

Letter n°29

Towards a mutation of capitalism: the end of neoliberalism?

"Everyone wants to live at the expense of the state. They forget that the state wants to live at the expense of everyone." Frédéric Bastiat

- Never since 1945, has the ratio of public spending to GDP in the world been so high, and we seem to have forgotten this tautology stated by **Frédéric Bastiat**, a French liberal economist of the first half of the 19th century. Since the beginning of Covid, \$13800 billion, more than four times the amount made available by governments in 2008, has been spent to help households, companies and communities.
- This crisis is an opportunity, and a time to reappraise the role of the state. Obama's \$800 billion plan was criticized, Trump's first plan, though much larger at \$2000 billion, was easily approved. Biden's plan, which draws some parallel to Franklin Roosevelt in its social aspects, appears popular with 70% of Americans support because it increases the income of the poorest, aims to reduce inequality and will be followed by an infrastructure plan, driven by an upwardly revised ecological ambition.
- The protection of the environment and the reflection on the role of man in the company, have imposed themselves on citizens, states and companies and are challenging certain principles of neoliberalism. Pollution, public and private debt, precariousness – we assess the burden passed on to future generations and the word of **Saint Exupéry in *Terre des hommes* "We do not inherit the earth from our parents, we borrow it from our children"** guides our thinking.
- In the eyes of its critics, neoliberalism, implemented by Ronald Reagan and Margaret Thatcher, reveals its demerits in a worsening of inequality, an excess of household debt, a stagnation of income and financial bubbles. Criticisms are mounting and states have changed their policies, but some of these problems, like worsening inequality and debt, are also evident in China.
- So, should we blame, anathematize and reject neoliberalism or seek to modify, dulcify and renovate it? The state is called upon, but is it equipped to optimize investment? To answer these questions, we will examine the drifts of neoliberalism and its inflections.

1. **Three drifts of neoliberalism:**

- The drift of inequality: several causes intertwined.

This will surprise some, but low or even negative interest rate resulting from cash injections and excess savings ("saving glut") is one of the seeds of the drift in inequality. There are three reasons for this: an incentive to substitute capital for labor, and thus a reduction in the share of wages in the value added of companies in favor of capital; a shift from the bond market towards the equity market which was one of the reasons for the strong performance of the stock exchanges since 2009 – this is an advantage for the well-off because, in the United States, 1% of the population hold almost 52% of the shares while 50% own only 0.7%. The third effect of zero interest rates is the penalization of pension systems.

The stagnation of wages, especially for the low-skilled, in the Western world over the past thirty years is another factor for this drift in inequality as real wage growth has been lower than productivity. The final explanation is the competition from low-wage emerging countries for low-skilled jobs.

To compensate for stagnant incomes, the first measure, in place till 2008, was to facilitate household debt. However, household debt rose very quickly from 60% of US GDP in 1998 to 80% in 2009. The 2008 "subprime" crisis and bankruptcies had put an end to this approach and since then, there has been a decline in the household debt ratio to 70% of GDP by 2019.

The second palliative, the successor to this diversion from private debt between 2008 and 2019, was to use public debt to partially finance transfers to households. In 2020, we witnessed the "helicopter money" policy – that is Trump and Biden cheques program for households and the payment of additional unemployment benefits. The bottom line is, despite the economic downturn and the explosion in unemployment, incomes have not fallen and savings have reached unprecedented levels. This is a social shift. But is it sufficient or appropriate? *Angus Deaton*, Nobel laureate in economics, in his recent book *"Deaths of Despair, the Future of Capitalism"*, mentions that the 165,000 deaths in United States (from suicides, alcoholism, overdose) are mainly among white, low-skilled workers, who have faced decreasing wages for decades.

- Deindustrialization:

Manufacturing value added as a percentage of GDP is now only 10% in France, 8.5% in the United Kingdom, 11.5% in the United States, 19% in Germany and just over 14% in Italy. The decline in the share of industry in GDP is a fairly general phenomenon but more pronounced in the United States, the United Kingdom and France than in Switzerland or Germany. Three-quarters of the decline in industrial employment was due to technical progress and productivity gains. Offshoring production is only a minor cause of job losses. The strategic mistake made in the 1990s was to regard keeping factories in Europe as a bad idea and developing research as a noble one.

