Degrowth & the financial system

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Thought experiment: ending GDP growth

Capping economic growth by capping resource consumption

• Annually reducing resource consumption licences by the rate of resource productivity increases.

• As a result the aggregate economic activity remains on the same level, GDP growth is eliminated.

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Suspicion: Degrowth means collapse

because without a growth perspective,

- Companies would refrain from investing,
- and their share values would plummet.
- Banks would stop lending,
- and their share values would go up in smoke.
- The whole financial system, based on the stock exchange, would collapse,
- with all stocks devalued
- and with it the *pensions of millions of workers* in particular in the affluent countries.

That is what the conventional wisdom of neo-classical economics says. As usual, it is nonsense.

Four main(stream) mistakes

(i) a misperception of economic processes e.g. under a resource capping approach caused by the theory of economic agents.

(ii) an outdated view on stock market mechanisms and values

(iii) the assumption that the stock market mechanisms would remain unchanged in a degrowth economy

(iv) unchanged expectations of benefits from the stock market.

Experiment: Economic Impacts

- Fierce business competition as the economy becomes a physical zero sum game, light & lean business out-competes inefficient, structural change accelerates.
- Whole business sectors disappear while new ones emerge: creative destruction at its best.
- Competition and innovation are directed towards increasing resource productivity.
- More frequent bankruptcies, monopoly & oligopoly control become more crucial than ever.
- Risks for lenders limits investment capital, difficulties for start-ups, but no collapse of bank lending. IPOs mobilise less enthusiasm.

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Experiment: Economic Impacts 2

- As the economy continues producing, stocks of assets grow, but output is limited.
- This would imply decreasing productivity if capital stocks are not forced to shrink.
- Bankruptcies are necessary means of capital destruction (instead of bubble-and-bust).
- Inwards and outwards FDI must be under control, like capital movements, to avoid loopholes.

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Experiment: Financial Impacts

- The risk of holding shares increases.
- With aggregate profits flat (depending on distribution conflict results) total annual dividends stagnate => fundamentals give no reason for further growth.
- Speculation is discouraged but exists.
- Pension funds cannot expect to multiply value to top up poor pensions.

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This implies collapse if

as in the representative agent model

• there is one bank, one company.

But if you take of each

(what an increase in realism & complexity!)

• one company tries to flourish at the expense of the other.

•Each bank tries to pick the winner

•Investment and lending continue, but damped.

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The stock market misperception

• Up to the 1980s, shares were bought to cash in dividends (rents). Expected profits were the basis of share prices ("the fundamentals").

• Since then, expected reselling price has become the mechanism dominating share prices. Not profit but speculation rules. Gains were high in the crisis when the bubble burst.

• The link to the real economy is lost – share values far exceed profits of the next decades.

• Degrowth does not end this automatically.

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The stock market under degrowth

• Dividends will be reduced – not from each firm, but in the aggregate.

• Bankruptcies and thus share value losses will be more frequent.

• Funds holding a diverse set of assets are at risk of not earning enough money to pay out investors.

• Speculation is still possible and can be successful, but will more often fail than under conditions of permanent growth.

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Misguided stock market expectations

- The importance of the stock exchange for raising capital would decrease.
- The stock market would no longer be a safe haven for pension funds; they will have to restructure their portfolios, reduce share holding, <u>accept minimal value growth rates</u>.
- This in turn eliminates the stock exchange multiplier effect on private pensions, makes them less attractive and more risky.

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Social Impacts: Pensions

- No stock market multiplier effect provokes the demand for an a priori appropriate level of a priori pensions.
- The perceived benefit of private against public pensions is turned around: private meaning more risk without more gains.
- 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.

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Pension schemes' money source

Public pay-as-you-go schemes and private insurance or fund systems both <u>derive the money they pay out from the production of the current year</u>, but either from salaries or from profits:

Pay-as-you-go schemes take money from members of the labour force and redistribute what they take rather completely through a more or less bureaucratic non profit system: the state of public insurances.

Private insurance systems take money from clients, invest and manage it in a profit-oriented system, and pay the transfers from the profits.

More capping, this time financial

If there is more wealth than can be profitably invested, money goes to speculation.

Redistributing income and framing it with an unconditional minimum and an absolute maximum does not change rent incomes. Wealth is the key.

If wealth concentration is to be changed, wealth to be redistributed, three options exist:

- Expropriation without compensation – unlawful,
- A tax higher than the income – daily trouble,
- Inheritance capping, say a limit of 10 mln €/cap: from birth to 80 yrs old a free rent of 10,000 €/m – and the rest is used for the public good…

Food for thought

"It is only in the backwards countries of the World that increased production is still an important objective; in those most advanced, what is needed is better distribution."

John Steward Mills (1857), Principles of Political Economy, Book IV

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“We have become far too clever to survive without wisdom”

E. F. Schumacher

Thank you for your attention

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