

THE PRESENT CRISIS AND THE WAY FORWARD

Discussions of the current world economic crisis tend to focus exclusively on the bursting of the housing bubble in the United States. This no doubt is the immediate cause of the crisis, but underlying its operation is the fact that the stimulus for booms in contemporary capitalism has increasingly come from such bubbles. The U.S. whose size and strength make it, in the current regime of trade liberalization, the main determinant of the pace of expansion of the world economy as a whole, has increasingly come to rely on such bubbles to initiate and sustain booms. The dot-com bubble whose bursting had caused the previous crisis was followed by the housing bubble which started a new boom. This has now come to an end, precipitating a major financial crisis and initiating what looks like a major depression reminiscent of the 1930s.

John Maynard Keynes, writing in the midst of that Depression, had located the fundamental defect of the free market system in its incapacity to distinguish between "enterprise" and "speculation" and hence in its tendency to get dominated by speculators, interested not in the long-term yield on assets but only in the short-term appreciation in asset values. Their whims and caprices, causing sharp swings in asset prices, determined the magnitude of productive investment and hence the level of aggregate demand, employment and output in the economy. The real lives of millions of people were determined by the whims of a bunch of speculators under the free market system.

Keynes wanted this link to be severed through what he called a comprehensive "socialization" of investment, whereby the State acting on behalf of society always ensured a level of investment in the economy, and hence a level of aggregate demand, that was adequate for full employment. This prescription entailed not only a jettisoning of the free market system in favour of State intervention, but also restraints on the free global mobility of finance, since meaningful State intervention could not be possible if the nation-State faced *internationally-mobile capital*. "Let finance be primarily national", he had said, if the State had to have the autonomy to intervene meaningfully in the economy.

The process of globalization, involving above all the globalization of finance, which began during the period of Keynesian demand management itself, has undermined Keynesian demand management in the capitalist countries, and removed a whole host of regulatory measures that characterized the Keynesian regime. Boosts to aggregate demand have of late come increasingly from the stimulation of private expenditure,

associated with the creation of bubbles in asset prices, rather than from an adjustment of public expenditure within the context of reasonably stable asset prices. The reliance on bubbles in short has acted as a substitute for the earlier regime of Keynesian demand management; it is management through the creation and sustenance of bubbles rather than through the pace of public spending. Not surprisingly, the frequency of financial crises, associated with the bursting of these bubbles, has increased greatly after 1973, and the capitalist world is even now headed for a major crash.

Governments in advanced countries have still not recognized this onset of a crash. They have proceeded on the assumption that the injection of liquidity into the system is all that is needed. It was thought initially that this injection could be achieved through the government purchase of "toxic" securities, but widespread opposition to that scheme has now made most governments accept the idea of injection of liquidity in lieu of equity, i.e. through the part-nationalization of financial institutions.

But injection of liquidity, even in this manner, is not enough. Credit will not start flowing simply because banks can access more liquidity. There has to be adequate demand for credit for viable projects by solvent and worthwhile borrowers. And this is not happening. First, the injection of liquidity does not improve the *solvency* of firms saddled with "toxic" securities, so that the risk associated with lending to them remains prohibitively high. And secondly, quite apart from this, the anticipation of a Depression makes borrowers chary of borrowing and lenders chary of lending.

This anticipation in turn derives from several factors: first, the bursting of one bubble is not necessarily succeeded by the immediate formation of another, so that some recession of a more or less prolonged duration is in any case inevitable. Secondly, the very scale of the current financial crisis is such as to entail an anticipation of a prolonged recession. And thirdly, since the recession has already started, the prospects of crisis-prevention now through the usual monetary instruments (including liquidity injection) appear distinctly dim. The scenario, in which tendencies towards increased liquidity preference on the part of private individuals and institutions and a downward slide in the real economy mutually reinforce one another, has already started unfolding itself and will continue for a prolonged period, *unless governments now act to inject demand into the economy directly*, apart from injecting liquidity. Until this happens on a large enough scale the Depression will persist.

The third world countries will not escape the effects of this Depression. True, many of them whose financial systems are still not

sufficiently “opened up” and hence have not been “contaminated” by any links to “toxic” securities, will escape the *direct* impact of the world financial crisis (though even they cannot escape some “sympathetic” movements in their financial markets as well). But they certainly will have to face the impact of the Depression of the real economy. Their export earnings, both merchandise and invisibles, will be hit, causing unemployment and output contraction on the one hand, and foreign exchange crisis, exchange rate depreciation and accentuated inflation on the other. (The latter will be aggravated by the outflow of speculative capital that had come in earlier to the “newly emerging markets” under the auspices of Foreign Institutional Investors).

