Trapped in a Recession*

C.P. Chandrasekhar

When the recently held annual meetings of the IMF and the World Bank ended, the only news to report was that confusion and disagreement afflicts the leaders and institutions charged with jointly managing the international economy. The absence of certainty and agreement was specially visible with respect to one issue: whether governments should revert to using fiscal policy measures and not just monetary policy initiatives to revive a global economy poised to slip into another deep recession.

Years of "quantitative easing' or injection of liquidity into the system through bond purchases by the US Fed, and similar moves elsewhere in the developed world, have helped return the banks that triggered the crisis back to profit. But it has not served other equally or more important objectives affecting other players. For example, it has done little to enhance credit flows to producers and homeowners or revive demand. The net result is that while finance flourishes, the real economy remains steeped in recession. Moreover, the surge in cross-border flows of capital to emerging markets that the easy money policy resulted in, has made exchange rate and monetary management in those economies difficult, and threatens to destabilise their financial and currency markets as the policy is wound down.

The result has been that many are coming around to the hitherto minority view that what is needed to stave off a renewed downturn is a greater reliance on fiscal policy. The G24 grouping (Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development) that includes representative of the most influential developing-country members of the IMF and World Bank went furthest in declaring thus in its Communique: "Despite a prolonged period of very low interest rates in AEs (advanced economies), robust recovery has not materialised, which emphasises the importance of deeper structural reforms and more supportive fiscal policy, including through infrastructure investment." It also noted the "risks from disruptive capital flows and exchange rate volatility associated with the exit from unconventional monetary policy in major advanced economies", and urged policy makers in the AEs, "especially those that issue reserve currencies, to give due attention to the risks and impact of spillovers on EMDCs (emerging market and developing countries) and to undertake effective coordination and communication of their policies."

But this is not just an EMDC view. The IMF's Economic Counsellor Olivier Blanchard has this to say in his foreword to the latest World Economic Outlook: "The weak recovery in the euro area has triggered a new debate about the stance of fiscal policy. The low spreads on sovereign bonds suggest that the fiscal consolidation undertaken during the past few years has built trust among financial investors that current fiscal paths are sustainable. This credibility, which has been acquired at a high price, should not be threatened. This does not imply that there is no scope to use fiscal policy to help sustain the recovery. As we argue in Chapter 3, infrastructure investment, for example, even when financed by debt, may be justified and can help spur demand in the short term and supply in the medium term. And should the recovery stall, being ready to do more would be important." For the chief economist of an agency that has stood firmly against deficit financed government spending as a stimulus to growth, and advocated "structural reforms", which is a misleading label for a combination of austerity, deregulation and 'flexible' labour markets, this was indeed a major concession.

However, the Financial Times (13 October 2014) reports that some members of the IMF's governing body present at the annual meetings at Washington D.C. "demonstrated frustration" with the fact that "the fund's emphasis had appeared to be too much about spending more money and not enough about reform." Reflecting that view, UK's chancellor

George Osborne is reported as having said “he was ‘sceptical’ about the IMF’s thinly veiled calls for looser fiscal policy”. Clearly, the long term failure of monetary policy to address the real economy problem is not as yet adequate to silence those who, in tune with financial interests, vehemently oppose the Keynesian option of the use of fiscal policy by a proactive state as a means of stabilising a capitalist system trapped in a recession.

This standoff does not bode well. It is more than six years since Lehman Brothers filed for Chapter 11 bankruptcy on September 15, 2008, exposing the financial mess that triggered the Great Recession. And yet the International Monetary Fund (IMF) has had to declare that global growth remains “mediocre”, in the October 2014 edition of its World Economic Outlook, and once more revised downward its growth forecast. The search for the “green shoots” of a robust recovery that began five year’s back still remains futile.

This is intriguing because about a year after the onset of the recession many so-called emerging market developing countries (especially in Asia) and some developed countries such as Germany had recorded a smart recovery. The concerted response of governments across the world, which combined substantially enhanced spending, tax cuts, financial sector bailouts and monetary easing had partially neutralised the spin off effects of the financial crisis and promised a return to growth. While recovery was not robust in the US, there were signs that the recession had bottomed out even there. The main areas of concern were the poor performance of the EU and the crisis afflicting the peripheral countries of Europe. But even in that part of the world the performance of the German economy gave cause for cheer.

