiest of Mr Obama's supporters. The result was predictable: as often happens during a deflationary period (think of the 1930s, for example), those who gain politically do not come from the revolutionary Left; they come from the loony Right. In the United States it was the Tea Party that grew on the back of a disdain for bankers,[6] a denunciation of the Fed, a clarion call for 'honest', metal-backed money,[7] and a revulsion towards all government.

Ironically, the rise of the Tea Party increased the interventions of the Fed that the movement denounced. The reason was simple: once the Obama administration had lost its way, and could not pass any meaningful bills through Congress that might have stimulated the economy, only one lever was left with which anyone could steer America's macroeconomy the Fed's monetary policy. And since interest rates were dwelling in the nether world of the first liquidity trap to hit the United States since the 1930s[8] (recall Chapter 2 here), the Fed decided that *quantitative easing* or QE the strategy that Chapter 8 describes in the context of the 1990s' 'lost Japanese decade' was all that was left separating America from a repugnant depression.

Did Mr Bernanke have good reason to act? Most certainly so! From 1990 to 2008 aggregate demand in America[9] hovered around a narrow band (between 98 per cent and 104 per cent) of its long-term trend level. In 2009 it fell off a cliff, and to this day has not recovered. Presently, aggregate demand remains 14 per cent down compared to where it would have been (its trend level) without the Crisis. This is a huge gap which, taken together with (a) the debt under which households are labouring and (b) the banks' reluctance to lend, guarantees not just high unemployment but also that many Americans will soon fall through society's cracks, becoming permanently unemployable.

When Mr Bernanke adopted QE, in a bid to put some oomph back into American aggregate demand, he inadvertently offered the Tea Party, and later the Republican mainstream, an excellent target: it was a wonderful opportunity to portray QE as the devil's attempt to corrupt the nation's soul; to debase its currency; to give a nation addicted to the debt drug another dose that sinks it deeper into dependency on Mephistopheles' cruellest instrument the printing presses, which can provide only temporary relief at the expense of medium-term hyper-inflation.

Of course none of that is true. While QE can be branded ineffectual, for reasons outlined below, the assertion that the Fed's QE will push America into another 1970s-like period of ever accelerating prices is ludicrous. Yet truth is not the currency in which the recalcitrant Right trades: terrifying impressions (that can be employed further to boost private appropriation of publically produced wealth) are!

Quantitative easing as the most complex form of wishful thinking

At the time of writing, the third round of quantitative easing, QE3, was in the air. It is worthwhile taking a look at what it means, because a great number of false accounts circulate whose profound error is particularly instructive regarding the nature of our Crisis.

According to the Fed's own announcement, every month (until further notice) America's central bank will be buying $40 billion of paper titles backed by mortgages (so-called mortgage backed securities, or MBS). Who will the Fed buy these MBS titles from? From private banks and other financial institutions, of course. And how will the Fed pay for them? Simply by crediting electronically the accounts that those institutions have at the Fed with the sums necessary to take these pieces of paper (the MBS) off their books. However, this new balance of dollars in the banks' Fed account *cannot* be lent to customers or business. They can only be swapped with other paper assets held by other banks. This is crucial for understanding why QE is *not* the same as money printing. Despite the technical nature of the 'transactions' involved, it is worthwhile taking a close look at it.

When the Fed buys $1, 000 worth of MBS paper from Bank X, $1,000 is taken out of the bank's 'assets' column in the Bank X's balance sheet and is replaced by $1,000 spending money held at a 'reserve account' Bank X keeps with the Fed. The said account is called 'reserve' because of the conditions the Fed attaches to its uses. To be precise, the Fed stipulates that this $1,000 can only be lent to other banks or used to buy other paper titles from other banks. Thus, the only way that the Fed's purchase of this $1,000 'worth' of MBS can find itself in the economy is if Bank X wants to buy some other piece of paper from another bank, say Bank Y. But even if it does, the money will enter the real economy only if that piece of paper title is new for example, if Bank Y had just lent $1,000 to some customer and passed this loan on to Bank X. If the paper title concerned is old, pre-QE, debt, all that QE would accomplish is that a paper title worth $1,000 would pass from the books of one bank to the books of another. The $1,000 would simply never enter the circular flow of income.

This is precisely why QE cannot fuel inflation. Indeed, it is the reason why the 2012 US inflation rate is lower than it was two years ago despite the massive volumes of QE1 and QE2 that preceded. So, what was the logic behind QE? Mr Bernanke's stated purpose is that the Fed's purchases of MBS will increase their price, setting off the following chain reaction:

- increased MBS prices will push down the interest rates people demand from them before purchasing MBS paper (since they will now sport more attractive price-growth potential);

- the lower interest rates associated with MBS paper will translate into lower interest rates for new mortgages;

- the lower interest rates on mortgages will boost the demand for new homes;

- the extra demand for housing will push up house prices;

- the increasing house prices will reduce the number of American families whose home is worth less than the mortgage that they have on it, turning them into mortgage slaves.

