The Respect of Uncertainty

The fact remains that the economic recovery during the second half of the 1980s allowed monetarists and uber followers of liberalism to scream triumphantly of their theories by putting more pressure on the governments of the day, which let themselves very easily be convinced to free capital from the suffocating grip of the state. Friedman was quick to conclude that episodes of hyperinflation and high unemployment which prevailed in the 1970s were entirely to be blamed on the failure of state governance which therefore had to give way to markets. Only markets could, according to him, breathe stability into an economy which was affected by misplaced government decisions. Always avant-gardes, the U.S. and Great Britain championed financial deregulation and the retreat of state influence, supposed keys to a prosperity which it imposed everywhere. The zenith was reached under President Clinton, who even went on to declare in his 1995 State of the Union Address that “the era of big government is finished”! Since then, the all-powerful U.S. showed itself to be dominated by its financial markets. It goes without saying that the loss of state influence was accompanied by a necessary decrease in its spheres of activity, and therefore public budgets which had to be substantially revised downward. Such was the requirement of a finance sector which demanded sobriety and discipline from states while it feasted under the weight of mass profit generated with the hyperbolic expansion of “financial engineering”. The European Union caught up with this bandwagon since the beginning of the 1990s with the Maastricht Treaty, which dictated to its members to maintain their budgetary deficits under 3% of their DGP and their public debt below 60%. Similarly for the former Iron Curtain countries to which one was to teach the virtues of the new financial orthodoxy whose admitted objective was to establish a single neo-liberal model worldwide. To reign, globalization had to standardize everything in its path. The new priority was to implant liberally accessible markets everywhere, subject to state intervention severely restricted to the definition of their interest rates whose single objective was to control inflation. In fact, the role of the central banker would be summed as increasing rates if inflation exceeded the threshold of tolerance and vice versa. There is no mention of fighting unemployment, improving working conditions or eradicating poverty. On the contrary, this period was one of spectacular regression
of the social state from which the means of its solidarity were removed. It is true that its ultraliberal restructuring yielded revenue by way of privatizations.

It was impossible in such blur to control cross-border or cross-continental capital flow which no one wanted to harness or even assess. Liberalism had therefore enshrined globalization characterized by the free reign of financial markets – that is to say pricing – since everything was then given a value. Tsunamis of investments and liquidities thus flooded economies – even the most reclusive in the world – so much so that expansion, modernization and even the most basic needs of certain countries were assured by private capital, nothing altruistic since it was their profit in sight. It is globalization that China, Latin America – in short, those that are referred to by the generic name BRICS and which could include all emerging countries – owe the growth of their exports and their financial surpluses and reserves. Everywhere where globalization passed, nonetheless it required healthy public accounts, a condition sine qua non to its investment and its provision of funding, even if none of its experts wanted to explain why and in what it was economically required to maintain its public finances balanced at all times. Indeed it has been more than thirty-five years that states have been required to curb their public deficits for no other reason than the economists and experts recommend it, even if they cannot explain these requirements! Still, to abdicate the essential of their financial powers in favor of a sprawling and sophisticated corporation, our states, unfortunately, no longer have the same powers over the economy. Deregulation, globalization and financierization have not always so far – and despite five years of crisis – surrendered, knowing that the context can be found now weakened to breaking point by the absolutely huge imbalances between a small group of exporting countries and a massive group of importers-consumers-debtors… Globalization – created in the West – has therefore devoured its parents since it is practiced – and prospers – on the bed of massive deficits in the U.S. and Europe (except of course in Germany). This regression of the state characterized by abandoning the disenfranchised classes only made the inequalities wider. The tiny wealthy minority enriched itself more while exploiting the middle class along the way – those dependent on only their salary – and who suffered stagnation or a decrease in their real income. Therefore, what is the intangible economic law that dictates unequivocally that a state must spend less than 3% of its GDP and that its debts must always be under 60% of its GDP? This dogma of 3%, which now dictates European economic choices, is, however, only a fanciful invention of Guy Abeille, a French official in the Ministry of Budget. Which today recognizes that “3% (were) invented an hour one evening in June 1981, on a table corner, and not based on any economic theory”. For its inventor, this “round” figure also made
you think about the “Trinity”. In this same vein, the ESM (European Stability Mechanism) explicitly states that the states will have to be financed only by the financial markets and thus be exposed more to speculation and financial risks. This mechanism represents an extra gear to austerity with the consequence of relinquishing the democratic control of the European Parliament or national states. The unstated goal is to dismantle the welfare states and conduct internal devaluations which substitute usefully currency devaluations. Whereas, in reality, only economic activity, growth and salaries count, and it does not matter – not at all – that money comes from public funds or private investments.