Two areas are of special concern here. One is the inevitable decline in the terms of trade for primary commodities that will occur in a Depression, which will push cash-crop growing peasants into even greater distress and destitution and into even larger mass suicides. (These have been already occurring for some time on a disturbing scale in countries like India). The second is the loss of food security over much of the third world that will inevitably occur. Food security in the third world of course has been getting undermined for some time now (see below), but matters will become even worse with the onset of Depression. There are at least three mutually-reinforcing reasons for this: first, the loss of foreign exchange earnings owing to the decline in exports and in the terms of trade will cause a decline in foodgrain availability in food-importing countries owing to a decline in their import capacity. Secondly, even if food availability is somehow maintained, the decline in the incomes of exporting peasants and small producers and of those affected by the rise in unemployment will mean that large masses of people will simply lack the purchasing power to buy necessary food. And thirdly, if the terms of trade of non-food primary commodities decline relative to food, as has been happening for some time now, then both the above problems will be greatly aggravated.

There is a tragic irony here. The booms fed by asset price bubbles not only did not benefit the large mass of peasants, petty producers, agricultural labourers, craftsmen, and industrial workers in the third world, but were actually accompanied by an absolute deterioration in their living standards. This happened not despite the boom but because of it, in a number of ways. First, with the interlinking of global financial markets, asset price booms in the US tended to produce stock market booms, and more generally financial sector booms, even in third world countries, where banks and other financial institutions withdrew from productive sector lending to speculative lending, from rural lending to urban lending and from agriculture and small-scale

sector lending to consumer credit to the affluent, and loans against securities. This damaged the productive base of the peasant and small-scale sector. Secondly, the changed role of the State in the new dispensation where it was more concerned with supporting the financial sector boom and in maintaining "the confidence of the investors" than with sustaining peasant and petty production, entailed a withdrawal of State support from the latter sector: input subsidies, the price support system, essential public investment, and State spending on rural infrastructure and on social sectors, were all drastically curtailed; and without them the entire small producer economy became submerged in crisis.

A simple statistic illustrates the point. During the quinquennium 1980-85, the per capita cereal output in the world was 335 kilogrammes. By 2000-05 it had fallen to 310 kilogrammes. This absolute decline in per capita cereal output meant also an absolute decline in per capita cereal consumption for the world as a whole. But since per capita cereal consumption, taking both direct and indirect consumption into account, increased for the advanced countries, the overall decline for the world as a whole was caused by a massive decline in the third world countries, where even countries like China and India which experienced remarkably high GDP growth rates, did not escape this trend.

The fact that this decline in per capita cereal output in the world economy was not accompanied by any rise in relative cereal prices (in fact between these two years the terms of trade of cereals vis a vis manufacturing in the world economy declined by nearly 40 percent), even when the per capita income in the world economy was increasing quite noticeably, suggests that the squeeze on the purchasing power of the masses in the third world was even greater. The other side of the speculative boom occurring in a deregulated and financially-interlinked capitalist world therefore was a drastic squeeze on the living standards of the masses, especially in the third world (which incidentally is one reason why the "locomotive" analogy often given for the US economy's role in the world economy is so inapposite: this locomotive while pulling some coaches, pushes back some others).

But even though the masses suffered from the effects of the speculative boom, they would also suffer additionally from the effects of its collapse. We do not have a symmetry here between the effects of booms and of depressions, and herein lies the tragic irony of the situation.

It is clear from the above that the need of the hour is not just the injection of liquidity into the world economy but also in addition the injection of demand. This can occur only through direct fiscal action by governments across the world. For activating governments for this, two

conditions have to be satisfied. The first is control over cross-border financial flows, for otherwise governments will continue to remain prisoners to the caprices of globally-mobile speculative finance capital. And the second is the setting up of an international financial facility, operated on principles different from the existing multilateral institutions, which not only makes concessional finance available to them, but also enables them, to substitute long-term loans for their current short-term borrowing, so that they are not caught "borrowing short to invest long".

The sectors where government spending will go up will of course vary from country to country, but the general objective of such spending must be the reversal of the squeeze on the living standards of the ordinary people everywhere in the world that has been a feature of the world economy in the last several years. In the United States government spending may have to take the form of increasing the social wage and enlarging welfare state activities generally, increasing infrastructure expenditure and making more funds available to states through federal transfers. But in India, China and other third world countries, in addition to welfare state measures, larger government expenditure has to be oriented towards a substantial increase in agricultural, especially foodgrains, output.

Taking the world economy as a whole, the new growth stimulus will have to come not from some new speculative bubble but from enlarged government expenditure that directly improves the livelihoods of the people, both in the advanced and in the developing economies, and that is geared towards improving the foodgrain output of the world through a revamping of peasant agriculture (and not through corporate farming, since that would reduce purchasing power in the hands of the peasantry and perpetuate its distress). In short, the new paradigm must entail a foodgrain-led growth strategy (on the basis of peasant agriculture), sustained through larger government spending towards this end, which simultaneously rids the world of both depression and financial and food crises. The trade and financial arrangements of the world economy have to be oriented towards achieving this rather than being made to conform to some *a priori* free market principles that have the effect of pushing the world economy into financial crises and slumps, and the peasantry and small producers of the world into destitution both during the booms and also, additionally, during the slumps.

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