

# Recession clouds gather over Davos summit

Nick Beams  
30 January 2001

Last year the annual meeting of the World Economic Forum in Davos (Switzerland) gathered in the wake of the protests in Seattle at the meeting of the World Trade Organization and the failure of the WTO to set in place a new round of trade negotiations. There were concerns voiced over what these events might portend, but the outlook was in general upbeat.

Discussion centred on the booming “e economy”, the role of the Internet and technology in boosting the US economy and the possibilities of a growing world economy in the aftermath of the “Asian financial crisis.”

The atmospherics at this year's 2000-strong gathering of business chiefs, political leaders, bankers, economists and academics were somewhat different. The technology-driven stock market boom has collapsed, the Japanese economy, after a few indications of a upturn, is sliding back into recession and, most important of all, growth in the US economy has come to a halt, with clear indications that it could enter a recession in the first part of this year.

An editorial in the *Financial Times* summed up the mood. “Last year, the e-word was all the rage in Davos; this year it is the r-word. Recession is uppermost in the minds of politicians and chief executives as they gossip at the World Economic Forum. The ‘new economic thinking’ of a year ago required for the ‘new economy’ dominated by e-commerce has all but gone.”

Underlying the change in outlook is the turnaround in the US economy, which, according to Federal Reserve Board chief Alan Greenspan, experienced a “very dramatic slowing down” at the end of last year with a growth rate “probably very close to zero at this particular moment.”

Pointing to the contrast with last year's summit, the *Financial Times* noted: “Gone are the breathless excitement about the ‘new’ US economy and the American triumphalism that previously both enthralled and irked other delegates. The question today is not about how high the US economy will soar but how far will it slide and how painful the fallout will be for the world. The consensus among economists in Davos is that full-blown recession will still be avoided but that the current sharp slowdown will increase US unemployment, deepen Japan's structural problems and damp east Asian growth.”

According to former vice-chairman of the US Federal Reserve, Alan Blinder, while a recession may be averted, the slowdown will be “quite a jolt” and may have the “feel of a recession.”

But what the attitude of the incoming Bush administration will be to the emergence of such a slowdown and its impact on the world economy, no one at Davos was ready to predict because the incoming president—or at least those who direct his policies—decided not to send a representative—a marked break from the practice of his predecessor.

Several key contributors voiced concerns over the state of the US, and, consequently, the world economy. Former US Treasury Secretary Larry Summers said of the US economy: “When you say that

someone is fundamentally healthy, all you are saying is that you don't know what he is going to die of.”

While warning of a slowdown, rather than an outright contraction, Blinder nevertheless put the chances of recession at 30 percent pointing out that this was “the first time there has been a realistic prospect of a recession in the US for a very long time.”

In a pre-summit interview, the normally upbeat secretary-general of the Organization for Economic Co-operation and Development Donald Johnston, warned that “we are in a period of adjustment, a market adjustment and a period in which growth numbers are being modified.”

During the course of the conference, the first deputy managing director of the International Monetary Fund, Stanley Fischer, said that the IMF had cut its forecast for world growth in 2001 to around 3.5 percent from the 4.2 percent expansion it had predicted last September. However, he continued to present a generally optimistic outlook telling the summit that he expected a pick-up in the US economy in the second half of the year and that even with the slowdown “we are still a long way from a global recession.”

The vice chairman of Goldman Sachs Asia, Kenneth Courtis, said the US and Europe had to take the lead in developing the fiscal and monetary response to a global slowdown because Japan had little room to increase official government debt and consumers were reluctant to spend.

These concerns were highlighted in figures published on the eve of the conference which showed that consumer prices in Japan last year recorded the biggest decline in 30 years, indicating the deflationary pressures operating throughout the economy. The weakness of consumption spending was further underlined by figures which showed a year-on-year decline of 0.9 percent in December—the 45th successive monthly fall.

Japanese Prime Minister Yoshi Mori told the conference that the 1990s had been a “lost decade” for Japan. Following the collapse of the financial bubble at the end of the 1980s, Japanese citizens had lost an estimated \$8.55 trillion, an amount twice that of Japan's Gross Domestic Product, as a result of falling equity and land prices.

Mori said Japan would enter an upswing once banks and corporations had adjusted their balance sheets. “A path has been solidly laid. I am determined to follow this path and implement the timely responses that will lead the economy to a full recovery,” he said.

But in the light of similar remarks from successive Japanese prime ministers over the last decade, no one was convinced. As Kenneth Courtis acidly commented: “The only way you can be optimistic about Japan is by looking at the charts upside down.”

While there were fears over the growth of the world economy, the general consensus was that even if the US experienced a sharp slowdown in the next two quarters years, it would undergo a recovery

in the second half of the year.

