Worsening problems for global economy

Nick Beams
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A comment in the *New York Times* last Saturday by well-known economist Jeffrey Garten calling for a global economic stimulus plan reflects growing concern in academic as well as financial and business circles that the world economy is facing a series of problems for which no policies have been developed.

Garten, who has held economic policy positions in the Nixon, Ford, Carter and Clinton administrations, listed the first priority as “reinvigorating global economic growth.”

“The world economy,” he wrote, “is in trouble: corporate investment and trade are slowing, factories are producing more than they can sell, and deflation is threatening many regions. The two potential economic engines besides the United States—Germany and Japan—are stagnating. Big emerging markets, from Indonesia to Brazil, are in deep trouble.”

Garten pointed out that even if the US economy, which accounts for around one third of global demand, were to grow at a healthy rate this year, it cannot by itself create a sustainable international recovery. In fact, the US economy is dependent on expanding foreign markets with overseas sales of goods and services making up some 25 percent of economic growth in the 1990s and major companies, such as Intel, Coca-Cola and Johnson & Johnson, dependent on Europe and Japan for up to 30 percent of their revenues. In other words, revival in the US economy is itself dependent on increased growth in the rest of the world.

But recovery in the rest of the world is a fast-receding prospect. According to a report published earlier this month by the United Nations, the world economy expanded by only 1.7 percent in 2002, and will grow by only 2.75 percent in 2003, compared to an earlier forecast of 2.9 percent growth.

The report, entitled the *World Economic Situation and Prospects for 2003*, predicted that the US economy would grow by 3 percent this year, compared to a growth rate of 2 percent for the European Union and 1 percent in Japan.

“The United States will continue to lead the global recovery, but without significant momentum,” the report said. “With domestic demand lacking vigor, economic recovery in Japan and Western Europe continues to rely chiefly on external demand and will remain fragile.”

On the basis of the UN’s own figures and analysis, the term “economic recovery” seems somewhat misplaced—global stagnation would be more appropriate.

Moreover, the UN report pointed to the possibility that the economic outlook could significantly worsen. Risks to the world economy include the threat of war in Iraq, already generating higher oil prices and economic uncertainty, and the prospect that stock markets could fall further. Despite two years of historically large corrections, stock prices remained high relative to traditional benchmarks and a prolonged depression in major equity markets could “send the global economy into a tailspin.”

In his comment, Garten also pointed to a number of factors that could trigger an economic crisis. A major increase in oil prices could “send the global economy into a deep recession” while Latin America “could also provide the spark for a global financial debacle” with Argentina and Venezuela in “deep trouble” and Brazil’s economy “fragile at best”. Another potential source of crisis, he noted, was the US dollar itself. Having fallen by 15 percent against the euro in 2002, foreign investors could “get nervous” if the trade deficit continues to soar and move to dump dollars on financial markets.

These mounting problems are compounded by the fact that stimulatory measures, on both the monetary and fiscal fronts, are having little impact. The US stock market has just completed its third consecutive year of decline—the worst result in 60 years—despite the cutting of official interest rates to their lowest levels in 40 years. Increased government spending along with the Bush tax cuts are also expected to have little or no impact.

As Morgan Stanley chief economist Stephen Roach noted in a comment published on Monday, while under “normal conditions” the US economy responded to a dose of fiscal and/or monetary policy there was very little that is normal in an economy that had passed through the “biggest asset bubble in 70 years.”

According to an analysis by Morgan Stanley economists Richard Berner and David Greenlaw, the US economy "virtually stalled in the fourth quarter of 2002, and entered 2003 with a whimper."

"Incoming data" they noted, "underscore the weakness: Corporate America slashed nearly 250,000 jobs in the past four months ... [and] far from abating, most of those declines came in November and December." Companies cut their orders for capital goods by an annual rate of 6 percent over the past three months while real consumer spending growth slowed to just over 1 percent, making the last three months of 2002 the weakest quarter in more than a year.

As could be expected, the right-wing *Washington Times* hailed Bush's tax cuts for the wealthy as "the right policy at the right time." But significantly its editorial welcoming the measures was headlined "Deflation warning."

Deflation conditions, it said, could pose "serious problems" for an economy where private-sector debt levels have soared in recent years because as prices fall, the real level of debt rises.

The source of the deflationary pressures is the so-called output gap—the difference between potential output and actual production. Whereas potential output has been expanding by about 3.5 percent each year from the mid 1990s, the US economy is expected to grow by less than 2.5 percent in 2002, following growth of only 0.3 percent in 2001 and an annual rate of less than 1 percent in the second half of 2000.

Given the widening output gap for the past two and a half years, "there's no mystery why deflationary pressures are intensifying," the editorial noted.

"Two important price indexes confirm that deflationary pressures have made themselves felt throughout the economy. The economy-wide GDP implicit price deflator has increased by less than 1 percent for the four quarters through the third quarter of last year. The annual GDP deflator has not been less than 1 percent since 1949. Even more disturbingly, a Commerce Department price index that measures the prices received by non-financial businesses has actually declined for four quarters in a row. That hasn't happened in more than 50 years."

Garten's call for a "worldwide economic stimulus plan" is based on the recognition that the US alone cannot promote a global economic recovery and that co-operation between the major industrial powers is necessary.

"In the immediate aftermath of World War II," he wrote, "the United States pushed for the establishment of the International Monetary Fund, and coordinated the Marshall Plan with European nations. Washington realized then that economic stability and prosperity were essential to a country's security. It's true today, too."

But there are vast differences between the situation in 1947-48 when the Marshall Plan for the reconstruction of Europe was launched and today. At that time the US economy comprised about 50 percent of world industrial output and its financial position was the strongest of any nation in history.

Today, after sliding into debt in the 1980s, the US is now the biggest debtor in the world. Its external debt of more than $2.3 trillion comprises more than 20 percent of GDP. The balance of payments deficit is running at an annual rate of around 5 percent of GDP, requiring an inflow of capital from the rest of the world of more than $1 billion per day to finance it. At the end of the 1940s when the Marshall Plan was undertaken, the US poured capital into the rest of the world economy. Today it sucks it in at a rate unprecedented in economic history.

Consideration of these issues points to some of the driving forces behind the impending war against Iraq and the strivings of US imperialism to establish global dominance—military means are increasingly being employed to try to compensate for a loss in relative economic power.

In other words, not only is Marshall Plan-type economic reconstruction and international co-operation impossible because of the underlying financial weakness of the US, it is this very financial weakness which, in the final analysis, is one of the central factors behind the increasing unilateralism of the Bush administration and its drive to war.