

Correspondence on global recessionary trends

Nick Beams
17 March 2001

Dear Mr. Beams,

We were very much impressed with your article on world economic recession. There are two questions we would like to ask: In your opinion, are there any mitigating factors which could slow or reverse the trend—though in the long run a world recession is inevitable?

China and the regional economies outside of Japan, which is part of the G7, are not mentioned. What do you consider the possibility for the continuation of Chinese development patterns in the light of a world capitalist recession? Is it possible for China to maintain a relatively high rate of growth in the process of internal economic integration and expansion of the national market combined with their ability to compete in international trade with the capitalist world? Do we have a new phenomenon as distinct from the Soviet economic isolation because of its own failure to key its economy to world trade and investment potentials? In opening to the West, the Chinese have become an accepted part of the world economy. But China maintains an independent approach to its own capital accumulation and allocation and maintains a degree of restriction over the effect of foreign capital flows in its own overall plans. In particular, in the event of world capitalist recession, will the Chinese be in a position to fulfill the new Five-Year Plan that has been announced?

Sincerely,

SG

Dear SG,

The reason I did not specifically comment on non-Japan Asia and China in the article on world recession is that trends in the world economy as a whole are essentially determined by the situation in the United States, Japan and Europe.

As to the question of whether a world recession is inevitable, I think the more important issue is to

examine the main tendencies of development. In 1997-98, in the wake of the so-called Asian financial crisis, there were definite signs of world recession. That crisis, as we noted, was not so much a product of “Asian factors”—risky bank lending, poor supervision and various other issues cited at the time—but was the initial expression in Asia of a growing crisis of the world capitalist economy. That analysis was borne out in September-October 1998, when the collapse of the US hedge fund Long Term Capital Management sparked a crisis in US financial markets requiring emergency intervention by the Federal Reserve Board.

In 1997-98 there were already definite recessionary signs, in particular the development of overcapacity in a number of major industries. In the event, a global recession did not take place, largely because of the continuing growth of the US economy, which provided export markets for the Asian economies.

The seeming ease with which the US economy averted a recession at that time prompted a series of claims that the so-called “new economy,” based on increased productivity due to high-tech innovations, was now immune to the operations of the business cycle, let alone longer term problems.

While there is no question that high-tech innovations increased productivity, there were other forces at work in the US boom as well. In particular, it should be noted that between 1994 and 2000 a private sector financial surplus equivalent to 2 percent of Gross Domestic Product was transformed into a historically unprecedented deficit of 5 percent. In other words, US spending on high-tech business investment, which played a key role in boosting growth rates, was being financed by increased debt. So great has been the turnaround that the US now requires an inflow of around \$1 billion per day from the rest of the world to finance its balance of payments deficit.

This means that world economic growth over the past

two or three years has been boosted by the high-tech US boom, which has been financed by increasing inflows of capital, attracted by the prospect of higher profits, and quick gains to be made on the stock market. This is an inherently unstable situation. We have seen a rapid about turn over the past months and the re-emergence of the underlying recessionary tendencies that appeared in 1997-98.

On the actual forecasts, I note that Morgan Stanley Dean Witter (MSDW), for example, predicts that world GDP growth will slow from 4.9 percent in 2000 to 2.8 percent in 2001, with risks “very much on the downside.”

MSDW chief economist Stephen Roach noted that the predicted growth compression for the world economy of 2.1 percentage points will be more severe than 1997-1998, when world growth went from 4.1 percent to 2.6 percent. For the US, MSDW predicts a slowing of the growth rate to just 0.4 percent in the second quarter of this year. This would represent a decline of 5.7 percentage points in a year and would mark “the swiftest downshift since the 7.1 percent deceleration seen in the depths of the 1981-82 recession—widely considered to be America's worst recession of the post-World War II era.”

The chief factor in the turnaround is the decline in information technology (IT) growth. Growth rates in this sector averaged around 13 percent per annum in the period 1996-99, before accelerating to 20 percent in 2000. But in the last quarter of last year IT growth fell to 7 percent on an annualized basis. The impact of this drop can be seen from the fact that it is estimated that over the past five years IT accounted for anywhere between 20 percent and 33 percent of total economic growth in the US.

This decline in the IT sector in the US is having a major impact on the Asian economies. According to a report in the *Financial Times* of March 12, while the decline was expected, its speed has “shocked many of Asia's exporters.”

“The most recent monthly economic data in non-Japan Asia show a sudden contraction. Thailand's exports dropped 3.9 percent in January while China's monthly export growth declined from 20-30 percent in the middle of last year to an increase of only 1 percent.”

The report cited estimates by Goldman Sachs that, on

a seasonally adjusted basis, fourth quarter exports in several non-Japan Asian countries suffered their steepest declines in 15 years over the previous quarter.

“The slowdown in Asian exports,” it continued, “began while US GDP growth was still robust because the region's exporters are tethered more closely to the fortunes of America's IT sector than ever before, says Sun-Bae Kim, an economist with Goldman Sachs. Asia is in effect the factory floor for many US IT companies, producing everything from chips to peripherals; roughly a third of Korean and Taiwanese exports are electronic goods.

“Rapid increases in US technology hardware spending in 1999 and early 2000 increased export growth in Taiwan, Korea and Singapore by 20-30 percent during that period. But the slowdown in US electronics orders last year quickly resulted in slower exports for those countries. Taken together, exports for the three contracted by 12 percent in the fourth quarter last year compared with the previous quarter.”

As for your specific questions on China, in particular the recently announced Five-Year Plan, they will be the subject of a forthcoming article to be posted on the WWS. Let me just note at this point that the Chinese economy is completely dependent on the growth in the world economy as a whole, and above all on demand from the US. And there are clear warnings from the Chinese government of the impact the US decline will have.

According to a report from Bloomberg's on March 12: “China's State Economic and Trade Commission Minister Mr Li Rongrong, said the country's state-run firms would struggle to earn as much as last year, as slowing US and Japanese economies put a dampener on export earnings.”

Yours sincerely,
Nick Beams



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