COVID-19 and the Hyper-Crisis of Neoliberalism: The Breakdown of Financialization

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ABSTRACT

The pandemic crisis produced by the SARS-CoV-2 virus, which causes the disease COVID-19, has rapidly exposed the limits of growth in neoliberal globalization, where financialization, far from bolstering global productive and commercial activities, has proved to be merely an efficient means of redistributing wealth towards society's wealthiest members. The paralysis of global productive chains and trade is exacerbated by the deterioration of financial-market assets and loss of liquidity, high levels of corporate and private debt in industrialized countries, and the prominence of the informal economy in developing countries. Taken together, these phenomena will make it impossible for the global economy to return to the way it functioned before the COVID-19 crisis. With the hyper-crisis of modern-day neoliberalism exacerbated by the pandemic, difficulties in the supply chains essential to global trade have increased the risks of default on sovereign and corporate debt markets. For both sectors – government and business – a temporary restoration of liquidity is mediated by issuing higher volumes of debt. In a context of uncertain recovery, falling investment, failing businesses, mass unemployment, and declining family income, this will shift insolvency from the real to the financial sector. The potential way out of this hyper-crisis of neoliberal capitalism should be a new development strategy based on domestic markets, which globalization has relegated to niches of industrial specialization dictated by the need for supplies in highly profitable productive chains in developed countries. The current crisis, with its attendant high unemployment and increase in poverty, will define workers' global struggle for better living conditions, thereby defining the structure of income distribution between capital and labor for the rest of the 21st century.

Keywords: Debt securities; financialization; global value chains; hyper-crisis; pandemic

THE CURRENT HYPER-CRISIS OF capitalism can be seen as an exacerbation of the functional contradictions manifest in the global economy since the 1970s, which peaked in the crisis of 2008. However, the unprecedented COVID-19 pandemic, like an echo chamber, has amplified the failures of the economic model that has driven the transformations associated with the global imposition of neoliberalism. In the network of global governance, organizations like the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), and the Institute of International Finance (IIF) are portraying this hyper-crisis of global neoliberalism as a crisis of imbalances between the productive and financial sectors (Gürcan 2019; Carlsson-Szlezak, Reeves & Swartz, 2020). In response to it, they are urging governments to inject money into their economies to minimize the lack of liquidity in businesses and keep economic activity afloat. Although such measures also seek to reduce large investors' exposure to the abrupt movements of capital which are occurring on securities exchanges, thereby preventing further contagion in the financial sector and safeguarding its tenuous stability, the argument holds up only on the assumption that the COVID-19 pandemic is an external shock. As such, it only impacts the markets indirectly through the shockwaves it sends through the economy, the psychology of investors, the financial markets, and the political leaders charged with making economic decisions.

In this context, the radical social distancing measures adopted in the attempt to contain the spread of the SARS-CoV-2 virus have caused violent disruptions in economic activity, which are resulting in loss of jobs and loss of income for businesses and families. This in turn is translating into tremendous stresses on patterns of local and global consumption. Thus, the imbalances in productive activity are deflationary.

However, this explanation ignores the real systemic nature of the hyper-crisis of modern-day neoliberalism. The appearance of COVID-19 has merely accelerated the breakdown of the agglutinating mechanisms of globalization in the real sector. It has revealed in uncompromising terms how governance based on financialization has failed to bolster global productive and commercial activities, and instead served only to advance a sharp redistribution of resources for the benefit of society's wealthiest. As a result, under the present crisis, the standard of living of workers and their families will fall to levels not seen since the Great Depression. Consequently, poverty and marginalization among the neediest, most vulnerable sectors of the global population will increase.

This article was prepared based on this fundamental reflection; it is divided into two sections. In the first section, we analyze the effects of the hyper-crisis of capitalism triggered by the COVID-19 pandemic on one of the foundations of neoliberalism, the paralysis of productive chains and the effects of this on the supply of goods on global markets. The second section examines the pressures the economic and social consequences of the pandemic are exerting on the financial markets, especially in the sovereign and corporate debt segments; without overlooking the fact that uncertainty and restrictions on liquidity are already affecting the functioning of commercial banks, presaging a rupture in global processes of financialization. Finally, we present some conclusions which will further help analyze this hyper-crisis of global neoliberalism and the network of financial governance.

