

# Surplus Energy Economics

How the economy REALLY works – Tim  
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## #132: The revenge of the spider

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### ECONOMIC RECKLESSNESS AND GFC II

If you're a regular visitor to this site, you'll know that we've covered a lot of themes, varying from the plight of individual economies to the madness of economic policy both before and – especially – since the 2008 global financial crisis (“GFC I”). You'll probably know, too, that the expectation here is for “GFC II”, a far larger sequel to the events of 2008.

You might also know that the coming autumn sees the opening of a window in which this second crisis might take place (though, in their very nature, the timing of such events cannot be predicted). So the aim now, with autumn approaching, is to summarise how things stand.

Let's start with the economy. Ever since the late 1990s there have been clear signs of deceleration in the pace at which underlying economic output has been growing. The interpretation put forward here is that this deceleration has been caused by an exponential uptrend in ECoE (the energy cost of energy). At least two other material headwinds can be identified – environmental stress, and mistaken economic policy – but a worsening in the energy equation has been the critical factor undercutting the potential for growth.

As modelled by SEEDS, these trends in energy have already put prosperity growth into reverse in the majority of Western economies, where prosperity per person generally peaked between 2000 and 2007. On this basis, the average Italian has become 12.3% poorer since 2001, the average American is 7.7% less prosperous now than he or she was back in 2005, and prosperity in the United Kingdom has fallen by 10.3% since 2003.

Where the West is concerned, the outlook is for more of the same. Mr Trump may or may not be able to “make America great again”, but neither he nor anybody else

can ‘make Americans prosperous again’. Much the same, varying only in rapidity of deterioration, applies to virtually all developed economies.

In recent years, the Emerging Market economies (EMs) have become more prosperous, though sometimes at rates nowhere near claimed expansions in GDP per capita. According to SEEDS, this improvement in EM prosperity looks likely to continue, albeit at fading rates. In theory, this leaves global prosperity pretty flat, with progress in the EMs offsetting impoverishment in the West. In practice, though, EMs may not be able to carry on growing their prosperity *at all* in a world in which their Western trading partners are becoming poorer.

Unfortunately, policymakers have never understood the processes undermining prosperity. Worse still, any concept of coming to terms with deceleration is wholly unacceptable, not least because the financial system is predicated entirely on perpetual growth. Of course, you might think that basing *anything* on perpetual economic expansion in a finite world is pretty crazy – but whoever said that either politics or finance has to be limited by rationality?

A direct consequence of the collision between resource reality and a commitment to growth in perpetuity has been an attempt to ‘cheat’, using financial *adventurism* in an ultimately futile attempt to get around the ending of growth.

This has taken two main forms. The first, adopted in the years before GFC I, was “credit adventurism”, making credit cheaper, and easier to obtain, than ever before. Since GFC I, this has been compounded by “*monetary* adventurism”, which has involved pouring mind-boggling amounts of liquidity into the system.

To a certain extent, the latter was a consequence of the former. By 2008, “credit adventurism” had created debt of a magnitude that was impossible to service under “normal” monetary conditions. Barring “reset” – ruled out because of the short-term pain that it would have caused – the *only* way to cope with such gargantuan debts was to make them ultra-cheap both to service and to roll-over.

Just as there have been two forms of adventurism, there are two forms of crisis. “Credit adventurism” led naturally to a credit (debt) crisis, which was why banks were in the eye of the storm in 2008. “*Monetary* adventurism”, on the other hand, leads to a *monetary* crisis, which is why *fiat* currencies will be at risk in GFC II.

These forms of adventurism have succeeded in creating an illusion of growth, convincing enough so long as we wear blinkers where underlying fundamentals are concerned. World GDP increased by 35% in the seven years between 2000 and 2007, and by 31% in the decade between 2007 and 2017.

But the escalation in debt alone gives the lie to any claim that this “growth” has been genuine or sustainable. Between 2000 and 2007, growth of \$25.5 trillion (at

2017 values) was accompanied by a \$52tn increase in debt, meaning that just over \$2 was borrowed for each \$1 of “growth”. Since 2007, the ratio has worsened markedly, with “growth” of \$29.8tn accompanied by \$99tn in borrowing, a ratio of \$3.30 of new debt for each growth dollar.