The liquefaction of fall 2008 is therefore the poison gift of financial innovation. By making markets more liquid in favor of volumes increasingly more pharaonically traded, globalization led to financialization and securitization having attracted more and more institutions, businesses and the private sector which invested without relying on financial markets. As almost all these liquidities in circulation were invested and less and less money remained uninvested, markets become more volatile in favor of stakeholders who bought and sold very frequently. The so-called “real” economy – narrowly dependent on markets – was naturally affected – and infected – by their inherent stability through the driving belts of scholarships and bank loans. Even more serious for economic activity which was gradually considered as an “investment” exactly like another, which ended up upsetting traditional economic cycles. This radical shift in the economic paradigm generated by massive cash flows – ready to be invested but also all the more ready to be divested – was obviously transformed by the fall into disuse of whole sectors of the economy or investment was only profitable in the long-term (as the industrial sector) and the emergence of sectors of economic activity (finance and speculation) where the returns on investments were realized in the short-term. Under the complacent watch of central banks which, loyal to their adherence to monetarist theories, consecrated a reference instrument – interest rate – as the supreme regulator of the markets and the economy. In fact, deregulation had left them with only this leverage which they used, nonetheless, in all directions – and downward – with the one and only objective being to fight inflation, the sworn enemy of Friedman & Co. The manipulation of leveraging interest rates therefore conditioned investments directed to the real economy. Indeed, when interest rates were low, it was worth taking on some exposure to invest in the economy, but these funds were quickly extracted when compensation offered
by interest rates proved juicier. Certainly, we know since Keynes that the volume of investments in the economy is a function of the interest rate in effect. Central banks have played it nevertheless so – under the guise of fighting dynamically against inflation – that permanent instability reigned among the economic players. During the only decade from 2001 to 2010, the U.S. Federal Reserve thus reduced its rates from 6% in January 2001 to 1% in June 2003 to raise them to 5.25% in June 2006 and bring them down to absolutely zero since December 2008!

In acting in this way, central banks only gave investors reason a posteriori to favor a very short-term horizon. By raising or lowering their rates substantially in so little time and by displaying an extreme reactivity to any inflationary threat, they donned the clothes of speculators who were recognized in them. And have somehow endorsed their actions. How can businesses keep employees under such conditions marked by a volatility in the capital flows available to them when it is impossible to plan calmly in the medium- and long-term? It is therefore uncertainty which undermines the workplace and which makes it hesitant to do any large scale hiring because it cannot permanently rely on the capital available to it. That is why, if the theory of self-regulating markets is good for investors, it is, on the other hand, a curse for unstable economies and for employees who live on tender hooks in fear of losing their jobs at any given moment. Of the rest, if markets really had the ability to self-regulate, the effects could have only been beneficial to the real economy which would have been smoothened by markets always at their best. Unfortunately for financial markets – and particularly for our economies – uncertainty causes financial crisis. The slowdown of investments in favor of the economy and market volatility is effectively incompatible with a weak forecast of the future, such as defended by the monetarists.

In other words, this uncertainty which is impossible to control or quantify imposes on those whose job is to take risks surrounded by all precautions and all preventions so as to not be swallowed up in the whirlpool of inherent volatility comprising the full range of investments, from personal loans to derivatives. As it is obviously impossible to predict future crises, good governance likely to be dictated by the regulator must naturally tend toward transparency, exhaustive evaluation and strict monitoring of risk. However, how do you convince the supporters of the efficient market that risks are not always reflected in the price? And that operators only have access to fragmented and incomplete pieces of information on which they base their decision-making? And that external shocks regularly affect market price? In reality, only the advent of crises inflicts such lessons on investors and speculator while making a good number disappear in passing. That we did not listen to
Keynes – who more than half a century ago – indicated that “our knowledge of the future is fluctuating, vague and uncertain”! How do we defend the monetarist argument according to which it is easy to make “rational” predictions concerning changing markets when the scientists themselves would like to predict a volcanic eruption or an earthquake? Nassim Taleb does not tell us anything new with his judicious allegory of the black swan. Markets are not right, they are not transcendent and history tells us that it is littered with failures, losses, erratic movements, with all the side effects that we know about in our daily lives. How can theories about perfect and omniscient markets claim, as they do, to have a constructive impact on the economy if they exclude all reliable prediction? Keynes had had this famous saying: “there is no scientific basis on which to form any calculable probability whatever. We simply do not know”. It is his famous “we simply do not know”, a real call to be more modest than aficionados – to the admirers, should we say – of the divinity of “markets”.

Let us compare these sayings with the certainties of an economist like Burton Malkiel, born in 1932 and educated at Princeton and Harvard, who assures that “True value (of the markets) will win in the end” since the stock market is, always according to him, a “long run weighing mechanism”. Let us therefore be comforted since stock market valuations are expected to achieve a balance even allow our businesses to generate profits. And too bad if we have to experience strong turbulent periods: in any event it is what is implicitly admitted in this “long-term”, indicating the hollow existence of short-term ups and downs which would severely affect the real economy, which is asked to bear its troubles patiently until markets arrive at ultimate wisdom. Keynes was ironically saying that: “on the long run, we will be all dead”… Must we thus be resigned to support and suffer training and especially the collapse of these bubbles that generate crises, financial desolation and panic while waiting for some kind of messianic balance of markets? Since, according to economists like Malkiel, crashes would only be setbacks which gradually forge this final stage of balance. Except for these episodes, indeed regrettable but also necessary like childhood diseases such as measles or mumps, information available to agents – complete and correct – would allow them to make adequate decisions at any time for market harmony and the proper functioning of the economy. In doing so, these theorists of “rational decisions” characterizing the life of markets miss the fundamental psychological component which affects any investment process, such as trust and reliability that stakeholders consider when making their decisions. Trust being a highly volatile and unstable concept.