The Productive Sector, Value Chains, and COVID-19

The crowning achievements of globalization, in the productive sphere, include global production chains whose links are articulated in different parts of the world based on the concordance in levels of productivity of the workforce in the various countries which form the essential parts of the structure. Such chains emerged in response to growing pressures on companies to lower the costs of supplying their products, leading them to design business strategies focused on creating lean manufacturing with hubs via delocalization and subcontracting. An important aspect of this process is that reducing costs depends fundamentally on eliminating or avoiding interruptions in supply chains. In this sense, the paralysis of trade flows produced by the ongoing hyper-crisis of neoliberalism shows that a large majority of global companies have failed to develop logistical strategies to mitigate their risk exposure in relation to the slump in productive activities in the Asian manufacturing sector. This is because, very few international conglomerates are fully aware of the networks and locations of all the companies which provide parts to their direct suppliers, due to their organizational scale (Haren & Simchi-Levy, 2020).

For example, in the textile and garment industry, retailers and marketers of clothing depend on full-package supply networks, in which they buy garments made in Asia from manufacturers in Hong Kong, Taiwan, and South Korea. When wage levels in those countries rose, manufacturers in East Asia started developing multi-layer global supply networks which allowed them to implement assembly bases in low-wage countries in Asia, Africa, and Latin America. Brand clothing manufacturers tend to create production networks in which garments are assembled using inputs imported from regional production networks. US manufacturers go to Mexico and the Caribbean Basin, while companies from the European Union work more with North Africa and Eastern Europe (Gereffi, 1999; Audet, 2004; Tewari M, 2008).

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With the hyper-crisis of global neoliberalism, these networks of manufacturers, differentiated and sustainable in a globalized economy operating without major disruptions, are facing choke points and bottlenecks which slow international production processes, resulting in job losses and slumping levels of global consumption and commerce. The situation has been exacerbated by the fact that the increasingly complex intersecting networks of global supply chains developed without a centralized administrative strategy capable of assessing the potential risks created by an interruption in the supply chain they depend on for essential inputs (Gertz, 2020). In parallel, the war among capitalists to generate ever-greater earnings has reached a point of saturation, and costs of research and development have risen; meaning that, in many traditional markets and activities, profit margins are far below the levels of the 1990s, when global value chains were in a process of full expansion.

With the opening of economies and the imposition of different export-led growth models (ELGM), global supply chains became differentiated among countries, resulting in a rapid succession of important shifts in positions of leadership in the global economy and trade. On the one hand, capitalist production (based on a wage-earning workforce) in the United States has ceased to be profitable several decades ago; since then, it has operated under a strategy which entailed increasing leveraging by families and companies to maintain domestic demand and consumption (Debt-Led Growth Model). In contrast, China, with its cheap and seemingly inexhaustible workforce, opted for an export-based development strategy (Strongly Export-Led Growth Model). Not only did it become a global manufacturing center; it displaced the U.S. as the global leader in commerce. Now, the paralysis of trade and the contraction of global investment produced by the COVID-19 pandemic is merely reproducing on a larger scale the choking of supply networks in global value chains which accompanied changes in global productive and commercial leadership.