Reindustrializing Europe or the United States, Japan or Korea will not so much involve repatriating low-value-added activities but about focusing on high-skilled activities. We are not going to close a factory in China to repatriate it to Italy or the United States but to open it in Vietnam or Bangladesh i.e., in countries with lower production costs. It is not a question of bringing back a relocated car assembly line in Morocco but, for example, of developing the electric car because it represents a growing share of registrations, 3% in 2019, 10% in 2020. "Europe of batteries" launched three years ago at the initiative of Germany, France and a few others, allowing for the production of 7 million batteries by 2025 and will be accompanied by the creation of skilled jobs. The labor cost differential is less sensitive to the overall cost because the electric car requires fewer hours of assembly. In other sectors, the focus will have to be on the top of the range.

- The concentration of companies and the tendency towards oligopoly:

"If you eliminate competition, the quality of the product deteriorates and the trade, instead of being a service, becomes an exploitation of the customer." This statement by *Adam Smith*, in *The Wealth of Nations* (1776), is still valid today. Concentration hinders innovation and causes services to be more expensive for consumers. The power of lobbying groups in Washington and the unquenchable quest for rent are abuses of capitalism and skew the market economy in the United States more than elsewhere and in sectors as diverse as digital, telecommunications, healthcare and banking.

A topical example lies in digital technology where in China, as in the United States and Europe, there is now the same desire to monitor digital leaders. For *Zuboff*, in his book *"The Age of Surveillance Capitalism,"* he asserts that surveillance capitalism poses a threat to society and capitalism. In the United States, Congress of all tendencies is considering amending antitrust law with four objectives: to prevent GAFAM from leveraging their platforms for their exclusive benefit, to curb their acquisitions, to prevent harming consumers and to better protect workers.

2. *Inflections:*

Between Germany's temporary (?) renunciation of the Stability Pact, the United States' commitment of \$4500 billion to fight the crisis, the European plan of €750 billion, a first in the history of Europe, the "whatever the costs" of Emmanuel Macron, and the strengthening of state intervention in Great Britain, there are countless signs of increased state involvement in the functioning of the economies, an idea that is, at first glance, contrary to neoliberalism. Let us recall the ideological sources of liberalism and assess the manifestations of state involvement,

a) *The ideological roots of liberalism and the ideas derived from it:*

"It is not from the benevolence of the butcher, brewer, or the baker that we expect our dinner, but from their regard to their own self-interest. We address ourselves not to their humanity but to their selfishness, and never talk to them of our own necessities, but of their advantages." These words by **Adam Smith** in his book *The Wealth of Nations* sum up the essence of liberalism.

However, liberalism is divided into different streams and there are undoubtedly differences between Hayek, Popper and Isaiah Berlin. For **Hayek**, state interventionism is inherently harmful, but **Karl Popper**, who knew him, defended a more progressive line, imbued with a desire for justice. The state is a necessary evil to alleviate injustice and ensure the redistribution of wealth. Economic freedom, he argued, must be complemented with a high standard of public education, a form of welfare state to **"protect the economically weak from the economically strong"**, pensions, unemployment insurance, free education to create equal opportunities. This is because **"economic power can be almost as dangerous as physical violence"**. And **Adam Smith** also noted that well-paid workers are more productive and that their prosperity guarantees social stability.

In concrete terms, if we consider education as a key to competitiveness, if we want to ensure equal opportunities, the major principle of liberalism, and if we do not want young people to give up their studies, study grants are no longer sufficient and we can instead think about minimizing tuition fees, or even, as in Denmark, allocating a monthly income of €750 to students. In job creation, the state can create an attractive environment, but it is not the state that creates jobs. The state should promote apprenticeships to protect employees through training, but not jobs because today there are no longer jobs for life.

b) *The six manifestations of increased state involvement:*

In the West as well as in China, Europe and the United States, the role of the state is growing. The state is increasing its priorities. The recent problem with the supply of electricity in Texas has strengthened the Democrats' determination to give the public sector a greater role. The same is true in Great Britain in rail transport. In China, the Communist Party's presence in private companies is being strengthened.