If all this transpires, the next hope is that a reduction in the incidence of mortgage bondage in American society ('negative equity' in the parlance of financiers) will cause more families to spend more readily, many to sell up and move to an area where they can find work more easily, others to slow down the rate at which they pay down existing debt (and spend some more) and, importantly, shift investors from MBS paper purchases to corporate bonds (i.e. more lending directly to corporations). This is, dear reader, Mr Bernanke's heroic theory of how his QE3 will deliver the nation from recession.

What's wrong with it? There is one simple omission: that for QE's virtuous wheel to start turning, a multiple coincidence of impossible beliefs *must* exist:

- Jack and Jill, who are Bank Y's customers, must trust that the real-estate market has bottomed out in the medium term and that their job is secure, so as to dare ask Bank Y for a mortgage.

- Bank Y must be willing to take the risk of stretching its already large ‘assets’ column by lending to Jack and Jill to buy a house in the hope that some other bank, Bank X, will buy that iffy mortgage from it using its QE-funded ‘reserve account’ at the Fed.

- Firms that are thinking of employing people like Jack and Jill (in the medium to long term) must believe that Bank X will indeed buy Jack and Jill’s mortgage from Bank Y and, moreover, that this sort of transaction will increase demand for their products, thus justifying more hires.

To cut a long story short, a great deal of believing must occur before QE delivers on its promise to boost employment and help the real-estate market recover. Alas, given the prevailing state of self-confirming pessimism, to expect that these beliefs will flood into the different agents’ minds at once is to believe in miracles.

To recap, ever since America became ungovernable (with the White House and Congress at loggerheads), the Fed was the only branch of government with any capacity to act upon the recession. QE helped to some extent to slow it down, if only because someone was doing something ‘big’. It was like cortisone that diminished the pain and lessened the symptoms without, however, providing a cure. As long as it did nothing directly to reduce the size of the debts people faced, or to increase the wages the low levels of which were (from the 1970s onwards) a fundamental root cause of the problem (recall Chapter 4), QE was never going to work.

While QE’s side effects may be nowhere near as toxic as the Fed’s ardent rightist opponents make them out to be, nonetheless they are real: mainly, QE gives bankers an incentive to lend overseas, just as Japan’s QE in the 1990s led to the carry trade that boosted the capital flows into the United States. As a result the exchange rate of developing currencies (Brazil being a case in point) appreciates fast, resulting in higher commodity (particularly food) prices, which worsen the circumstances of less-well-off Americans and threaten developing nations with rapid capital inflows; this (as South East Asia, Ireland and Spain can testify) can quickly turn into an exodus that leaves nothing standing behind in its wake.

Perhaps America’s greatest tragedy, as these words are written, is that the public debate is ensnared in a cul-de-sac. By focusing on QE, on the pros and cons of a new gold standard, on the unsustainability of the federal debt, on whether the solution lies perhaps in a large reduction in living standards, Americans are thrown off the key point: the cause of their distress is the fact that, for the first time since World War II, the United States has lost its capacity to recycle the planet’s surpluses. Without an alternative mechanism for achieving this recycling, America’s (and the world’s) capacity to recover is severely circumscribed.

Europe after the Minotaur

Bankruptocracy, as the previous chapter argued, is as much a European predicament as it is an American ‘invention’. The difference between the experience of the two continents is that at least Americans did not have to labour under the enormous design faults of the eurozone. Imagine their chagrin if the citizens of hard-hit states (e.g. Nevada or Ohio) had to worry about a death embrace between the debt of their state and the losses of the banks who happened to operate within the state! Additionally, Americans were spared the need to contend with a central bank utterly shackled by inner divisions and the German central bank’s (the Bundesbank’s) penchant for treating the worst-hit parts of the Union (the eurozone, that is) as alien lands that had to be fiscally waterboarded until they ceased to obey the laws of macroeconomics![10]??In the past In the past two years, the debate in Europe has focused exclusively on issues that sound technical and minor, especially when projected against the background of Europe’s extraordinarily rich history. Will there be ‘conditionality’ attached to the recently announced purchases of Italian and Spanish bonds by the European Central Bank? Will the bonds that the ECB purchases be treated on something financiers refer to as a *pari passu* basis (in relation to bonds held by private institutions)? Will the ECB supervise all of Europe’s banks, or just the ‘systemic’ ones?

These are questions that ought to be of no genuine interest to anyone other than those with a morbid interest in the interface between public finance and monetary policy. And yet these questions (and the manner in which they will be answered) will probably prove as important for the future of Europe as the Treaties of Westphalia, Versailles or even Rome. For these are the issues that will determine whether Europe holds together or succumbs to the vicious centrifugal forces that were unleashed by the Crash of 2008.

