Degrowth, the financial system and the pension system

It has been argued that degrowth would lead to a catastrophic economic collapse triggered by a collapse of stock exchange values. However, this analysis rests on several flawed assumptions: (i) an outdated view on stock market mechanisms and values (ii) the assumption that the stock market mechanisms would remain unchanged in a degrowth economy (iii) unchanged expectations of benefits from the stock market and (iv) a misperception of economic processes e.g. under a resource capping approach caused by the theory of economic agents.

(i) Up to the 1980s, shares were bought based on the expected dividends. The formulas used to justify the stock exchange value were driven by corporate profit expectations (the “fundamentals”), and shares were held over longer periods. The stock exchange value was not of dominating importance as it was not the main source of income; instead shares generated rents. Since then, holding periods have become shorter (down to milliseconds), and the expected gain from holding shares is based upon buying and selling at varying ratings; annual dividends play a minor role. In particular institutional investors try to make money from trading rather than from holding shares, hedge funds as much as pension funds. Speculation, bets on rising or falling stock market ratings (both can generate profits) determine the prices. The link to the real economy has been largely lost – the total value of shares by far exceeds the corporate profits to be expected in the next decades. This does not affect the real economy as long as the share value remains virtual money, but it creates severe strains whenever shareholders try to cash in, converting the virtual money into real income (as they will have to do, in the case of pension funds, to live on the accumulated wealth). Deleveraging by big institutional investors depresses the value of stocks, causing a vicious cycle if the funds do not manage to attract enough new capital to avoid liquidating some stocks: a Ponzi scheme.

(ii) As with degrowth the total annual surplus is to shrink, dividends will be reduced too – not from each firm, but in the aggregate. Thus funds holding a diverse set of assets are at risk of not earning enough money to pay out investors, in particular as in a degrowth economy bankruptcies and thus share value losses will be more frequent. Consequently, the stock exchange investment risk increases, speculation is still possible and can be successful, but will more often fail than under conditions of permanent growth.

(iii) The importance of the stock exchange for raising capital would decrease. In such a situation, the stock market is no longer a safe haven for pension funds; to safeguard their assets they will have to restructure their portfolios, reduce shareholding, and accept minimal value growth rates. This in turn eliminates the stock exchange multiplier effect on private pensions, makes them less attractive and more risky, supports a move to pay-as-you-go schemes, and provokes the demand for an a priori appropriate level of pensions. With an ageing society, and a significant share of voters concerned about pensions, politics will have to react. However, there will be little additional money available to spend as without economic growth, what can be redistributed on top of the current wealth production are only the gains from productivity increases. This points to a serious problem any degrowing society has to solve: the distribution of income between labour, capital and public institutions / the state, including social security and pension systems.

(iv) Based on neoclassical macroeconomic theory, arguing with the expected behaviour of representative agents, economists have argued that an end to growth would lead to a collapse of the capitalist market system (interestingly, some Marxist economists have drawn the same conclusions, welcoming the collapse and proclaiming degrowth as a recipe for their ends). However, this expectation is plausible only in a model world consisting of one bank, one firm, one consumer etc. – as soon as two or more banks, producers and consumers are taken into account, the presumed unwillingness to produce and invest as no success (growth is possible) will turn into a fierce competition about who will be able to stay, who will grow and who will go bust, amongst producers as much as amongst lenders: creative destruction at its best. Thus the direct collapse effect is an artefact of overly simplistic economic theory, not a phenomenon of the economy (although still other effects may cause collapses).

In conclusion, private pension schemes are identified as demanding growth and enforcing socially unsustainable policies, while pay-as-you-go pensions schemes offer the opportunity to accommodate degrowth and strengthen socially responsible politics. However, making the necessary funds available will require caution in order not to cause collateral damages.

Enforcing degrowth in a market economy is shown to be possible, a matter of political will and dedication against massive economic interests. Having done so, solving distributional questions will be a major challenge, together with changing public institutions (e.g. retirement systems) and consumption patterns (limiting consumer autonomy by choice editing).