Central bankers warn: No sustained growth from stimulus spending

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The 2008-2009 annual report of the Switzerland-based Bank of International Settlements, published on June 29, is a sober warning that the gargantuan bailouts and stimulus packages of the last year will not produce lasting growth. The trillions of dollars spent so far on the crisis could easily, the BIS argues, "come to naught", with "a significant risk that the current stimulus will lead only to a temporary pick-up in growth, followed by protracted stagnation".

The stimulus will give governments and their constituent populations a false sense that the crisis is passing, the BIS says. As a result, the stimulus and bailout packages (an estimated $5 trillion by the end of 2010—or 8 percent of global GDP) are likely to prolong the period of slow growth. The world will be swamped by debt.

The new BIS report, an institution often called "the central bank of central banks", is the clearest indication yet that, despite persistent spin about "green shoots", the best-informed personnel in the global policy-making bureaucracy are very pessimistic about global prospects.

The BIS, whose directors include US Federal Reserve Chairman Ben Bernanke and Bank of England Governor, Mervyn King, concludes that the economic crisis is practically beyond the capacity of national governments to resolve and will result in a new army of permanently unemployed workers. Further, because the only measures that the major banks are willing to stomach are public guarantees and subsidies, the "daunting" task of reforming the banking system and of reducing the global mountain of toxic assets is, and will remain, still-born.

Despite the accuracy of some aspects of the BIS diagnosis any suggestion that a financial reform process directed by enlightened BIS economists, rather than politicians subordinate to the financial elite, would bring the global crisis to a quick close should be rejected. BIS "cures" include allowing large, insolvent "zombie banks" to fail. But this proposition glosses over the risks posed for the global financial system and the danger of a second generalised collapse.

Moreover its technocratic solutions would be disastrous for workers. The BIS proposals still involve governments spending unlimited billions on purchasing or offsetting "toxic" debt. On this score the BIS makes the same demand as every other leading capitalist institution: that the working class foot the repair bill via effectively permanent reductions in social spending, including health and education. "Getting public finances in order will therefore be the main task of policymakers for years to come," the BIS counsels.

No return to financial health, no end to the crisis

"How could this happen?" the BIS report begins. "No one thought the financial system could collapse.... The fact that things apparently worked so well (up until the time that they did not) gave everyone a false sense of comfort. After all, when things are going well, why rock the boat?"

While the report does not identify the fundamental contradictions of capitalism that caused the crisis, it nevertheless paints an accurate picture of the surface processes: trade and savings imbalances, a prolonged period of low interest rates leading to asset bubbles. These factors combined with and were exacerbated by flaws in the financial system's risk-pricing mechanisms, those flaws being themselves the product of "distorted incentives" for "market players", including financial sector employees.

In plainer terms, the financial system became an instrument for massive personal profiteering on the part of the super-rich that made the investment and borrowing decisions. The asset bubble was unprecedented in human history. The value of global financial assets grew from less than 100 percent of global GDP in 1990 to nearly 400 percent in 2007.

The BIS report describes how, in the fourth quarter of 2008 "the financial crisis intensified to the point where it overwhelmed the real economy." The collapse of Lehman Brothers and the subsequent run on the interbank lending market led to the realisation that what engulfed the planet was a crisis not of

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liquidity, but solvency. Consumer demand, especially in the United States, plummeted, driving down trade volumes. International trade fell by 17 percent in the 12 months from June 2008.

The response of most central banks has been to cut interest rates to zero or near zero. Governments, meanwhile, have embarked on an unprecedented campaign of stimulus spending and marshalled unheard of sums to plug the balance sheets of banks that were rapidly sinking.

But this policy response has been "messy", BIS says. Moreover, "two enormous risks to long-term recovery lurk amid the massive short term efforts."

First, "policy actions taken so far may be insufficient to restore the health of the banking system." In particular, "progress on problem assets has been slowed by the complexity of the securities involved, the legal constraints and, above all, the limited political will to commit public funds to the cleanup effort."

This last claim is ridiculous given that the UK and the US governments have so far respectively spent 20 percent and 6.7 percent of their national GDP on bailing out their shattered banking sectors. Nevertheless, it is true that the sheer complexity of the securitisation structures from which the financial crisis emerged, places the task of global detoxification beyond the capacities of individual national governments.

The second risk is that "a lack of well-articulated exit strategies for the monetary, fiscal and financial repair programmes threatens to hinder rather than support necessary macroeconomic adjustments." In particular, "there is the danger that fiscal policymakers will exhaust their debt capacity before finishing the costly job of repairing the financial system", that is, the cleaning up of bank balance sheets.

The BIS is warning that if governments keep trying to spend their way out of the crisis but do not undertake a root-and-branch repair of the financial system, the global economy will continue to stagnate for the foreseeable future and the so-called Keynesian stimulus policies of leading governments "could undermine the credibility of fiscal policies to facilitate recovery."

"Persistent low growth," the BIS report continues, "could lead to consensus that government deficits will remain large for years to come. If that were to happen, investors and institutions could sour on the prospects of holding long-term sovereign debt."

In short, there is a limit to the amount of debt that the world can absorb. That limit may already have been reached.

Permanent unemployment and government cuts

This does not imply that the other option—removing toxic assets from bank balance sheets immediately—provides a solution. According to the report's authors: "Losers need to be allowed to lose.... [Governments] will be tempted to turn a blind eye to insolvent institutions, allowing them to continue operating—but as hard experience teaches us, zombie banks [banks with no net worth] must be closed or returned to health as quickly as possible. In all of these cases, governments must realise that, by insisting on speedy resolutions despite political controversy, they are acting in the best interests of the public."

But one needs to look no further than the example of the Lehman Brothers investment bank to realise that 'letting losers lose' is no solution to the problem of an insolvent global banking system. As the BIS report itself notes, when Lehman was allowed to go under on 15 September 2008, it almost took the entire global financial system with it.

What the working class should take from the BIS report is that the global recession will be an unprecedented disaster for ordinary people.

The BIS observes that "the protracted nature of the current crisis implies that a non-negligible proportion of workers could permanently drop out of the effective labour force.... In the United States, 'permanent' layoffs (of workers not expected to ever regain the same job) rose to a record 52.9 percent of the unemployed in May 2009." Meanwhile, the trillions that governments are spending to dig the global economy out of its hole will be paid for by workers in the form of savage budget cuts.

As events around the world are already demonstrating, the provision by government of even the most basic services—public hospitals, public education and other vital social needs—is fast becoming an open question.

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