Even so, they are not issues that are worth expounding upon here. All they do is to reflect a tragic, underlying reality that can be described in simple lay terms without the use of any jargon whatsoever: *Europe is* *disintegrating because its architecture was simply not sound enough to sustain the shockwaves caused by our Minotaur's death throes.* The previous chapter dedicated several sections to describing the eurozone's construction and all its faults; the manner in which Europe's version of bankruptocracy sprang up. In particular, the section on Europe's 'tumbling mountaineers' captures nicely the domino effect which began with Greece and ended up (after this book's first edition saw the light of day) engulfing two proud and immensely productive large European nations: Spain and Italy.

On the basis of Chapter 8's analysis, it is quite obvious that the insolvency of Madrid and Rome had nothing to do with fiscal profligacy (recall that Spain had a lower debt than Germany in 2008 and Italy has consistently smaller budget deficits) and everything to do with the way in which the eurozone's macroeconomy relied significantly for the demand of its net exports on the Global Minotaur. Once the latter keeled over in 2008, and Wall Street's private cash disappeared, two effects brought Europe to its knees.

One was the sequential death-embrace of bankrupt banks and insolvent states (beginning with Greece, moving to Ireland, to Portugal and continuing until Italy and Spain were torn asunder). The other was the Minotaur's simulacrum (seethe previous chapter for this metaphorical sketch of the German economy) and its determination to hang on to its option of exiting the eurozone at will, therefore denying each and every rational plan for mending the currency union in a sustainable manner.

Has anything of analytical significance occurred in Europe since Chapter 8 was penned two years ago? I can think of three moves that Europe's leadership made that are worth a mention as they prevented the eurozone's final collapse, keeping it in a state of slow-burning disintegration:

1. The European Central Bank's decision, between December 2011 and February 2012, to print around 1 trillion euros and lend this to the eurozone's insolvent banks in exchange for worthless collateral. In so doing, some of that money (no more than 30 per cent) was then lent by the banks to the fiscally stricken member states (e.g. Italy). This operation (known as LTRO) bought the eurozone another eight to nine months.

2. The partial write-off of Greece's debt, in March of 2012. Alas, this write-off, a formal default by any standards, was unique in economic history in that it left the indebted nation with a heavier debt burden at the end of 2012 than that which it was shouldering at the end of 2011 !

3. Following an admission, in August 2012, by the president of the European Central Bank that the eurozone was disintegrating,[12] the ECB announced that it would be prepared to buy unspecified Italian and Spanish secondhand bonds in order to keep the interest rates paid by these two countries manageable. However, as the price for carrying the German government with him, the ECB's president, Mr Mario Draghi, also announced that these 'operations' (which are now known as outright monetary operations, or OMT) would be conditional on further austerity, vouched for by inspectors. Thus, surreptitiously, Europe's central bank sacrificed, on the altar of keeping on Germany's 'right side', its most prized principle: central bank independence. Many a reader may protest that I left out of my short list of significant changes the June 2012 Summit Agreement according to which Europe's leaders, at the insistence of the Italian and Spanish prime ministers, agreed to separate the continent's banking crisis from the debt crisis. How would that separation be achieved? By unifying the banking systems of the eurozone countries, infusing them with capital from the 'centre' and desisting from counting these capital injections as part of the national debt of the countries in which the banks are domiciled. This agreement, if it were implemented fully, would have been an important step towards arresting the euro crisis's triumphant march. But it will not be! Days after it was reached, Germany's leadership began a clever and determined campaign to pull the plug. I have no doubt that this the most significant agreement to date is dead in the water, and thus not worth the ink in which it is printed.

The telling question thus becomes: why such resistance, particularly from Germany, to every idea that would end the euro crisis? The standard answer is that Germany does not wish to pay for the debts of the periphery and will resist all federal-like moves (e.g. a banking or a fiscal union) until it is convinced that its partners will behave responsibly with their German-backed finances. While this captures well the mindset of many Northern Europeans, it is beside the point. Consider the following mental experiment, which, I believe, helps us unveil a deeper motive.

Picture the scene when a sheepish finance minister enters the chancellor's Berlin office bearing a control panel featuring one yellow and one red button, and telling her that she must choose to press one or the other. This is how he explains what each button will do:

The Red Button If you press it, Chancellor, the euro crisis ends immediately, with a general rise in growth throughout Europe, a sudden collapse of debt for each member state to below its Maastricht limit, no pain for Greek citizens (or for the Italians, Portuguese, etc.), no guarantees for the periphery's debts (states or banks) to be provided by German and Dutch taxpayers, interest rate spreads below 3 per cent throughout the eurozone, a diminution in the eurozone's internal imbalances, and a wholesale rise in aggregate investment.

