

A precipitous drop in America's industrial production from Jan. 1974 to Jan. 1975. The fall had recorded its lowest monthly drop in 37 years in January, 1975. (1967=100)



Recession hits the stomach. Unemployed Americans queue up for free food.

THE ECONOMIC CRISIS

The opening weeks of March witnessed a lowering of the bank rates in both the U.S. and Britain in still another bid to breathe new life into their ailing economies. In early April, the American public has been let in on the grim facts that its unemployment rate had reached an all-time high of 8.7% while industrial production had dropped a further 3.6% in January, to record its biggest fall in 35 years. A few weeks earlier, President Ford had revealed in his budget for 1975 that U.S. consumer prices would reach a new high, rising up to 11.3% while the real G. N. P. would record its steepest fall of minus 3.3%. This recession that has plagued the American economy over the last 18 months has hit the economies of all industrialised countries almost as hard. These were but a few of the more recent signs that the world economy was going through its most difficult phase since World War II.

Galloping inflation, acute imbalance in the international payments system following a collapse of the old monetary order, near stagnation in the real output of many major

nations, along with soaring levels of unemployment have continued to create a situation of danger and uncertainty for those developed and developing countries having market economies.

After the end of World War II especially since the 50's in Western Europe and the 60's in America, Western governments had apparently learnt how to avoid deep economic recessions. Under Keynesian economics they learnt how to relax

credit and stimulate demand by either cutting taxes or by increased Government spending or both. The post World War II period saw an increased prosperity in the Western World and a feeling existed that business cycles and depressions were basically a thing of the past. The consumer society and the new affluence was evident everywhere. The period also saw the increased pauperisation of the Third World as terms of trade continued to turn

Trend in the consumer prices index (percentage rise on the basis of annual average)

	1968	1969	1970	1971	1972	1973	1974
Belgium	2.70	3.75	3.91	4.34	5.45	7.	12.7
Netherlands	3.72	7.42	4.57	7.48	7.80	8.	9.6
France	4.64	6.05	5.66	5.21	6.06	7.4	13.6
German Fed. Rep.	1.65	2.59	3.83	5.13	5.76	7.	7.
Italy	1.28	2.66	4.97	4.78	5.75	10.8	19.4
United Kingdom	4.70	5.45	6.37	9.44	7.07	9.2	16.
United States	4.20	5.37	5.92	3.40	3.30	6.2	11.1

Source : Kredietbank

against raw material producers, whilst products of the industrialised nations continued to rise in price. This resulted in a virtual subsidising of the Western World economies by the Third World during the post war period.

As the economic crisis deepens in 1975 the conventional Keynesian economics is found to be increasingly inapplicable whilst the Third World continues to make increasing demands for a larger share of the world's wealth.

DIMENSIONS OF THE PROBLEM

A quick glance at the major indicators of the leading market economies of the world reveal the depth of the problem.

The United States

"The indicators of business conditions have switched from Yellow to Red" is how the U.S. magazine *Business Week* described the change from stagnation to recession in the U.S. at the end of last year. The automobile industry, a key branch of the U.S. economy has been severely jolted by one of its worst sales collapses in history. These storm signals are repeated in other branches of production too. For the first time since the war, the G. N. P. in the U. S. dropped by 2.2% in 1974 compared with a growth rate of 5.9% in 1973. Inflation too increased, for 1974 prices rose 10.2% compared with 5.6% in 1973.

The stock prices index in the United States, the main barometer of the economy, sank nearly 50% by December 1974 compared with its peak in January 1974, a loss in value of 500,000 million dollars. It has been having a minor rally recently which observers feel will probably be temporary because of the poor structural situation of the economy. Inventories of unsold stocks have greatly increased and business failures have taken a sharp upward turn, with even major firms in trouble. (Iran had to rescue the American flag carrier Pan Am a few weeks ago.)

The decline in industrial production is widespread and accelerating and now touches the whole range of manufacturing - consumer durables,

steel, chemicals, textiles are all in a rapidly accelerating downward spiral, while the automobile industry is further down the scale. Manufacturing is consequently now operating at only 70% capacity in the U.S. as a whole.

