Unsteady as she goes – The world economy is locked into a crisis that is far from over

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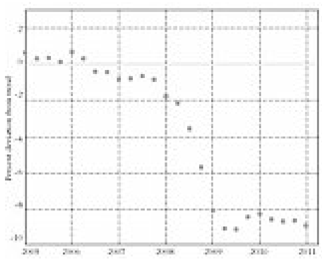
For a while the high priests of capitalism congratulated themselves on the robustness of the economic recovery. Financial markets soared and there was euphoria about the robust expansion of the "emerging market" economies of the Global South. But in the past few weeks it has begun to sink in that the world economy is locked into a crisis that is far from over.

This reality has penetrated even the inner sanctums of the economics profession, where it is rarely admitted that markets can do any wrong. Robert Lucas, who received what is (rather dubiously) called the Nobel Prize for Economics in 1995 for his services to the cult of the market, gave a recent lecture in which he noted that the American economy normally grows by around 3 percent a year. The Great Depression of the 1930s marked an enormous deviation from this trend—real gross domestic product fell by 34 percent between 1929 and 1934. But what Lucas calls "the current US depression" represents another major deviation, though not as great, since growth is just under 10 percent below trend: the "Depression of 1930s and the current one are both much deeper, more prolonged than typical". [1]

Lucas notes that, as in the Great Depression, the present crisis started in the banking system, though this time the American state didn't sit by, but pumped in vast amounts of liquidity, preventing total collapse. Lucas supports these policies, but he argues that business investment and consumer spending are being held back by the prospect of higher taxes, Barack Obama's healthcare reform and the imposition of very mild new controls on financial markets, all of which will turn the United States into a European-style welfare state. This is ridiculous. Gavyn Davies points out that, "as yet, there has been no increase in taxation, on the rich or anyone else. Nor have the Obama administration's medical and financial sector reforms really taken effect. It would take a remarkably farsighted private sector to have already reacted adversely to this set of long-term reforms, even if they might do so eventually". [2]

Figure 1: US recession: GDP deviations from trend



Source: Lucan, 2011

All the same, the global economic recovery does look like it's running out of steam. In recent weeks the US, the eurozone and Britain have all released data showing that growth is slowing. There is also increasing evidence that China, whose helter-skelter expansion has driven the recovery, is slowing down, though this means it is forecast by Goldman Sachs to grow at 9.4 rather than 10 percent this year. [3]

As Lucas points out, the problem isn't lack of money. Global profit margins are estimated to have risen by 40 percent in 2010, and are forecast to rise by another 11 percent in 2011. [4] So companies are flush with money. According to the *Financial Times*, "less than three years on from the dark days of the financial crisis, companies are sitting on a bulging war chest of several thousand billion dollars of cash". But it also reports that, burned by the financial crisis and worried about the future, they are wary about opening their coffers to spend on takeovers or new investments. [5]

The official explanation for the growth slowdown is the impact of various external "shocks"—the rise in the oil price, for example, and the disruption caused to global supply chains by falls in Japanese production after the Tohoku tsunami. No doubt these played a part, but the reality is that the world economy is still deeply constrained by the effects simultaneously of the crisis and of the measures taken to prevent it becoming even worse. The financial bubble that precipitated the crisis was driven by massive borrowing by states, banks and individual households. All are now trying to borrow less and save more. Since higher saving reduces effective demand for goods and services, the economic consequences are negative.

Thus take the American housing market, incubator of both the bubble and the crash. Figures released at the end of May show housing prices have suffered a double-dip—in other words, having fallen and then recovered, they are falling again. House prices are now 33 percent below their peak in 2006, a steeper fall than the 31 percent drop during the Great Depression. The problem is partly oversupply—ten million vacant homes, 2.3 million in foreclosure because their owners couldn't keep up their mortgage repayments. Demand is also falling because the high level of unemployment encourages young people to stay with their parents rather than buy their own home. [6] Rising house prices played a crucial role in driving higher consumer demand (since they allowed households to borrow and spend more) during the boom of the mid-2000s. [7] So an important engine of economic growth is broken—not just in the US, but in countries such as Britain, southern Ireland and Spain that also experienced property bubbles in the previous decade.

The so-called crisis of sovereign debt falls into the same pattern. Financial markets have been targeting governments that they believe can't pay back their debts. This process has gone furthest in the eurozone, where Greece, Ireland and now Portugal have been placed under the supervision of the "troika" of the European Central Bank (ECB), the European Commission and the International Monetary Fund to ensure that they implement savage austerity policies in exchange for financial support.