Escalating indebtedness has not been the only consequence of financial adventurism, of course. The crushing of returns on invested capital has created huge shortfalls against the amounts that we ought to have put aside for retirement, all but destroying the viability of pension provision for all but a wealthy minority. Monetary adventurism may not – yet, anyway – have created a spike in consumer inflation, but it has led directly to massive bubbles in asset prices.

Critically, the worsening ability of the economy to carry these excesses has been disguised by the phoney “growth” created by the simple spending of borrowed money. Everyone appreciates that an individual does not become more prosperous simply because he or she runs up an ever-bigger overdraft, and spends it. Unfortunately, observers – including policymakers – *do* seem to believe that economies can prosper by racking up ever bigger debts, and mortgaging the future, and then pushing the proceeds through consumption.

There are even those who believe that the inflated prices of stocks, bonds and property constitute “wealth”, even though the only people to whom such assets can be sold are *the same people to whom they already belong*.

If we strip away the simple spending of borrowed money, SEEDS calculates that claimed “growth” (of \$55tn, or 76%) since 2000 falls to less than \$21tn, with the remaining \$34tn an illusion conjured out of adventurism. Meanwhile, the deterioration in trend ECoE, from 4.0% back in 2000 to almost 8% now, means that aggregate prosperity increased by just \$16.4tn, or 24%, over the period as a whole.

Unfortunately, world population numbers expanded by 22% over the same period, so growth in average prosperity has been just 2.3%, over seventeen years. All and more of that increase has gone to the EMs, leaving the average Western citizen poorer.

What we are left with, then, is deteriorating Western prosperity, faltering underlying output in the world as a whole, unprecedented levels of debt, grotesquely inflated asset markets, and huge hostages to fortune, not least in the destruction of pension provision.

In simple mathematical terms, SEEDS estimates that “reset” in 2008 would have required ‘value destruction’ – a fall in the aggregate prices of assets – of the order of \$84tn, equivalent to almost \$100tn today. Of course, monetary adventurism was used to avoid reset in GFC I – carrying that value overhang forwards – and we’ve

gone on adding to it, at steadily rising rates, ever since. SEEDS puts scope for value destruction today at over \$400tn, which should be treated as a (very approximate) order of magnitude of the extent to which asset values have to fall.

This, of course, is ‘first order’ *value destruction*. If the prices of your shares, bonds and property fall, you still own them, and no money has actually flowed out of your bank account. The real problem is ‘second order’ value destruction, which is what happens when the value of your assets falls to a level lower than the sum you borrowed to acquire them.

Though the scale of the sums involved is almost impossible to calculate, we can conclude that the world will face vast ‘second order’ value destruction when GFC II happens.

We can be equally certain that, rather than accept the necessity of value destruction on a scale roughly four times larger than 2008, the authorities will resort again to adventurism, pouring liquidity into the economy at rates which dwarf anything experienced during and after GFC I. The strong likelihood has to be that adventurism on this scale will undermine the value of *fiat* currencies, destroying many whilst inflicting hyperinflation on those which survive.

The public, on the other hand, can hardly be expected to like getting ever poorer, especially whilst the distortion of the relationship between incomes and asset values seems to have made a minority wealthier whilst imposing austerity on everyone else. Whether, during GFC II, they will turn increasingly towards insurgent (“populist”) politicians, or opt instead for the collectivist offer of a Left made resurgent by popular adversity, is a second-order question. What we *can* anticipate, with high levels of confidence, is political and social change at least commensurate with the scale of economic and financial upheaval.

Those with long memories might remember a song for children called “there was an old lady who swallowed a fly”. After the fly, she swallowed a spider (“that wriggled and jiggled and tickled inside her”), the point being that she swallowed the spider in order to catch the fly. Thereafter, ever larger animals were ingested to catch the one swallowed previously – “she swallowed the bird to catch the spider”, and so on – finishing up with swallowing a horse (“she’s dead – of course”).

By this analogy, the system “swallowed a fly” in the years before 2008, then “swallowed a spider” during GFC I in an attempt to deal with it. In real life, swallowing a fly can happen to anyone, and swallowing a spider is at least feasible. Swallowing a bird, however, is not.

In this sense, GFC II is set to be the spider’s revenge.