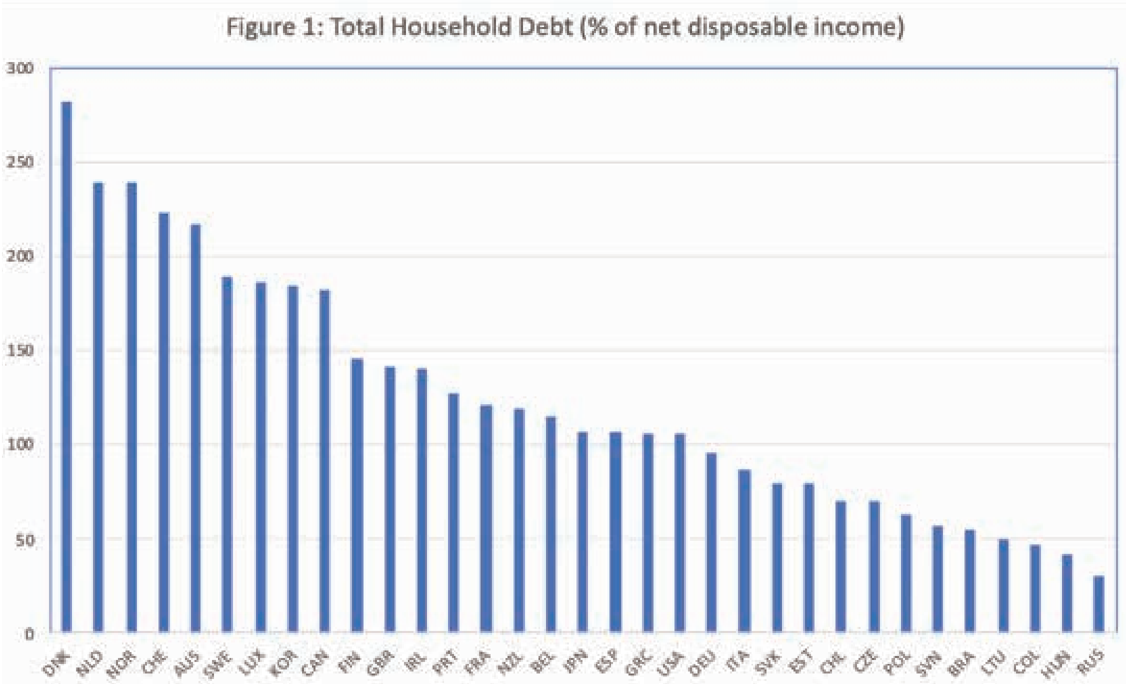
In Latin America, neoliberal globalization consolidated two models of specialization in production and participation in global commerce. The first, adopted in countries like Argentina, Brazil, and Chile, features a heavy reliance on natural-resource-based industries to produce products like vegetable oils, pulp and

(Xinhua/Wang Fei, 2020)

paper, iron and steel, fish meal, aluminum, orange juice, and other goods. Such industries are usually capital intensive and highly automated, using discontinuous-flow production processes and relatively little labor. The second, developed mainly in Mexico and some Central American countries, was characterized by the consolidation of a tendency toward specialization in assembly (contract manufacture) in industries which produce computers, televisions, video players, and garments for export to the United States. These sectors rely heavily on unskilled labor (Katz & Cimoli, 2001)

The industrialization patterns of recent decades produced two modes of participation in international commerce for the economies of Latin America. It is noteworthy that before the COVID-19 pandemic shook the very foundations of neoliberal globalization, Latin American countries had sought to maximize their economic openings through free-trade policies in an attempt to produce a dynamic change in the structure of local production, based on what was seen as the region's natural comparative advantage: cheap unskilled labor (Katz, 2001). This was despite the fact that sectors of the region's export industries produce with low added value. Consequently, the productive specialization of the aforementioned Latin American countries was associated with two different forms of subordinate insertion in global commerce. In the case of Argentina, Brazil, and Chile, commercial integration was accomplished through what is known as the Weakly Export-Led Growth Model; this did not lead to significant changes in their traditional productive structure, but did produce substantial external imbalances. In the case of Mexico and some countries in Central America, commercial development was based on a Debt-Led Growth Model, in which policies of stabilization and financial deregulation facilitated a massive influx of capital. This, through indebtedness, sustained private consumption (Lavoie & Stockhammer, 2012; Hein & Mundt, 2012).

These models of commercial insertion have led to a polarization of manufacturing production. The first pole of production rests on the sector of micro -small and medium- sized businesses which produce consumer goods of low capital intensity for domestic consumption; the second pole is made up of large multinational corporations which produce raw materials (iron and steel) and/or products assembled in the contract manufacturing (maquiladora) industry (e.g. computers, automobiles) for export. This produces highly differentiated growth rates, which in turn reflect the varying elasticities of demand on the domestic and foreign markets. The factor common to productive specialization and insertion of Latin American countries in international trade circuits is the precariousness of work. This became the basis for these states'