These arrangements represent a significant restriction of national sovereignty: for example, the Financial Times reported in late May that "European leaders are negotiating a deal that would lead to unprecedented outside intervention in the Greek economy, including international involvement in tax collection and privatisation of state assets, in exchange for new bailout loans for Athens". [8] In fact, there are plenty of precedents from the 19th and early 20th centuries, when consortiums of European states took over financial control of indebted states such as China, Egypt and the Ottoman Empire.

Predictably, the "rescues" have simply made it harder for the victim states to repay their debts. Austerity measures cut economic output and so debt rises in comparison with national income, pushing the burden of repayment to impossible levels: the Greek economy is forecast to shrink by 3.5 percent this year, after contracting by 4.4 percent in 2010. [9] Greece is universally expected to default on its debts. This is a problem for the German and French banks that lent heavily to Greece and the other smaller eurozone states during the credit boom of the 2000s.

Moreover, if default spread beyond Greece, it might wipe out a large chunk of the capital of the ECB, the eurozone's ultra-orthodox guardian of stability. As part of the highly dysfunctional "rescue" of Greece in May 2010, the ECB agreed to prop up the weaker eurozone governments by buying their bonds. According to the *Financial Times*:

"*Under the securities markets programme, it acquired €75 billion in government bonds, almost two-thirds of which are Greek. It also has on its books perhaps €150 billion in other financial assets put up as collateral by Greek banks, much of which is backed by Athens.*

Should Greece default, the value of those holdings would decline sharply. The ECB bought the bonds at market prices, which assumed some risk of default, so the immediate losses might be manageable. JPMorganChase calculates that, with €81bn in capital and reserves, eurozone central banks could withstand even a 50 percent "haircut", or discount, on Greek bonds. But if write-downs on Portuguese and Irish bonds followed, eurozone governments might be forced to provide billions of euros to rebuild the ECB's balance sheet." [10]

Both the eurozone crisis and the US housing double-dip demonstrate how badly damaged the global financial system was by the bubble and the crash. But we can also see how state policies—particularly the drive to austerity—have complicated the situation. Elsewhere government intervention has had different but also destabilising consequences. Chinese banks—under government orders—made $1.4 trillion worth of new loans in 2009, which helped to drive the economy, along with those supplying it with raw materials and components, out of recession.

The apparent success of China and other "emerging market" economies in weathering the Great Recession has played a critical role in boosting financial markets after their recovery from the crash. A fair chunk of the cheap money created by Western central banks has flowed into the big economies of the Global South, pushing up their exchange rates and thereby increasing the problems with which their industrial firms have to grapple in fending off cheap imports from China (whose currency is, of course, pegged against the dollar). Much of the excitement in the financial markets this year has been generated by firms trading in commodities—for example, the stock market launch of the Swiss-based trader Glencore.

Fast growth in the "emerging market" economies has helped to pull up the prices of food, oil, and other raw materials. In 2010 China became the largest consumer of energy, with 20.3 percent of global consumption (the US share was 19 percent). [11] The IMF commodity price index rose by 32 percent between July 2010 and February 2011, with the food price index rising even faster, by 41 percent. [12] The resulting pressure on living standards helped to precipitate the revolutionary wave in the Arab world. This is a political and economic problem as well for the countries at the heart of the recovery. The *Financial Times* recently reported: "Year to year figures for the latest months available show inflation in fast-growing BRIC nations of 6.5 percent in Brazil, 8.7 percent in India, 9.6 percent in Russia and 5.3 percent in China. The International Monetary Fund predicts this year's emerging market average rate will be 6.9 percent, compared with just 2.2 percent for the developed world". [13]

In China food prices are rising at twice the overall inflation rate, and a bubble has developed in the property market. The inflationary surge is stoking social tensions—thus higher fuel prices goaded lorry drivers in late April to go on strike, and blockade Shanghai's port of Baoshan, clashing with riot police. Then in mid-June migrant workers clashed with police in the southern factory town of Zengcheng after security guards attacked a pregnant street hawker. The government, nervous about the forthcoming handover to a new generation of party leaders, is trying to cool the economy down by, for example, increasing interest rates. But there may be a bigger bust on the way. Nouriel Roubini, respected for his accurate forecast of the financial crash, has been arguing for some time that China has been developing its own bubble:

"*China's economy is overheating now, but, over time, its current overinvestment will prove deflationary both domestically and globally. Once increasing fixed investment becomes impossible—most likely after 2013—China is poised for a sharp slowdown… China has grown for the last few decades on the back of export-led industrialisation and a weak currency, which have resulted in high corporate and household savings rates and reliance on net exports and fixed investment (infrastructure, real estate, and industrial capacity for import-competing and export sectors). When net exports collapsed in 2008-2009 from 11 percent of GDP to 5 percent, China's leaders reacted by further increasing the fixed-investment share of GDP from 42 percent to 47 percent.*

Thus China did not suffer a severe recession—as occurred in Japan, Germany, and elsewhere in emerging Asia in 2009—only because fixed investment exploded. And the fixed-investment share of GDP has increased further in 2010-2011, to almost 50 percent.