These predictions may well be borne out—the operation of the business cycle is subject to many factors. But analysis which remains at this level tends to overlook deeper processes at work in the US economy and their long-term impact.

The US has now enjoyed its longest economic boom in history. But notwithstanding the growth in labour productivity resulting from technological innovation, a key factor in sustaining the growth rate has been the increase in indebtedness, particularly over the past five years. And this has resulted in a series of structural changes.

The growth of debt has fuelled demand, which in turn has led to a widening balance of payments deficit, now estimated to be \$430 billion and approaching 5 percent of GDP. However, as Greenspan pointed out in his remarks to the Senate Budget Committee on January 25, this process “cannot go on indefinitely” and “something must give at some time.”

So far the increasing international indebtedness of the US economy has been sustained by an inflow of capital, especially from Europe. “Were it not the case,” Greenspan noted, “the exchange rate of the American dollar would have declined quite appreciably.”

But the big question is whether this capital inflow will continue in the face of a fall in the US stock market and a decline in the US growth rate, and what impact consequent movements in the value of the dollar will have on the world economy. It is in this context that the potential “nightmare scenario” for the Federal Reserve arises.

On the one hand, a recession in the US would necessitate a **cut** in interest rates to sustain both the American and global economy. On the other hand, if such a recession were coupled with an outflow of foreign capital and a decline in the value of the dollar, it would necessitate an **increase** in interest rates to sustain the financial position of the US.

The “conventional wisdom” is that at worst the US will suffer a short recession. But the structural changes in the US economy are nevertheless too large to be ignored. In a recent *Newsweek* article columnist Robert J. Samuelson, for example, pointed out that there were some “eerie parallels” between Japan at the beginning of the 1990s, following its boom of the late 1980s, and the US today.

“The early signs of a slowdown (or a recession) have stirred only modest anxiety that the slackening of economic growth will be anything more than a temporary inconvenience,” he wrote. “This complacency may well be vindicated. But Japan’s experience suggests another lesson: exceptional booms sometimes cause exceptional—and unpleasant—busts. This is the tidal wave that could overwhelm the Bush presidency.”

According to Samuelson even more worrisome than the growing signs of recession was the fact that “America’s longest boom has created conditions that have rarely, if ever, existed before”.

\* The increase in consumer spending has reduced the personal savings rate in the US economy to zero.

\* The capitalized value of US stocks hit 100 percent of GDP in 1995 (a level only attained once before in 1929) before rising to 180 percent at the start of 2000. Even with the market decline in the rest of the year, it was still at 150 percent of GDP by year’s end, about triple the level of 55 percent in 1990.

\* Since 1995 a growing share of business investment has been financed by high-risk capital - from venture capital and new sales of stock—with these sources providing funds at an annual rate of \$350 billion in the first half of 2000, compared to \$86 billion in 1995.

\* The US trade and current account deficits have entered

“unexplored territory” rising to nearly 5 percent of GDP compared to the previous high point of 3.4 percent of GDP in 1987.

Another warning of the implications of the long-term structural changes in the US economy is provided in a recent analysis by Jerome Levy Economics Institute economist Wynne Godley, who maintain that “the medium term outlook for the US economy could be much more depressed than most economists now expect.”

Godley points out that most predictions have centred on the supply-side, ignoring the role of demand, with claims that rising productivity has meant that the growth of the US economy has now become “structural.”

“Yet aggregate demand,” Godley notes, “has risen in the United States, and the motor driving it has been both unique and unsustainable. During the 45-year period between 1952 and 1997, total private expenditure was almost always below disposable income. In the third quarter of 2000, spending exceeded income by 8 percent. This excess was only possible because the private sector had been realizing assets and borrowing on an increasing scale; the indebtedness of the personal sector reached 1.1 times its annual flow of disposable income—a record—while debt of the private sector as a whole reached 1.7 times disposable income—another record.”

According to Godley, recent levels of expenditure “cannot be sustained unless the flow of net lending continues on at least its present scale, requiring a further rapid increase in indebtedness. The daunting implication is that aggregate demand will fall if the growth of debt merely slows.”

With clear signs that the limits to business sector borrowing are now being reached, Godley maintains there are parallels with the situation in Britain at the end of the 1980s. The collapse of the debt-induced Thatcher boom led to a fall in GDP and a rise in unemployment of about 3 percentage points.

“One does not need an econometric model to conclude that a similar rise in US private net saving could result in a recession of comparable magnitude; it would imply a fall of 8 percent in total private expenditure relative to income as well as a shift of the budget back into deficit. The implications for the rest of the world would be serious.”

What these warnings point to is that by the time of the next Davos summit, the changes in the world economy, resulting from the historically unprecedented developments in the US, may be even more far-reaching than those which have taken place in the past 12 months.



To contact the WWS and the  
Socialist Equality Party visit:

**[wws.org/contact](http://wws.org/contact)**