- First inflection, the globalization-relocation debate:

The Covid crisis illustrated some of the evils of globalization. Shortages in the medical sector have highlighted the deleterious effects of budgetary savings in recent years, the limitations of a zero inventory and "just in time" policy, the abandonment of certain industrial sectors, and dependence on China for goods deemed essential. From the United States to Europe, there is a desire to relocate. This is the meaning of the Buy American Act and the increase in standards to encourage relocation.

Sovereignists will applaud "economic patriotism," while liberals will worry about creeping protectionism. To repatriate operations and to close borders, would be to close off opportunities and there is no guarantee that a local player would be more efficient than a remote factory in the world in

supplying large quantities of vaccines quickly – this is the current debate.

Globalization has reduced low-skilled employment in Western countries but improved the purchasing power through low-priced imports. A country like France would not necessarily benefit from a repatriation of activities from China or other emerging countries because its trade deficit results from trade with European countries such as Germany and trade with emerging countries is quite small, excluding commodities. In France, for example, in 2020, according to the Treasury Department, 40,000 jobs were created or saved thanks to international investment and, in 2019, the flow of French investments abroad was €34 billion, quite close to the €30 billion of foreign capital invested in France, according to statistics from the Banque de France. It is hard to see how a foreign investor would be more dangerous for a local client than a domestic investor. On this issue, neoliberal logic must continue to prevail. In the case of foreign takeovers of local companies, the state should only be able to oppose a state-subsidized foreign company as this could distort competition. One can thus criticize France for not allowing the acquisition of Carrefour by Canadian group Couche Tard.

- Second inflection, fostering innovation and re-industrialization:

Supporting innovation, relocating strategic industrial sectors, and increasing the share of industry in GDP are the leitmotifs of Western governments. But states must balance the benefits and costs of such a policy – benefits in terms of job creation, handicaps in terms of competitiveness. Innovation, as Schumpeter has shown, is an essential factor for growth, and recently Aghion has made it the core of his book "The Power of Creative Destruction." Crises can be opportunities and we remember that Microsoft was created in 1975 during a crisis, Uber and Airbnb in 2008-2009 during another crisis.

Similarly, the crisis caused by Covid has accelerated the digital revolution in companies, encouraged the growth of certain groups and generated increased productivity in the organization of production, distribution, mass production and, thanks to 3D, the production of small series. Digital technology, one of the themes chosen in our investment strategy, is the energy of the twenty-first century.

- Third inflection, combating inequality, strengthening education, ensuring equal opportunities:

This is the third manifestation of the adaptation of liberalism. The \$1200 and \$600 cheques distributed by the Trump administration and now the \$1400 cheque allocated by the Biden administration provide additional purchasing power, especially to the most disadvantaged. Biden follows in the footsteps of Franklin Roosevelt with a more social connotation of the role of the state. Targeted cheques are an advancement of a traditional Keynesian policy.

If Boris Johnson has, for the first time, taken the Labour's strongholds around Newcastle, it is because his program is distinct from Thatcher's.

The thought about a universal income or the idea of a minimum income for young people has not yet matured, but it is progressing. Experiments on universal income are being conducted in Finland with 2000 people receiving €560/month and in Alaska with more than 600,000 people receiving an income of \$1000 to \$2000/year.

- Fourth inflection, strengthening the efficiency of the welfare state, reducing inequality and increasing taxes:

It is no longer a question of reducing the welfare state but of ensuring greater efficiency. However, if the demand for an increase in the care effort is legitimate, it will have to overcome the obstacle of financing or else it will be found with new debts.