The problem, of course, is that no country can be productive enough to reinvest 50 percent of GDP in new capital stock without eventually facing immense overcapacity and a staggering non-performing loan problem. China is rife with overinvestment in physical capital, infrastructure, and property. To a visitor, this is evident in sleek but empty airports and bullet trains (which will reduce the need for the 45 planned airports), highways to nowhere, thousands of colossal new central and provincial government buildings, ghost towns, and brand-new aluminium smelters kept closed to prevent global prices from plunging." [14]

The fact that Roubini got the financial crisis right doesn't mean he will also get China right. There is an alternative scenario—very much pushed by the leadership of the Chinese Communist Party—according to which the economy will gradually reorient towards the domestic market on the basis of a new model that gives priority to consumption over investment and exports. But this isn't a simple matter of shifting policy. Institutionalised class interests are also involved. Herman Schwartz writes:

"The largest economic benefits from growth have gone to the children of the party elite, who have constituted themselves as a new economic elite… These children also hold 85-90 percent of the key positions in the five most important industrial sectors: finance, foreign trade, land development, large-scale engineering and securities. Their control over these positions has assured their wealth in a society in which markets largely function via contacts, not contracts. From their point of view, profitability ultimately rests on exports rather than on a brutal struggle in a Chinese market characterised by no brand loyalty, no product differentiation, and workers' emerging ability to push wages up." [15]

Now there are counter-trends. The Chinese authorities are nudging the renminbi very slowly up on the foreign exchanges and beginning to allow it to be used in bond issues and the like, primarily in Hong Kong, which still has its own financial system. Renminbi deposits in Hong Kong have risen from 90 billion in the middle of last year to 510 billion ($78.7 billion) at the end of April, though this still represented only 7 percent of total deposits. [16] These are essential steps if the renminbi is to join the dollar and the euro as an international reserve currency used by foreign investors, which would also require a move away to pegging it to the dollar at an exchange rate that favours exporters. [17] The sheer scale of China's growth is widening the domestic market, and encouraging both local firms and transnationals to fight for market share. But whether changes of this kind will turn the super-tanker of the Chinese export economy round quickly enough to avoid the crunch predicted by Roubini is quite another matter. And if China does suffer even a significant growth recession, where output doesn't fall but the rate of growth does, all bets are off.

Worries about the state of the Chinese economy were one factor in the abrupt sell-off in early May that saw the prices of oil and other commodities fall sharply (though oil rose again a month later after Iran and Venezuela blocked Saudi Arabia's attempt to get the Organisation of Petroleum Exporting Countries to agree to raise output). There is increasing evidence that the global commodities market is now well integrated in the financial markets. A recent study has found that the futures prices of non-energy commodities have tended to rise and fall since the early 2000s in line with the price of oil, something that hadn't been seen since the years of high inflation in the 1970s and early 1980s. Part of the explanation may be the increasing investment (up from $15 billion in 2003 to $200 billion in 2008) in bets on the commodities markets. [18]

Price movements in other words are becoming driven less by changes in supply and demand than by flurries of speculation—something that was already evident in the sharp fall in the oil price as the financial crash gathered pace in the autumn of 2008. The commodities sell-off is therefore a sign that the markets themselves are beginning to get worried.

This situation poses a dilemma for the US Federal Reserve Board and the other leading central banks that now play the main role in managing advanced capitalist economies. The uptick in inflation is putting them under pressure to move away from the ultra-cheap money policies that they embraced in response to the 2008 crash. The ECB has already started to push up interest rates. But an end to cheap money might kill off an already fragile recovery. The Fed's quantitative easing programme (QE2), under which it decided to pump $600bn into the financial system, is due to finish at the end of June. But, given complete gridlock in the US Congress (where Republicans who won control of the House of Representatives thanks to the Tea Party movement are demanding massive spending cuts), the electronic equivalent of printing money may be the only way of propping up the economy if it looks like sliding back into recession. There is growing talk of "QE3". The managers of global capitalism have a very limited set of options.

Britain: intimations of mortality?

