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CAPITAL AND CRISIS

Mumbai, Shanghai, London, New York

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UNCERTAINTY LOOMS OVER the future prospects of the global economy. The International Monetary Fund and United Nations' agencies predict continued slow growth in the coming years. Other experts, however, see possibilities of a sudden decline.

The two engines of economic growth are new markets and technologies. Say a village in Himachal Pradesh is in equilibrium. Goods produced are consumed and growth rate is zero. Suddenly demand for potatoes comes from Maharashtra. Buyers are willing to pay a high price for them. Farmers of Himachal invest in making canals and increase production of potatoes. They sell the producte at high price and earn good money. They buy TV and fridge from the money earned. Such opening of new markets leads to a virtuous cycle of demand, investment, production, income, consumption and growth. The same happens with the introduction of a new technology. Say tractors are introduced in the Himachal village. It then becomes possible to cultivate larger area of land. The increased production is sold and TV bought from the income.

Present high incomes of the developed countries are based on opening of the markets of colonies in the 18th and 19th century and development of new technologies of internal combustion engine, atomic energy, jet airplane, computer and internet. This happy situation is now coming under stress. Developing countries are themselves producing the goods that were being imported till recently. They are even exporting these goods to the developed countries. Only imported cars were available in India in the 1950s. Today indigenously built Indica is being exported. This is like the situation that Himachal potato growers would face after cultivation started in Maharashtra. They would have to sell their produce at low prices. Wages of their workers will decline. They would face negative growth rates.

No new commercially viable technology has also been developed in the last decade. The last such technological innovation was that of the internet. In the result the developed countries no longer have any unique product that they can sell to the developing countries at profit. The decline of the developed countries is pulling down the whole world economy because their share in the world economy is large.

The American Government put in place a fiscal stimulus package to help overcome this loss of incomes. Interest rates were slashed and tax breaks given to taxpayers to help them withstand the pressures of decline in wages. Buoyed by easy money, American people continued to borrow and consume as previously under the impression that the recession will soon come to an end. But the recession has not come to an end. American companies are finding their markets slipping. They do not have any new technologies which they could sell at high prices. On top of this the burden of the stimulus package is now devolving upon them. Revenues of the American Government are less due to slashing of tax rates. The Government has borrowed huge amounts from the market and also printed money to make available easy finance to the people. It has needed more of these funds for the war in Afghanistan. This debt is leading to decline in the value of dollar against other currencies. America simply cannot continue borrowing such huge amounts. It will have to set its house in order. That will entail imposing more taxes on the already distressed people and will be painful.

A report datelined June 15 has this to say: "The rich-world's economic prospects darkened over the last month, a Reuters poll of economists showed, with new signs of a slowdown in the United States compounding already stern fears about the poor fiscal health of Western economies... Economists took an axe to the outlook for US economic growth following a raft of dire jobs and industrial data this month... 'Two key downside risks have increased over the past few months - the risk of a disruptive default in Greece and of a significant slowdown in the US,' said Kurt Karl, chief US economist at Swiss Re in New York, in a research note... The consensus forecast for US second-quarter gross domestic product was slashed to an annualized 2.5 percent from 3.3 percent in last month's poll, following a weak 1.8 percent rate of growth recorded in the first quarter." The report shows buildup of pressures on the American economy.

One cannot repair structural weaknesses of the economy by implementing stimulus packages. Such packages are helpful only to overcome temporary problems. Tiresomeness of a healthy athlete can be removed by giving him lemon water. But tiresomeness of a cancer patient is not removed in this way.

The Euro's situation is no better. This region is equally affected by loss of markets of the developing countries and absence of new commercially viable technologies. Difference is in the strategy adopted to face the downside. America has provided tax cuts and easy loans and encouraged its people to face the choppy world markets. America has not much increased welfare expenditures. It has allowed reduction of wages so that cost of production is reduced and jobs are saved. The General Motors, for example, reached such a wage reduction agreement with its Unions. Europe, on the other hand, has ignored the global crisis and continued in its business-as-usual ways. Government welfare expenditures have been increased to shield the people from the downside. This has led to burgeoning debt and Greece is poised on verge of default. Public unrest has erupted on the streets of Athens against the proposed austerity measures. It is expected that Germany will bail out these troubled countries for the present. But this will only make things worse in the coming period. Germany itself is likely to come under pressure as its exports falter.

The world economy will face the fallout of problems of America and Europe. Share of these countries in the present global incomes is large. However, the contagion is unlikely to spread to the developing countries. Reason is that loss of the developed countries is due to gain of the developing countries. Transfer of manufacturing from America to India means that loss of America is gain of India. This can be understood by an example. Farmers of Himachal may lose due to increased potato cultivation in Maharashtra. But farmers of Maharashtra will gain and the Indian economy will be stronger as a whole. The cost of potatoes in the larger economy will decline and help people improve their standards of living. Similarly China and India will gain from the decline of the developed countries and the world economy will be better. Between the two, China will gain less because its economy is more dependent upon exports to the developed countries.

The situation fast moving towards a new multipolar world economy which will see Mumbai and Shanghai emerge as centers of economic prowess equal to that of London and New York. □□□