Overall the perception was that world economy was moving along a multilane growth highway, with the emerging markets and Germany growing fast, the US doing reasonably well and ‘Europe other than Germany’ performing poorly. So the hope was that, with the worst over, the better performers would pull the global economy out of the recession. It is that hope that is under challenge now, for a number of reasons. The first is that the crisis in Europe not only remains severe, but has also begun to tell on growth in Germany. With exports hit by slow growth elsewhere, especially in Europe, the German economy too seems on the verge of recession. The second is that while growth in the US and UK is better than in the worst period of the recession, neither is the recovery complete nor is the promise of potential growth up to expectations. Finally, rather than serving as locomotives for recovery, emerging markets are turning into victims of the sluggishness elsewhere, with growth decelerating in China and India, and shrinking significantly in countries like Brazil. China’s annualised growth rate is expected to slip to 6.8 per cent in the third quarter of 2014 from 7.5 per cent in the second, and Brazil is expected to record 0.3 per cent growth this year as compared with 2.5 per cent last year.

The quick fading of the early post-crisis signs of recovery was clearly the result of a shift in the policy stance of developed country governments and international financial institutions. When the crisis first broke both monetary and fiscal policy measures to stall and reverse the recession were adopted by governments worldwide. Not only was liquidity pumped into the system by buying up stressed or worthless financial assets on the books of banks and financial institutions and cheap credit provided to them, but spending by the government and incentives for spending by the private sector were a core part of the policy. These had to be financed with budgetary resources and, since taxes could not be raised in the middle of a recession, implied widening fiscal deficits and a rising public debt to GDP ratio in many countries. That, however, was an issue that could have been addressed in due course. Yet the policy was not pursued till it had delivered the required result. So long as it suited finance it was allowed to continue. Initially, as part of the fiscal measures, governments bailed out the banks by buying equity needed to render them solvent, often with money borrowed from those very banks. Once this was done, banks now exposed to a large volume of public debt turned against further borrowing by governments on the ground that public

debt GDP to ratios had reached levels that threatened the solvency of governments. Borrowing to ensure the solvency of banks was welcome, but increasing public debt to ensure the recovery was not.

The biased vision underlying these contradictory responses was obvious. At the time when public debt to GDP ratios were rising, so were the assets on the balance sheets of many central banks, which were acquiring worthless financial assets from the financial institutions to both give those assets some 'market' value as well as to infuse cheap liquidity that the banks could use to invest across the world to return to profitability. For example, the balance sheet of the Federal Reserve or the assets it held through purchases of financial instruments ballooned from $800 billion in 2008 to more than $4 trillion recently. This was not seen as a problem because it suited finance, but rising public debt stocks were seen as an aberration because it did not suit finance.

It could, of course, be argued that the opposition to debt-financed public expenditure is not new, and prevailed during the 1990s and the early 2000s (before the crisis) as well. But at that time, even though wages of workers were not rising, demand was buoyant because of the flow of credit that financed their consumption and housing investments. Debt-financed private expenditure was substituting for the shortfall in debt-financed public expenditure to drive growth. It was because such debt proved unsustainable that the crisis occurred. And now with household balance sheets burdened with debt, neither are banks willing to lend to them nor are they willing to take on more debt. What is needed is an increase in incomes to wind down household debt, rather than increased household debt to drive growth. It follows that factors other than debt financed private expenditure must stimulate such growth. Hence the need for debt financed public spending.

The opposition to such public spending implies that while it was the speculative thirst of a deregulated finance that triggered the financial crisis and brought about the Great Recession, what we have now is a peculiar situation where finance capital is back to profitability and is thriving but the real economy and the rest of the system is mired in recession. What deregulation and the subsequent proliferation of finance capital have done is to endow finance with this immense power to turn everything in its favour at the expense of every one else. So long as that power remains unchallenged the IMF may be forced to periodically revise downwards its growth estimates for some time to come, with the much awaited recovery remaining elusive. In fact, we may have another depression.

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