The Yellow Button If you press it, Chancellor, the situation in the eurozone remains more or less as it is for a decade. The euro crisis continues to bubble along, albeit in a controlled fashion. While the probability of a break-up, which will be a calamity for Germany, remains non-trivial, the chances are that, if you push the yellow button, the eurozone will not break up (with a little help from the European Central Bank), German interest rates will remain extremely low, the euro will be nicely depressed ('nicely' from the perspective of German exporters), the periphery's spreads will be sky-high (but not explosive), Italy and Spain will enter deeper into a debt-deflationary spiral that sees to a reduction of their national income by 15 per cent over the next three years, France shall slip steadily into quasi-insolvency, GDP per capita will rise slowly in the surplus countries and fall precipitously in the periphery. As for the first 'fallen' nations (Greece, Ireland and Portugal), they shall become little Latvias, or indeed Kosovos: devastated lands (after the loss of between 25 per cent and 40 per cent of national income, a massive exodus of their skilled labour) on which our people will holiday and buy cheap real estate. In aggregate, if you choose the yellow button, Chancellor, eurozone unemployment will remain well above UK and US levels, investment will be anaemic, growth negative and poverty on the up and up.

Which button do you think, dear reader, the chancellor would want to push? And, a quite separate question, which of the two buttons would the median German voter want her (or him, in years to come) to push?

Of course, this is both a hypothetical and an empirical question and no one can answer it definitively. However, the answer is not as straightforward as it would be in America or Britain. Whereas the yellow button would hold no attraction for the American president or the British prime minister, for the German chancellor the yellow button is a far more powerful option. Even if the chancellor wanted to opt for the red button, she would be terrorised by the reaction of the German electorate were she to do so. Letting the Greeks and the Italians, the Spaniards and the Portuguese, off the hook of their Great Depression so 'easily' would be unlikely to win many votes east of the Rhine and north of the Alps.

For two years now, the German public has become convinced that Germany has escaped the worst of the Crisis because of the German people's virtuous embracing of thriftiness and hard work; in contrast to the spendthrift Southerners, who, like the fickle grasshopper, made no provision for when the winds of finance would turn cold and nasty. This mindset goes hand in hand with a moral righteousness which implants into good people's hearts and minds a penchant for exacting punishment on the grasshoppers even if punishing them also punishes themselves (to some extent). It also goes hand in hand with a radical misunderstanding of what kept the eurozone healthy and Germany in surplus prior to 2008:that is, the Global Minotaur whose demand-generation antics were for decades allowing countries like Germany and the Netherlands to remain net exporters of capital and consumer goods within and without the eurozone (while importing US-sourced demand for their goods from the eurozone's periphery).

Interestingly, one of the great secrets of the post-2008 period is that the Minotaur's death adversely affected aggregate demand in the eurozone's surplus countries (Germany, the Netherlands, Austria and Finland) *more* than it did the deficit member states (like Italy, Spain, Ireland, Portugal and Greece) seeFigure 9.6. While the sudden withdrawal of capital from the deficit countries brought about their insolvency, countries like Germany saw their 'fundamentals' more grievously affected by the Crash of 2008. This fact, in conjunction with the terrible squeeze on German wages (discussed in the previous chapter), explains the deeper causes of the animosity in places like Germany that so very easily translates into anger against the Greeks and assorted Mediterraneans feelings that are then reciprocated, thus giving the wheel of intra-European animosities another spin, favouring the rise of xenophobia, even Nazism (in countries like Greece quite incredibly), and thus leading to a wholesale readiness to push all the yellow, as opposed to the red, buttons in sight.

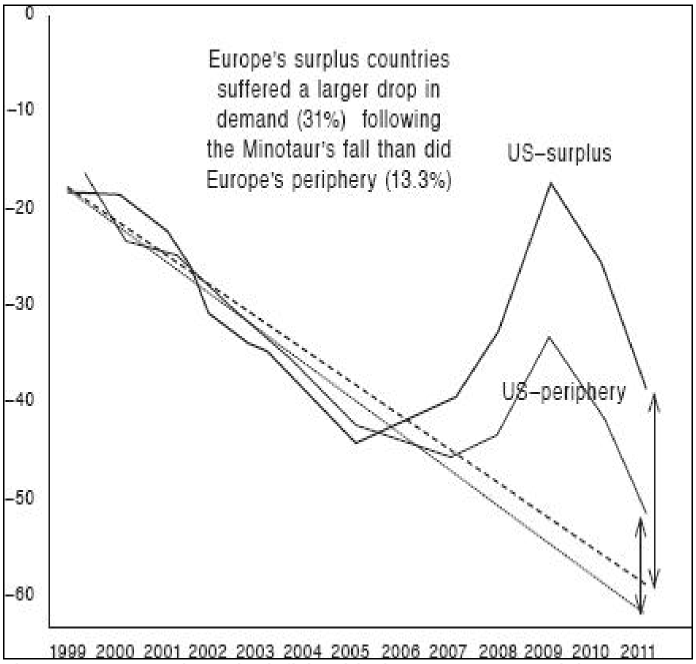


Figure 9.6 US goods trade deficit with the eurozone's periphery (Italy, Spain, Ireland, Greece and Portugal) and with the eurozone's surplus countries (Germany, Austria, the Netherlands and Finland)
Source: US Bureau of Economic Analysis.

