

Officials discuss global economic crisis - Not a "new economic paradigm" but old disorders

Nick Beams
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For the past 12 months economic commentators and pundits in the United States have issued reassuring statements that the American economy will not be adversely affected by the Asian crisis, that its deflationary effects will even be beneficial, and that there is nothing on the horizon to cloud the picture of continuing economic growth and rising share values. Some even went as far as to suggest that a 'new economic paradigm' was in force.

In recent weeks, however, there has been a growing realisation that not only will be the United States affected but the Asian crisis is the expression of a deep disorder within the world capitalist system of a type not experienced since the 1930s.

This change of outlook was reflected in a July 6 article in the *New York Times* on the first anniversary of the outbreak of the Asian crisis, which began with the floating of the Thai baht on July 2, 1997.

Few alarm bells rang a year ago, but it is a much different story today.

'From the White House to the International Monetary Fund, officials are concerned that the effects of the crisis will be worse and longer-lasting than they thought even three months ago. What particularly scares Clinton administration officials, though they are loath to say so on the record, is that the unpredictable economic contagion is no longer limited to the Pacific Rim.'

Washington officials 'are publicly understating the depth of the problems so that they do not scare the markets.'

According to well-known economic commentator Allen Sinai: 'The Asian crisis is off the radar screen of history in its seriousness, scope and eventual potential to do severe damage to the economy.'

He told the *New York Times* that it was the 'single most negative event since the Great Depression in the United States.'

'But what makes this problem so distinct is that it is not just an economic bust. It is laced with every type of financial crisis and instability that has ever shown up in the real world or any textbook. And while there are some brilliant minds working on it, no one can deal with it - not [US Treasury Secretary] Rubin, not [deputy US Treasury Secretary] Summers, not any single country, not the IMF.'

Similar comments were echoed in an article published in the July 13 edition of the *Australian Financial Review* on the sixth annual meeting of the Australian American Leadership Dialogue held in Washington last weekend.

This year the discussion was on the impact of the Asian crisis, bringing a 'consonance of views, coloured by the fear that the world is likely to face the most serious global economic challenge since 1929.'

What some of the 'best minds' in America and Australia are saying to each other includes the following:

'The pace of capital mobility has overwhelmed the world. It has not previously witnessed, much less understood, how devaluation in Thailand would have repercussions in Korea and Indonesia, and then flow on to Japan, precipitating a currency crisis in Russia, with Brazil poised to be next on the hit parade.'

'The economic crisis, which no one saw coming, will last a very long time. The only good news is that there has been no military externalisation of the crisis - yet. The very disturbing news is that no one has in hand with certainty the answers as to what needs to be done to reverse the devastating macro-economic trends in the region, or to begin to bring Indonesia back.'

All the predictions that the Asian crisis would result in only a short, sharp downturn with almost no impact on the major capitalist countries have proved to be wrong.

According to a study released last week by the Institute of International Finance, a Washington-based lobby group of major banks, the United States trade deficit will rise by \$35 billion as a result of the Asian crisis. The adverse effect on the major industrial countries will be \$115 billion with a \$46 billion loss for developing countries.

The IIF forecast a 0.7 percentage point decline in US economic growth and a 1.4 percentage point cut in Japanese growth. Europe would experience a \$39 billion decline in trade and a 0.6 percentage point fall in growth.

Even before the Asian crisis hit, falling commodity prices were indicative of an underlying tendency in the world economy towards deflation and slump. Now this tendency has accelerated, bringing about a series of currency and financial crises for countries dependent on commodity exports, particularly of oil.

Currencies which have fallen to record lows in the past few weeks include: the South African rand, the Chilean and Mexican pesos, the Canadian dollar and the Pakistani rupee. Other currencies are set to join them.

At least 25 countries depend on oil for a fifth or more of their foreign exchange reserves, including Russia and Nigeria as well as countries in Latin America and the Middle East.

So far this year oil prices have fallen from \$19 per barrel to below \$13 and in real terms are down to less than 1973 levels. One of the chief factors in the price slide has been the crash of the Asian economies, which accounted for two thirds of the increase in world petroleum consumption between 1992 and 1996.

Now these economies have entered an ever-deepening recession. According to the *Business Week* magazine the Indonesian economy, which shrank at an annual rate of 12.2 percent for the first half of the year, could contract by as much as one third for the year. The economies of South Korea and Thailand could decline by 10 percent.

Growth is also reported to be slowing in China, with predictions that the targeted rate of 8 percent - itself a decline over previous years - will not be reached. If the downward trend is not reversed, pressures will increase for a devaluation of the Chinese currency, threatening a further round of currency devaluations in Asia.

Like a red-ink stain spreading across the globe, falling growth rates are starting to hit the major capitalist countries. The British manufacturing industry has officially entered a recession with output falling for the past two quarters. Orders seem certain to decline for the three months to June as well.

First quarter growth of 2.5 percent in Britain was probably half that rate in the June quarter and the economy as a whole could slide into recession by next year, if not earlier. In continental Europe, the signs of recession are also apparent after a brief upturn. The growth rate has fallen from 3.2 percent in the first quarter to 1.5 percent in the second.

In an editorial comment, the US magazine *Business Week* warned that it was time governments made policy adjustments to meet the emerging situation.

'The global economy is downshifting from fast to slow growth, with the US no exception. Yet fiscal and monetary policy remain tight just about everywhere. Unless policymakers begin to ease up, there could be economic trouble ahead.

'A run of recent surprises makes for a darkening economic outlook. In the US growth is slowing down more sharply than anticipated, from a 5.4 percent annual rate in the first quarter down to a pace of zero to 2 percent in the second. The Asian crisis is finally hitting hard, striking at both exports and corporate profits. Inventory accumulation is at a record high, manufacturers are cutting back, and the high-tech sector, especially chips, is being slammed. Job growth is slowing.'

Across the Atlantic an article in *The Economist* expressed similar fears and drew attention to potential problems arising

from the fact that investment spending has fueled American economic expansion.

'The two big investment-led recoveries this century - America's in the 1920s and Japan's in the late 1980s - ended in deep recessions,' it noted. 'The risk is that over-investment, encouraged by a booming stockmarket, could lead to over-capacity, declining profits and - eventually - to a nasty contraction.'

It is certainly a sign of the times that the coming downturn is not being discussed in terms of the 'normal' operation of the business cycle but rather with references to 1929.

And an indication of the speculative character of the sharemarket boom, which has formed the basis for many of the claims of a new economic paradigm, was seen in figures on the rise of the so-called Internet stocks.

As estimates for second quarter profits for US firms were being cut to their lowest levels in eight years, the shares of the Internet directory company Yahoo! climbed to more than \$199, giving the company a value of \$9 billion.

The \$24.5 billion share value of Internet bookseller Amazon.com was greater than that of the two major book retailing firms, Barnes & Noble and Borders, combined. America Online, with shares at more than \$113, was of greater value than Alcoa, Eastman Kodak, Goodyear Tire & Rubber, International Paper, J P Morgan, United Technologies and Union Carbide - companies whose shares form part of the Dow Jones industrial index.

At work here is not some new, hitherto unrecognised, economic process, but rather the historically well-known type of frenzied speculation which precedes a major collapse.

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