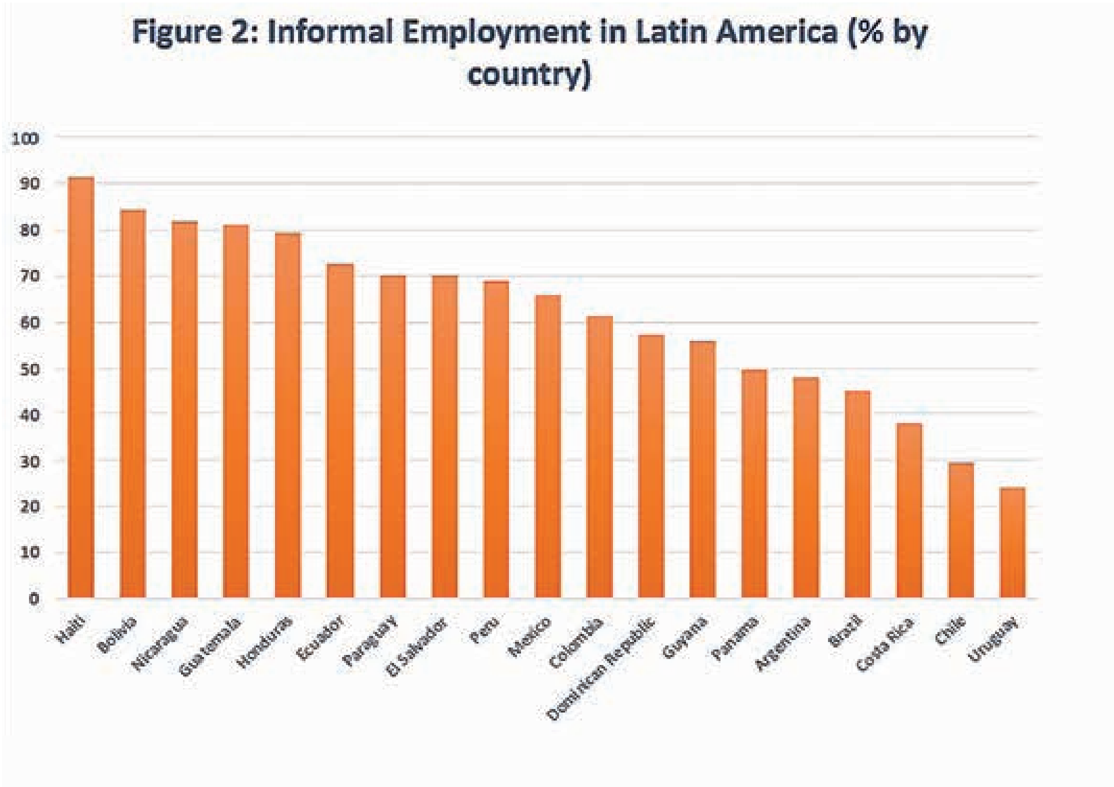
Graphic 1: Figures are for the latest available year (2015–2018).
Source: OECD, National Accounts Statistics: National Accounts at a Glance. OECD: https://stats.oecd.org/

competitiveness, which explains the substantial contraction in consumer goods at the global level since the 1970s.

From a broad perspective, the pandemic crisis has shown that consumption as an engine of growth, based on global production processes, has very narrow limits. On the one hand, the purchasing power of workers in developed countries is associated with their capacity for indebtedness. In most cases, the total debt of households greatly exceeds their total disposable income (Figure 1). In developing countries, boosting demand among the working class depends on their economies being able to increase formal employment to build a consumer base similar to those of developed countries, and thereby to establish sustainable debt mechanisms for wage earners to drive the growth of domestic consumption.

According to the International Labour Organization (ILO) (2020), around 6.7% of all jobs are expected to be lost in the second half of 2020 as a result of the economic impact of COVID-19; this is equivalent to 195 million full-time workers.[1] This in turn will cause a massive spike in household debt in relation to income, triggering a sharp drop in private consumption, especially among low-income, high-debt households. For example, "the bottom 90% of households by net wealth represents more than 72% of outstanding debt in the U.S., but controls less than 15% of financial assets" (IIF, 2020a). Thus, lower-income

1 The ILO estimates this figure based on variations in working hours; it reflects both layoffs and other temporary reductions in working time.



Graphic 2: Figures are for the latest available year (2012–2018). Informal employment includes own-account workers outside the formal sector, contributing family workers, employers and members of producers' cooperatives in the informal sector, and employees without formal contracts. This harmonized series on informality is derived from processing national household survey microdata files using a consistent approach. Source: ILOSTAT

families are more vulnerable to the economic consequences of the COVID-19 pandemic.

For Latin America, the direct impact of the pandemic on the job market is an upturn in levels of informal employment. While at present, 60% of the economically active population already depend on the informal economy, massive layoffs – some of which have already begun, and more are anticipated – will increase pressures on the job market, and by extension levels of informal employment. With the loss of jobs in the formal economy, consumption will fall even further from the levels seen before the pandemic (Figure 2).