To recap, the Minotaur's surplus recycling was essential to the maintenance of the eurozone's faulty edifice. Once it vanished from the scene, the European common currency area would either be redesigned or it would enter a long, painful period of disintegration. An unwillingness by the surplus countries to accept that, in the post-Minotaur world, some other form of surplus recycling is necessary (and that some of their own surpluses must also be subject to such recycling) is the reason why Europe is looking like a case of alchemy-in-reverse: for whereas the alchemist strove to turn lead into gold, Europe's reverse alchemists began with gold (an integration project that was the pride of its elites) but will soon end up with the institutional equivalent of lead.

China after the Minotaur

The final chapter of the first edition of this book looked at the soaring dragon waiting in the wings, purportedly to take over from the Global Minotaur. In that conclusion, written back in January 2011, I wrote:

> To buy time, the Chinese government is stimulating its growing economy and keeps it shielded from currency revaluations, in the hope that vibrant growth can continue. But they seethe omens. And they are not good. On the one hand, China's consumption-to-GDP ratio is falling; a sure sign that the domestic market cannot generate enough demand for China's gigantic factories. On the other hand, their fiscal injections are causing real estate bubbles. If these are unchecked, they may burst and thus cause a catastrophic domestic unwinding. But how do you deflate a bubble without choking off growth? That was the multi-trillion dollar question that Alan Greenspan failed to answer. It is not clear that the Chinese authorities can.

In the period that followed after those lines were written, events have confirmed the projected pattern. Figure 9.7 reveals that the falling rate of Chinese consumption is continuing unabated. In 2011, of every one dollar of income produced, only 29 cents entered China's markets. With net exports making a small annual contribution to domestic demand (even though they contribute greatly to the country's capacity to invest and thus boost productivity), the onus falls increasingly on investment to meet the demand shortfall. However, as suggested in the above paragraph, this emphasis on investment is a double-edged sword, as it threatens to let the genie out of the bottle in real-estate markets, where bubbles have been looming threateningly for a while now.

Indeed, in 2011 the Chinese authorities tightened up the administrative conditions for providing new housing loans, in the hope that such a move would leave productive investments unaffected while curtailing the funding of more white elephants and empty apartment blocks (which Chinese middle-class professionals buy, having borrowed heavily, but leave empty in the hope of selling them for more later on a standard bubble-in-the-making).

Figure 9.7
Composition of Chinese aggregate demand (% of GDP)

	1990	1995	2000	2005	2009	2011
Private consumption	49	44	45	40	34	29
Investment	35	42	36	42	48	58
Government consumption	12	13	17	12	11	10
Net exports	4	1	2	6	7	3

Source: National Bureau of Statistics of China.

Unfortunately, while demand for housing fell, the telltale signs soon appeared that the government's intervention was about to deflate not just the housing bubble but also industrial output. What telltale signs? The level of electricity output plateaued in early 2012. The last time that had happened, in 2008/9, the growth rate of industrial production declined sharply soon after, causing Beijing to stimulate the economy at a level that further suppressed the consumption ratio. To avoid this, the government is now relaxing its constraints on mortgage provision, accepting the renewed risk of a bubble in housing.

In summary, just as in Europe's surplus countries, so too in China, the one-fourth reduction in global aggregate demand occasioned by the Global Minotaur's passing has impeded any meaningful recovery. Indeed, it has made the world we live in more precarious because the remedies attempted (stimulus in China, QE in the United States, austerity in Europe) increase the probability that the Crisis will spawn nasty little appendages. For until and unless a global recycling mechanism rises from the Minotaur's ashes to replace him, the world will remain an insecure, depressing place.

Postscript to the new edition

History's actors

We are an Empire now, and when we act, we create our own reality. And while you are studying that reality judiciously as you will we will act again, creating other new realities, which you can study too, and that's how things will sort out. We are history's actors ! and you, all of you, will be left to just study what we do.

With these words, a high-ranking US official captured nicely the essence of America's post-war magnificent audacity. Not once, but twice, the United States smashed pre-existing realities to fashion new ones. The first time, it had no choice. World War II had thrust America into the role of an unwilling reality-fashioner. It responded brilliantly, with a *Global Plan* that delivered global capitalism's finest hour. And when its Global Plan reached its sell-by date, the United States spent no time dithering, or 'studying' the existing reality.

Instead, it actively sought to disintegrate the degenerating reality, to cause a major, worldwide crisis that would spawn a newer, hyper-vibrant reality: the *Global Minotaur.* It was the second time in its history that America had reshaped the world not so much in its image but in a manner that converted a creeping weakness into majestic hegemony.

The key to America's success was the recognition of the indispensability of a global surplus recycling mechanism (GSRM). Hegemony differs from domination, or from vulgar exploitation, in that the true hegemon understands that its power must be replenished not through further extraction from its subjects but from investment into their capacities to generate surpluses. To take from its subjects, the hegemon must master the art of giving in return. To maintain power, it needs to bolster its surpluses; but to do this, it must redirect large parts of it to its underlings.