Corporate taxation, which has been declining in recent years, may have reached a bottom. Since the early 1990s, the corporate tax rate in the OECD has fallen from 42% to 27%. Today, several countries are considering a hike. In Britain, the Minister of Finance is planning an increase from 19% to 25% by 2023. In the United States, Biden's program envisages an increase from 21% to 28% in the corporate tax rate. In addition, thanks to Biden, there is progress in the debate on minimum tax of multinationals including GAFAM with a projected rate of 12%. Notwithstanding the need for money by governments, the increase, even temporary, of income tax is ruled out by many.

- Fifth inflection, reduce business dependence in the short term and facilitate energy transition:

Many states in recent years have been concerned about the trend towards less labor protection. The partial unemployment compensation offered by the states in 2020 has enabled companies to avoid cash flow problems and preserve jobs.

States are getting involved in the energy transition and, sometimes under pressure from public opinion, sometimes at the initiative of governments, they are adhering to carbon footprint reduction targets, working to ensure that companies comply with them and considering the implementation of a tax.

The stakes are high and the responsibility towards future generations is at stake. Even Exxon, once led by Rex Tillerson, a climate sceptic and a short-lived Trump minister, decided to follow the example of other majors to invest in green energy. Banks, most recently HSBC, under pressure from shareholders, are having to limit fossil fuel financing and gradually withdraw themselves from the financing of coal-fired power generation.

In short, for companies, adherence to ESG objectives could result in either a decrease in margins, thus weaken stock market valuations, or in price increases designed to absorb these additional costs and thus create inflationary pressures. It seems that activist shareholders will not tolerate a sacrifice of margin to climate objectives, an underperformance of the stock market and, this is the point of the action taken against the president of Danone.

- Sixth inflection, managing debt with central banks:

Several stigmas will remain from this crisis, in particular the increased debt of governments and companies. Allowing long-term rates to fluctuate according to supply and demand is a risk, and in order to avert it, central banks could, like the Bank of Japan, decide to cap long-term rates. Again, neoliberalism would suffer a bend.

Conclusion:

- The end of neoliberalism? The expression may be excessive, but there are four shifts:

Firstly, less globalization of production chains, more regionalization with fiscal or political incentives for repatriation. Examples are numerous, from Japan's willingness to subsidize companies returning from China to Biden's declaration to reactivate the "Buy American Act."

The second shift is towards more interventionist states: from a cyclical point of view, they offer guarantees to companies. From a structural perspective, we are seeing a return to industrial policy, an acceleration of energy transition and a more rapid dissemination of digital technology. From a fiscal perspective, we should note both Biden's progress towards fairer taxation of GAFAM and multinationals, and the decision to increase the corporate tax rate in Britain, as will perhaps be the case tomorrow in the United States. From a sectoral point of view, the idea is to increase state control over GAFAM, to better regulate them, to monitor their dominant positions and to not let private actors decide on the application of the rules of democracy.

Thirdly, at the monetary level, the central banks which are certainly independent, had to shelve the monetarist doxa, the primacy of the fight against inflation, in order to increase the effectiveness of economic policies.

The fourth shift is that, at the company level, the objective of profitability must be reconciled with regard for the environment, a greater consideration of a balance between profit, human and social aspects, and therefore investments are likely to thwart the objective of maximizing short-term profits.

- But beware of excessive intervention and undue distrust of the private sector. As **Milanovic** rightly points out in his book "**Capitalism, Alone,**" there is no alternative to globalized capitalism. Capitalism will continue to play on competition and accumulation. Whether it is American-style capitalism or Chinese state capitalism, the driving force remains the same, it is profit and the maintenance of social stability requires growth.
- Liberalism is a flexible doctrine; it is able to adapt to a complex and changing reality. States need to be more involved because after the pandemic, the economic, social and psychological costs to young people will be heavy. The debt passed on to future generations has worsened and energy transition must be accelerated because, as we know from the World Health Organization (WHO), 12 million people worldwide die every year because of the environment. As the philosopher **Hans Jonas** wrote in **The Imperative of Responsibility: "Act so that the effects of your actions are not destructive of the future possibility of such life"**.

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