Financial Markets, Financialization, and COVID-19

Another pillar of neoliberal capitalism shaken by the COVID-19 pandemic is the global network of financial markets; particularly sovereign and corporate debt markets, and, by immediate contagion, private banking. In other words, the basic network of institutions of neoliberal financial governance on which global financialization has relied over the last 40 years. This is understood as the unbalanced relationship between the financial and real sectors of economies, which has been identified within globalized capitalism as the tendency for the value of transactions in the financial sector to greatly exceed the value created in the real sector (Toporovski, 2000; Epstein, 2005; Bellamy & Magdoff, 2009; Lapavitsas, 2011). This gap has widened as policies of financial liberalization and deregulation – encouraged under the Washington Consensus by the pillars of global financial governance, the IMF, OECD, and IIF – were complemented by the opening of capital accounts, favoring the global movement of capital and the execution of cross-border financial transactions.

Under neoliberal globalization, financial transactions – purchases of instruments, debt, and loans for purposes other than production or commerce – have gained a never-before-seen autonomy from the real sector.

Following this approach, the interrelationships between financial markets, institutions, and instruments were linked to a system which depended for its smooth functioning on the existence of exchange stability; sufficient liquidity in the interbank market; and low, stable exchange rates which would permit both validation of debts and payments and the valuation of portfolio investments in the financial market.

Under neoliberal globalization, financial transactions – purchases of instruments, debt, and loans for purposes other than production or commerce – not only gained a never-before-seen autonomy from the real sector. They became a source of speculative earnings for large investors and global companies able to benefit from movements of capital and their effects on interest and exchange rates; variables which directly impact the behavior of prices of stocks, securities, and credit. At the other extreme, in the case of workers, the global persistence of informal employment, which comprised almost 50% of the total active workforce, and inequalities of earnings between the top executives of large companies and the lowest salaries of the rest of the workforce, were compounded by other phenomena which boosted indebtedness among workers and their families. The relocation of companies and policies of labor flexibilization, based on outsourcing, exacerbated the loss of collective bargaining capacity and contributed to the weakening of job markets; this in turn caused a cheapening of labor and a drop in its share of salaries in global income from the levels seen in the 1980s. Thus, families with formal jobs increasingly took on debt as a complementary means of maintaining their level of consumption (ILO, 2008; 2011, 2013; 2017).

In the global financial crisis of 2008, the bursting of the real-estate bubble was first felt in banking circles. Due to the ties among intermediaries (mortgage, commercial, and investment banks, and institutional investors), this evolved into a crisis which dragged down the leading banks in developed countries and their institutional investors (insurance companies, investment funds, and pension funds). With the collapse of the network of bank obligations and the disappearance of liquidity in interbank markets, the crisis spread to the real sector, affecting all companies which had made investments in structured products, collateralized debt obligations (CDOs), and other derivatives (swaps, forwards, options, etc.), or which had taken part in processes of securitization; that is, debt transfer strategies which were incorporated in packages tradable on the stock exchange.

In fact, the world economy never overcame the effects of the 2008 crisis. To a great extent, the funds from government bailouts and monetary policies of quantitative easing, whose goal was to boost liquidity in markets by increasing bank reserves, served instead to clean the balance sheets of large intermediaries affected by the crisis. There followed a round of mergers and acquisitions in the global banking industry, augmenting its international concentration. Thus, the assets of the world's 10 largest banks – 4 of them Chinese, 1 Japanese, 2 American, 1 English, and 2 French –add up to U.S.$28.54 trillion (Kim, 2016; Rao-Nicholson & Salaber, 2016). Amid widespread job losses and the closure of companies resulting from the COVID-19 pandemic, past-due loan portfolios of the highly concentrated international banks will increase exponentially, affecting their financial gains and the availability of credit to productive sectors. This will not only contribute to the ongoing global recession and stagnation, but also erode the already precarious stability of international financial systems.

Unlike the 2008 financial crisis, the present hyper-crisis of neoliberalism has seen the composition of debt shift from bank credit to bonds. As a result, the fundamental uncertainty in financial activities today is produced by the high levels of debt in the form of bonds. This has sowed panic among large investors, who do not expect that in the short or medium term, their issuers – corporate and sovereign debt – will be able to redeem their obligations; even more so when the long-term outlook (between three and five years) does not include forecasts which allow them to anticipate achieving a minimum balance between risk and yield.