Britain is very much part of this broader economic picture. In the first quarter of 2011 even the Greek economy grew faster. Growth in manufacturing, which had been stronger than in the rest of the economy because the 25 percent fall in the pound since 2008 has cheapened exports, is slowing down. The combination of spending cuts, wage freezes, tax increases and higher inflation is squeezing living standards brutally. Even the government's tame Office for Budget Responsibility predicts that spending in 2015 will be only 5.4 percent higher than the peak of 2008. The *Financial Times* commented:

"In fact, before the 1970s, you have to go back to the 1900s for a similarly slow improvement in living standards… Before the early 1900s, only the 1840s saw similarly slow spending growth, although figures available for the period are sketchy. A slowdown in international trade and a sharp reduction in overseas demand for British goods, combined with a series of poor harvests, helped to produce a deep recession from 1840-42." [19]

The rationale for the Conservative-Liberal coalition's austerity programme was that the economic slack creating by making sharp cuts in public spending would be taken up by more robust private sector growth. But all the signs are that the private sector is being dragged down by the squeeze in the public sector. By early June the Observer was reporting:

"*Some of Britain's leading economists are warning the chancellor, George Osborne, that the economy is too fragile to withstand his drastic spending cuts and that he must draw up a plan B.*

Experts, including two former Whitehall advisers and two signatories of last year's high-profile letter backing the Tories' cuts, have told the Observer that they have profound concerns about the direction of Treasury policy." [20]

Osborne continues to dismiss the necessity of a plan B for stimulus measures if the economy slid back into slump, an idea first mooted by the cabinet secretary, Gus O'Donnell, in December. But the pressure on the government to change course is likely to grow. Its other big area of vulnerability is, of course, the National Health Service, where Andrew Lansley's proposals massively to extend the market have run into huge opposition. The Liberal Democrats have made rolling back these plans the test of their new assertiveness after the massacre they deservedly suffered in the May council elections.

But the Tories' hand within the coalition has been strengthened by the election results. After losing nearly 700 seats, the Lib Dems are in no position to threaten to bring the government down, since they would be massacred in the subsequent general election. Labour was the main beneficiary of the Lib Dem wipeout, ending up narrowly ahead in vote share, with 37 percent to the Tories' 35 percent and just short of a majority in the Welsh Assembly. But the Tories could still take some comfort from the results. Not only were they satisfied, as the most wholehearted opponents of the Alternative Vote, with the crushing victory of the No campaign in the referendum but, as John Curtice points out:

"*At roughly 800 seats, Labour's net gains fell short of the target of 1,000 seats that some commentators suggested the party needed to show it really was back on the road to recovery. Part of Labour's problem was that its vote increased most in traditional Labour territory—the north and working class seats with relatively large levels of unemployment—a pattern that reduced the yield its advance produced in terms of seats.*

The Conservatives suffered in Scotland too, leaving the party with its worst ever result in Scotland. But in Wales the party enjoyed a modest increase in support and claimed second place in the Assembly from Plaid Cymru. Meanwhile its performance in the local elections was on a par with last year's. For every seat it lost to Labour it seemed to gain one from the Liberal Democrats, leaving the party with a surprise net increase in seats. For a party in government, the Conservatives will doubtless see this as an achievement." [21]

And of course in Scotland, where the polls initially predicted a Labour victory in the elections to Holyrood, instead it suffered a thumping defeat at the hands of the Scottish National Party. The result was a triumph for Alex Salmond's strategy of carefully positioning the SNP slightly to the left of a lacklustre Scottish Labour leadership, and therefore harvesting the strongly social democratic loyalties of the Scottish electorate. But it also underlined that the electoral base of the two big parties remains much weaker than it was in the decades immediately after the Second World War. Because they are less tightly bound to one of these parties, voters are much more volatile. Richard Seymour elsewhere in this journal emphasises the limits of the revival in Tory fortunes under David Cameron. Using Nick Clegg as the fall guy worked this time for the Tories, but it may not work again. A succession of U-turns, over not just the NHS but also, for example, sentencing policy and benefit cuts, has underlined the fragility of the coalition despite the front offered by Cameron and Osborne.

All the same, Labour's less than stellar performance is increasing the pressure on Ed Miliband from the Blairite right. Never really reconciled to his victory in the leadership election last autumn, they continue to repeat the mantra that the only way to beat the coalition is to press on with Blair's agenda of neoliberal "reform". His response, to embrace the "Blue Labour" agenda of Jon Cruddas, Maurice Glasman and others, seems like an alternative way of tacking right, by adopting a Labourist version of Cameron's Big Society emphasis on community, and in the process pandering to the reactionary prejudices that the "Blue Labour" stereotype attributes to white working class people. [22]

This means the developing resistance to austerity can't look to the leadership of the Labour Party for support or direction—though huge numbers of Labour supporters are involved in this resistance. The trade union leaders, by contrast, have been forced to move because of the very direct threat that Osborne's cuts represent to large portions of their base. The giant TUC march on 26 March brought the organised working class onto the streets in unprecedented numbers. The critical question, as ever, remains whether the very broad opposition to austerity can be translated into real collective action in which workers use their economic muscle to block the coalition's offensive.