All through the two distinct post-war global realities that it singlehandedly created, America took great care to put in place serviceable GSRMs over which it expected to have total control. During the Global Plan era, it assumed it would be the surplus trader. Its hegemony thus revolved around the recycling of large parts of its surplus capital (earned on the back of its trade surpluses) to Japan and Europe which, as planned, it was benefiting from, since the Japanese and the Europeans were using these transfers to buy American-produced, or -controlled, goods and services.

When the United States found itself, unwittingly, in a large trade and budget deficit, it moved on. It caused a global earthquake as a prelude to the Age of the Global Minotaur; my allegory for a massive GSRM which reversed the flow of global trade and capital flows. America henceforth was to provide foreign industrial centres with sufficient demand for their output in return for around 80 per cent of their capital flows. That this violent transition took at least a decade of terrible disintegration, debt crises, wholesale instability and global stagflation was, to America's elites, a reasonable price to pay; no more than a transition cost that the world's social economy and America's working families were billed for by our history's actors the astute officials of successive American administrations.

Self-restraint and the dangers of success

Self-restraint, as the philosophers know, is a rare and bewildering virtue. It is also a virtue that tends to come unstuck the more powerful we become. In this it resembles the relationship between trust and success: the stronger the bonds of trust between us, the greater our collective and individual success. But success breeds greed, and greed is a solvent of trust. Similarly with self-restraint: having it can help one succeed. But then success poses a threat to one's self-restraint.

This *paradox of success*, as it pertains to self-restraint, proved the undoing of both of the global 'realities' that the United States created after World War II. The first time, it was the US government that fell prey to its negative engineering. The second time, it was America's private sector, and in particular its financial sector. To seehow these two failures were snatched from the jaws of success, let us consider two questions, one concerning 1971, the other 2008.

What tripped up the Global Plan, causing it to lose its footing and to collapse in 1971? The answer: the US government's inability to exercise self-restraint vis-Ã -vis its own capacity to exploit its original exorbitant privilege; its ability, as custodian of the world's reserve currency, to print *global public money* at will.

And what was it that wounded the Global Minotaur mortally in 2008? Again, it was an American failure at self-restraint. Only this time it was not the US government's failure (even if a case can be made that it happened on the US government's watch) but that of the private sector in general and of the banks in particular: the American financial sector failed spectacularly to exercise self-restraint vis-Ã -vis its capacity to exploit its newfangled exorbitant privilege; its ability, as custodian of global financialisation, to print *global private money* at will.

Can the Minotaur survive?

In the book's first edition, I expressed serious doubts that the Minotaur can survive. Two years later all hope of a resurrection has evaporated. The Crash of 2008 has knocked so much of the financial stuffing out of the American economy, as well as depleting New York-based financialisation of its overall energy, that the Minotaur's magnetic power over foreign capital cannot recover. Wall Street may have been fully resurrected, reporting profits that would not look out of sorts back in the heady days of 2006; the US government is attracting more foreign capital than ever before; the banks that were too big to fail have grown even bigger (at least in relative terms). Yet the capitalisation of Wall Street is now too thin to attract the tsunami of foreign capital that kept the Minotaur in rude health. Indeed, in 2012 bankers were complaining loudly that, despite a return to obscene levels of profit-taking, they were failing to provide their investors with 'sufficiently' high returns due to the new regulations introduced by government.

In reality, what lies behind the bankers' squeals against the new reality is that their banks can no longer single-handedly recycle the world's surpluses. What is more, the new regime that has been established after 2008-09, in the United States and in Europe the 'system' I have labelled *bankruptocracy* is too introverted and insufficiently attractive to act as a drawing card for the necessary capital inflows. No, the Global Minotaur is today at the stage the Global Plan had found itself in after 1971: a state of irreversible degeneration.

A world economy stunned

Despite the welcome rise of the 'emerging economies', we still live in a world dominated by the West. Post-Minotaur, this means that our lives are ruled over by the Global Minotaur's surviving handmaidens: Wall

Street, Walmart, Germany's provincial mercantilism, the European Union's absurd pretence that a currency union can prosper without a surplus recycling mechanism, the growing inequities within the United States, within Europe, within China, and so on. A world without the Minotaur but ruled by its handmaidens is an illogical, absurd place.

The best example of its absurdity is the way in which public debate deals with so-called *global imbalances*: the systematically increasing trade surplus of some countries (Germany and China are good examples), which are mirrored in increasing trade deficits in others.[2] All commentators are now in agreement that increasing global imbalances were a cause of the eventual rupture in 2008. One would, consequently, be forgiven for imagining that a reduction in global imbalances would have been welcomed. Alas, the opposite is true.