Amid the current hyper-crisis, obligations in the form of government and corporate bonds are collapsing because there are no prospects for long-term profitability for investment funds and large institutional investors worldwide. Therefore, on the one hand, problems of public liquidity are increasing as governments have had to make extraordinary expenditures on healthcare and unemployment benefits; on the other hand, corporate revenues are falling due to supply bottlenecks in global value chains and the paralysis of global trade, combined with falling demand due to layoffs and confinements. This has reduced opportunities to diversify investments to their lowest possible level.

The evolution of debt figures between 2008 and 2019 is more than illustrative. In this period, global government debt doubled, reaching U.S.$70 trillion, while non-financial corporate debt reached U.S.$74 trillion. Considering all economic sectors, in 2019 alone debt rose by U.S.$10 trillion to reach U.S.$255 trillion, almost 322% of global GDP. One could only anticipate the further exacerbation of these conditions in the post-coronavirus period.

In Latin America and the Caribbean, growth of debt through issuance of sovereign and corporate bonds has also been significant, reaffirming the subordination of real-sector activities to the flows of liquidity between global financial centers. The region's sovereign debt rose from U.S.$10.2 billion to U.S.$42.4 billion between 2008 and 2019, and corporate debt surged from U.S.$8.8 billion to U.S.$72.6 billion in the same period. Most importantly, the average gross public debt of central governments

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throughout the region grew to 44.8% of GDP in 2019, an increase of 14.4 percentage points compared to 30.4% of GDP in 2008 (IIF, 2020b; ECLAC, 2019, CEPAL, 2020).

Governments and corporations face different problems. The former are experiencing rising fiscal deficits and financial demands to confront the COVID-19 pandemic, implying a new wave of sovereign debt which, in a context of contracting global liquidity, means greater stresses on global securities markets and reduced access to liquidity on secondary markets.

This is critical because, to sustain the financial lines of support to business, governments have to trade sovereign bonds, since parts of their central bank reserves are invested in government debt issued by other countries. The problem is that such debt is being sold at the same time as higher-risk variable-income assets. Consequently, the guarantees for government loans, which allow companies to acquire debt on the financial markets, cannot be enforced; in other words, they must be written off and the resulting losses will then appear on government balance sheets, giving a further boost to the spike in all countries' sovereign debt.

In the case of corporate debt, the core problem is that corporate fixed-income securities tend to be more closely correlated to stocks. Therefore, when stocks lose value, historically bonds also fall, and high-yield bonds tend to drop (credit spreads expand) much more than investment-grade bonds (McKinsey Global Institute, 2018; Çelik, Demirtaş & Isaksson, 2020). In this context, even commodities like gold have not been spared from massive sales and falling prices. Therefore, the risks of investments other than sovereign and corporate debt are also extremely high as a result of the COVID-19 pandemic.

For corporate debt, an additional risk derives from economic and financial damage to supply chains. This results from potential insolvency preventing clients from paying their debts and uncertainty in establishing credible contracts in terms of compliance between companies, suppliers, and clients. In addition, prices for insurance policies and premiums corresponding to commercial hedging strategies will reach unsustainable levels.

In the context of a highly concentrated global banking sector – which, combined with securities exchanges, is another of the operational pillars of financialization – the instability of bank revenues, derived from noncompliance with contractual terms for debt and payments between banking intermediaries and large companies, exposes the fragility of access to liquidity in the global banking market. Due to the damage the COVID-19 pandemic is inflicting on the payment capacity of debtors, whether companies or families, the quality of bank assets will diminish as banks' revenue streams dry up due to defaults on payments and falling fees and rates. The harmful effects of the COVID-19 pandemic range from loss in value of companies' fixed assets and sales, loss of family earnings, and unemployment, to lower consumer spending on retail businesses.

Even if interest rates remain low, any increase in loan volumes may result in higher delinquent portfolios for banks. Thus, bank losses will rise in parallel to the problems of other sectors of the economy: small businesses, tourism, hotels, entertainment, and air transportation. A substantial slowdown in investment banking activity is also to be expected due to the cancellation of investment projects by companies in global manufacturing, wholesale commerce, aviation, and energy; particularly the oil and gas sector, which is immersed in an ongoing crisis that has had an unprecedented impact on production and prices.