As Martin Smith shows elsewhere in this journal, the conservatism of the union bureaucracy remains a huge obstacle to such action developing. But the bureaucracy is itself divided and under pressure to act. As we go to press, large numbers of public sector workers are due to go on strike on 30 June, mainly in response to attacks by the government and employers on their pensions. The signs are that the British workers' movement is entering a more turbulent phase.

These developments coincide with a more general uptick in resistance in Europe, with the massive youth protests in Spain and Greece, and, of course, as Anne Alexander's article on Egypt reminds us, the revolutions in the Arab world continue. In Britain the same radicalisation that was expressed in the student protests at the end of last year has been in the efforts at direct action on 26 March and the wave of SlutWalk anti-rape demonstrations.

One striking feature of the Spanish protests was the rejection of political parties and even the trade unions. This no doubt has much to do with the fact—in Spain as elsewhere—that the political elite remains locked into the neoliberal consensus, and with the failure of the union bureaucracy (despite last autumn's general strike) to mount sustained resistance to austerity.

But there is a broader factor at work as well. Recent mass struggles—including the student movement in Britain and the Arab revolutions—have been marked by the relative lack of involvement of substantial political forces (with the important, but complicated, exception of the Muslim Brotherhood in Egypt). The problem here isn't simply the general weakening of political parties, but also the fact that what were the great ideologies of emancipation in the 20th century—socialism (the workers' movement), nationalism (the anti-colonial struggles), liberalism (the revolutions of 1989)—have much less of a hold than they did a generation or two ago. Liberalism has been discredited by the experience of neoliberalism, and in the Middle East by its association with US imperialism; socialism has had to carry the burden of Stalinism and social democracy; and nationalism has been caught up in the failure of so many postcolonial regimes. These experiences are part of the story of the erosion of mass parties in recent decades.

None of these ideologies are in any way dead, and all are capable of revival. But the weakening of their influence means that mass movements tend not to have any clear ideological articulation. This doesn't mean that these movements are purely spontaneous or that no political activists are involved in them. On the contrary, revolutionary socialists, for example, can be proud of the role they have played in struggles as diverse as the British student movement and the 25 January Revolution in Egypt. But, for much wider layers, suspicion of all political organisation and the belief that movements can sustain themselves through their own horizontal networks have become a kind of common sense. This then helps to sustain the kind of illusions in social media so effectively criticised by Jonny Jones in our last issue. [23]

None of this alters the fact that we are experiencing an international renewal of struggle that continues the process of radicalisation beginning with the Seattle protests in November 1999. But revolutionary socialists have to recognise that this radicalisation doesn't automatically lead those affected towards Marxism in the way that tended to happen during its predecessors in the 1930s and the 1960s and early 1970s. We have to fight to make our voices heard. This is no great injury—no one has the right to imagine they are the voice of history, but it is a challenge.

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Footnotes

[1] Lucas, 2011.

[2] Davies, 2011.

[3] http://blogs.ft.com/beyond-brics/2011/05/24/better-late-than-never-goldman-cuts-china-forecast/

[4] Jackson, 2011.

[5] Milne and Sakoui, 2011.

[6] Harding, 2011 and Kapner and Politi, 2011.

[7] See, for example, the data in Duménil and Lévy, 2011, chapter 10.

[8] Spiegel, Peel and Atkins, 2011.

[9] Hope, 2011.

[10] Atkins, 2011.

[11] Pfeifer, 2011.

[12] IMF, 2011, pp30, 37.

[13] Wagstyl and Wheatley, 2011. In April South Africa joined the four original BRIC states (Brazil, Russia, India, and China).

[14] Roubini, 2011.

[15] Schwartz, 2009, p168.

[16] Konyn, 2011.

[17] See the analysis, sceptical about the claims that the renminbi is set to replace the dollar as the main reserve currency, in Eichengreen, 2011, pp143-147.

[18] Tang and Xiong, 2011.

[19] Pimlott, 2011.

[20] Stewart and Boffey, 2011.

[21] Curtice, 2011.

[22] Wintour, 2011. For a critique of “Blue Labour”, see Rooksby, 2011.

[23] Jones, 2011.