After 2008, because of America's deep recession, its trade deficit shrank and the global imbalances thus diminished. Similarly, in the eurozone a devastated periphery abruptly turned away from imports, and therefore the internal trade imbalances are shrinking there too. Nevertheless, such rebalancing is further destabilising the world economy as the drop in trade deficits (within and across regions) goes hand in hand with *greater* imbalances in the realm of capital movements. Worse still, the rebalancing of trade accounts is accompanied by a worldwide increase in both the mountains of unpayable debts and of idle savings (that are too scared to turn into long-term, productive investments).

It is, indeed, a strange world that one moment exorcises global imbalances but suffers the next when they diminish. Of course the puzzle dissolves the moment we begin to think of these matters in terms of the Global Minotaur parable; of a terrible beast that, nevertheless, stabilised an unstable world by filling the gap of an official GSRM that went missing in 1971. And now that the beast is gone, our world is in a state of permanent instability, chronic uncertainty and a never-ending slump.

The missing mechanism

Global capitalism cannot be stabilised on the basis of more investment, better gadgets, faster railways, smarter innovations. This is the error of vulgar Keynesians who think that if only the state spent and invested wisely, all would be well. Similarly, global capitalism will not regain its lost poise if central banks focus on price stability, and the task of rebalancing the world economy is left to the magical machinations of supply and demand. This is the even more menacing error of libertarians. The stability of global, but also regional, capitalism requires a global surplus recycling mechanism a mechanism that markets, however globalised, free and well-functioning they might be, cannot provide.

So, the question is: if America cannot supply the missing GSRM, and Europe is too busy disintegrating, who can? China? Alas no. China is evidently working hard, and with considerable success, in creating a Chinese version of partial globalisation; one that puts Beijing at the centre of a vast network of trade and investment deals with India, Africa, Latin America, but also involving European, American and Japanese multinationals. China will try to keep US, European and Japanese officials at bay and, before long, promote its own currency, the renminbi (RMB), as the main means of exchange within those networks. However, these networks are condemned to be embedded in a wider world economy that China cannot rebalance due to a radical incapacity to generate sufficient demand for it.

And now what? In search of history's next actors

Without a GSRM materialising soon, the future is better left uncontemplated. For, on the one hand, we shall have a West caught in the poisonous webs of the dead Minotaur's handmaidens, unable to rise to the challenges of our post-2008 world, stagnating, losing its grip on reality, failing to match its outcomes to its capacities or to create new 'realities'. On the other hand, there will be the emerging economies, bristling with people ready to transcend constraints, to spawn new 'realities', to expand existing horizons. Such a two-speed world is highly inflammable, predicated as it is upon the clash between those speeding ahead economically and the others who stagnate while maintaining a virtual monopoly over military power, over the world's reserve currency, and over the planet's transnational institutions (the UN Security Council, NATO, the OECD, the IMF and the World Bank).

So, if a GSRM is *sine qua non* for a stable globalised social economy, and without it we run the risk of returning to a pre-World War II form of radical precariousness (with the added risks emanating from modern means of mass annihilation), is there a brighter, an alternative, future?

One bright scenario would seethe formation of a grand coalition of emerging countries that forges a de facto GSRM on the basis of planned investment and trade transfers between them. For instance, instead of China simply stepping on Brazilian toes, and purchasing Brazilian productive assets without the consent of Brazilian officials, imagine a system whereby China's investments are channelled on the basis of some agreement with Brazil's government that involves capital inflows into Brazil analogous to Brazil's sale of primary goods to China as well as Chinese technology transfers to Brazil. Such agreements between Brazil, China, Argentina, India, Turkey and selected African countries could act as a GSRM that would promote stable growth. The fact that it would leave our Western bankruptocracies out on a limb would be the icing on the cake.

A second, even brighter, scenario would be for the West to have an epiphany and, at long last, embrace John Maynard Keynes's suggestion of an International Currency Union; the very suggestion America rejected in the Bretton Woods conference of 1944. Is this far-fetched? Very much so. But then again, the Crash of 2008 did concentrate some intelligent minds. Before his fall from grace, Dominique Strauss-Kahn, the former managing director of the IMF, was asked by a BBC journalist about his thoughts on how the global economy ought to be reconfigured in the aftermath of the 2008 events. His astonishing answer was: Never in the past has an institution like the IMF been as necessary as it has been today! Keynes, sixty years ago, already foresaw what was needed; but it was too early. Now is the time to do it. And I think we are ready to do it!

Clearly, the 'it' which Strauss-Kahn was referring to was none other than the creation of a multilateral GSRM, just like John Maynard Keynes had proposed in 1944, at the Bretton Woods conference. That is, a surplus recycling scheme that would not rely on some bright officials and the unaccountable financial sector of a single country, as the Global Minotaur was, but on a well-run, global organisation that consciously and transparently sets the parameters for the recycling of goods, profits, savings and demand.