As a result, the cumulative structural imbalances between the real and financial sectors in the wake of the 2008 crisis have merely been augmented by the slowdown in business activity, rise in unemployment, and loss of earnings resulting from the impact of COVID-19 on all sectors of the economy. Thus, the harm to economic activity is global. Advanced economies are expected to suffer an average GDP contraction of 6.1% (6.0% for the U.S., 7.5% for the Eurozone). For emerging markets and developing economies, anticipated losses are in the order of 0.1%; in Latin America and the Caribbean, GDP is expected to fall by 5.3% (CEPAL, 2020).

The tensions COVID-19 has created in the network that has supported financialization in the economies of countries, businesses, and families, have various impacts. Based on the scale of the damage caused to financial markets, we can expect to see further questioning of the institutions in the financial arena which have supported neoliberal governance and its policies of financial deregulation and liberalization, fomenting cross-border financial businesses which produced massive speculative gains to the detriment of the real sectors of economies. The process began with banking and non-banking financial intermediaries expanding their operations without seeing massive flows of financing and funding for investments in the areas of production and circulation. Then came the deregulation of operations, with financial instruments and securities used for acquisition of assets with debt; not to increase installed capacity, diversify markets, or increase investment volumes, but so that large companies could have financial assets on their balance sheets with which to speculate at times of greater financial instability and reduction in global liquidity.

Also, funding of operations on markets for debt instruments with government guarantees will be tested, to the extent that such guarantees will prove unenforceable and be added to ballooning public debt and financial obligations assumed by governments. Thus, the obligation of states to operate on the basis of tax surpluses is losing the positive economic meaning which the institutions of global financial governance gave it for decades. Now more than ever it is crucial to recognize the need for fiscal spending and monetary policies to be subject not to the dogma of a balanced budget, but the real need for economic growth.

In this sense, the results of efforts to reactivate the global economy are uncertain; they will depend on the world's ability to create a strategy for economic growth different from that which preceded the hyper-crisis of neoliberal capitalism triggered by the COVID-19 pandemic.

Conclusions

For at least 40 years, globalization favored the consolidation of neoliberalism, which found in the creation of global value chains and the opening of national economies: the perfect means to differentiate countries' spaces of reproduction in productive and commercial terms. Most developed countries made global commercial networks and control of markets the source of expansion and profitability for their companies. However, emerging and developing countries – with some exceptions in emerging countries which rapidly took the lead in productive industry and commerce – assumed subordinate roles in supply networks within those chains and focused on producing raw materials or products with low added value. Against this backdrop, the outbreak of the SARS-CoV-2 virus and the COVID-19 pandemic has accelerated the breakdown of lines of communication in global governance, especially in supply chains between developed and developing countries which sustained global value chains. This will exponentially boost unemployment and plunge into insolvency households which have maintained their level of spending by taking on debt.

But the COVID-19 crisis is also torpedoing the functioning of financial markets; further revealing the limits of financialization, which were already visible in the crisis of 2008. The immediate economic perspective prefigures severe problems for sovereign and corporate debt markets, but also for the commercial banking sector: to face the crisis, governments are increasing their sovereign debt even more and corporate securities are rapidly losing value on debt markets worldwide. In both cases, a temporary restoration of liquidity is limited to issuing large volumes of debt. In a context of uncertain recovery, falling investment, failing businesses, massive job losses, and falling family income, this is causing the crisis to shift from the real to the financial sector as levels of insolvency rise.

The potential solution to this hyper-crisis of neoliberal capitalism should be a new development strategy based on domestic markets, which globalization has relegated to industrial specialization dictated by needs for supplies in highly profitable production chains in developed countries. This is despite the fact that domestic production costs may initially be higher than those achieved to date in globalized production. Growing domestic markets is at loggerheads with the interests of huge, highly concentrated, and centralized globalized companies, which have no ties to the development strategies of nation states. Thus, the COVID-19 pandemic has cast doubt on the criteria of efficiency of international competitiveness and has once more underscored the need to make the economic development of nations the fundamental goal of public policy.

The challenges are daunting. On the one hand, the financial architecture must be redesigned to reverse the supremacy of the financial sector over the real sector of the economy, which requires giving global finance new content. On the other, the prevailing contradictions of neoliberal governance, in terms of the tensions between the needs of major global economic players and the international workers' struggle for better living conditions, must be exploited: this hyper-crisis of global neoliberalism will force us to redefine the structure of income distribution between capitalists and workers for the remainder of the 21st century.

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