Two years later, Strauss-Kahn's daring statement appears more like 'famous last words' than a genuine programme for policy change on a planetary scale. Indeed, the very image of a handcuffed Strauss-Kahn being forced into a NYPD car, a few weeks after he had made that statement to the BBC, is deliciously symbolic of the flicker-like nature of the elites' post-2008 rethink. Since then, dominant politicians, heads of the IMF and the World Bank, private and central bankers alike, generally the stewards of world capitalism, seem to have chosen to un-learn very quickly the lessons of 2008. They resemble drivers who, upon being fined by the police for speeding, drive within the speed limit for a few dozen miles before gradually returning to the original speed, hoping that this time 'it will be different'.

The omens are thus not good. Never before have so many powerful people understood so little about what the world economy needs in order to recover. Never before have history's actors been so painfully absent. Our only hope is that history often forges new possibilities at a time when none seems present. So, let us allow optimism to shine through the darkness and pose the question: if the Global Minotaur is to be replaced by a well-designed, collectively agreed GSRM, who might act as the agent of this birth? Who will emerge as history's actors this time?

Previously, I argued that this time historical agency might spring out of the emerging economies. However, I must make a confession a few sentences before the book's end: I do not believe it will. With Europe out of contention, and the emerging nations buffeted by both the Crisis and a lack of tradition in mould-breaking on a global scale, once more it is the United States that must provide, perhaps for the last time, the missing agency. Put simply, I just cannot seehow genuine progress towards building a wholesome GSRM can be made otherwise.

Of course, the prerequisite for this is that America's policy makers grasp the meaning and irreversibility of 'their' Global Minotaur's demise, and are energised by the dystopian prospect of a permanently stagnation-prone world economy. Then and only then is there a chance of a collective future that is rational, stable and pregnant with an iota of hope that our latest Crisis will be allowed to unleash its creative potential.

While emerging countries like China, Brazil, India, South Africa and so on *must* contribute important building blocks in the construction of this brighter future, America must nevertheless lead. If it does, perhaps centuries later its own Minotaur's death will inspire the poets and the myth-makers to mark its demise as the beginning of a new, authentic humanism. If it does not, then our generation's postmodern 1930s will last a lot longer than a decade.

Recommended reading

Many of the arguments in this book are explained in much greater and more scholarly detail in the book that I co-authored with Joseph Halevi and Nicholas Theocarakis: *Modern Political Economics: Making Sense of the Post-2008 World* (London and New York: Routledge, 2011). Readers may be interested in the large relevant bibliography it offers. Having said that, let me warn you that it is a dense, academic book; certainly not one to take along to the beach!

Those interested in the Global Minotaur's lineage may wish to consult the paper that Joseph Halevi and I published on the subject in 2003: 'The Global Minotaur', *Monthly Review,* 55 (July-August 2003): 56-74. This article occasioned a series of questions and answers that were later published as 'Questions and Answers on the Global Minotaur', *Monthly Review,* 55 (December 2003): 26-32.

Turning to something completely different, and far more edifying, I thoroughly recommend two books that will make you smile, laugh and generally lift your spirits thanks to their fine prose and imaginative links between matters of finance and matters of life. The fact that they were penned by two accomplished novelists is no coincidence. They are Margaret Attwood's *Payback Debt and the Shadow Side of Wealth* (Massey Lecture, Canadian Broadcasting Corporation, 2008); and John Lanchester's *Whoops! Why Everyone Owes Everyone and No One Can Pay* (London: Allen Lane, 2010).

And since I have recommended literary books on the Crisis, I cannot resist the temptation to suggest that those readers who have never read *The Grapes of Wrath* should make amends. No other book, especially not one by an economist, can convey better what a crisis does to people what it really means to become the plaything of a depression's unchecked forces. Thus: John Steinbeck. *The Grapes of Wrath* (New York: Viking Press, 1939).

Before I recommend books on the Crash of 2008 itself, I want to mention three books by James Galbraith which are an excellent introduction to the period preceding it: *Created Unequal: The Crisis in American Pay* (New York: Free Press, 1998); *The Predator State: How Conservatives Abandoned the Free Market and Why Liberals Should Too* (New York: Free Press, 2008); *Inequality and Instability: A Study of the World Economy just before the Great Crisis* (New York: Oxford University Press, 2012).

Finally, I draw your attention to two books on the Crash of 2008. From a plethora of books that I could have recommended, I have chosen one by a well-known Marxist and one by a well-known financier. It is astonishing how mutually consistent their arguments are: a sure sign that, at a time of crisis, logic brings people of different ideological backgrounds closer at least if they are hungry enough for the truth and thus prepared to be baptised in the shock of unfolding drama. The books are: Rick Wolff, *Capitalism Hits the Fan: The Global Economic Meltdown and What to Do about It* (Northampton MA: Olive Branch Press, 2010); George Soros, *The Crash of 2008 and What It Means: The New Paradigm for Financial Markets* (rev. edn, New York: Public Affairs, 2009).