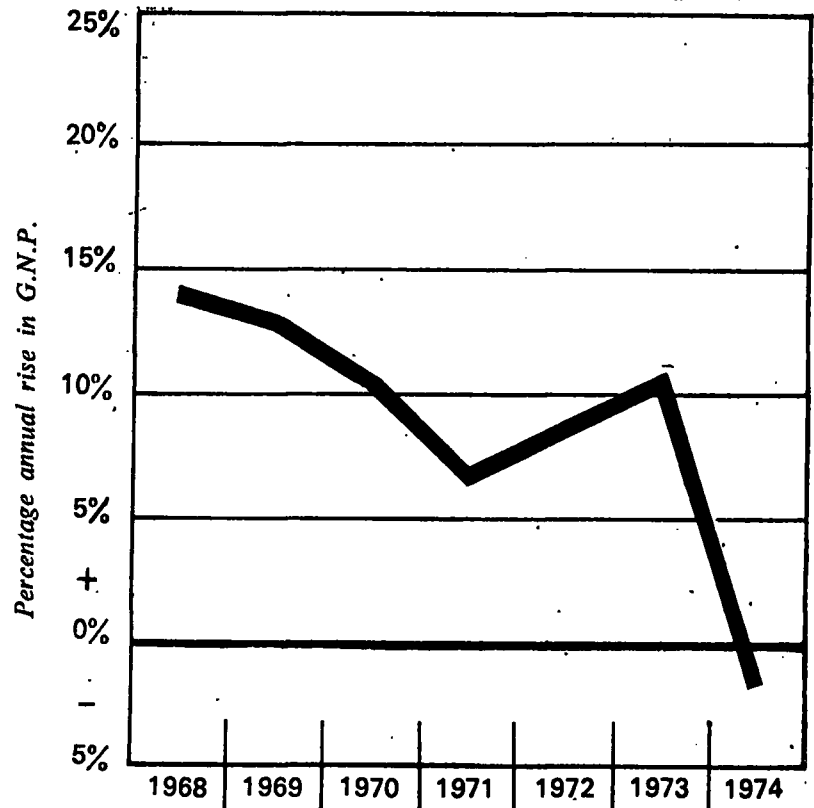
The result of the dramatic downturn has been a text book inventory recession as firms cut back on their unsold stocks of goods. Production is cut because of low sales, workers are then laid off, unemployment consequently rises, sales then shrink further and production is cut still further and so on, down the spiral. In the U. S. the downward spiral has in previous recessions been checked short of catastrophe because firms have managed, to increase production before consumers ran out of money to buy the goods produced. If the dramatically increased unemployment were to continue and purchasing power were to decline further, the present decline could result in the downward spiral running its full course, leading to a near total collapse.

After a slight increase in industrial production during 1973 the British economy found itself once again in a state of chronic stagnation

last year. Prices on the London stock market reached the lowest point in the twenty years in 1974. Britain's balance of payments deficits (\$ 9,000 million annually) exceed even Italy's (\$ 6,000 million). The most recent London Business School (LBS) economic forecast confirms the seriousness of the medium term economic situation. Over the next three years as a whole the LBS sees total output as virtually stagnant, with no sustaining rise in any of the major components of economic demand. In output terms, the LBS sees the depth of the recession occurring in the first half of 1976.

In Italy balance of payments is in the red to a tune of \$ 5,500 million; 1.2 million are unemployed and consumer prices have gone up by 25% in the last few months. Industrial growth has slowed down. Fiat production is down by 40% and nearly 1/3 of Fiat's 200,000 work force have been on a three day week since October. At the end of January 16 million Italian workers launched a national strike demanding retention of their jobs and opposing fascism. With the undercurrents of neo-fascism strong in Italy fascism is increasingly feared as the economic

JAPAN — End of the Miracle. Growth Goes Negative



situation nears that of the 1930's which gave rise to fascism in the first place.

In West Germany, the strongest European economy, the GNP is down and industrial production is slowing down, car production is reduced by a quarter. The West Germans however have faced only a 7% inflation rate, which is much lower than anywhere else in Europe. Unemployment in West Germany is around the 1 million mark and has been increasing for several months. Now West Germany has stopped importing migrant workers whilst it has been offering large sums of money to induce those already there to leave. In France, production was falling as 1974 ended and there was considerable scepticism that the Government's 1975 goal of a 4% increase would be reached. Slowdown in production had left France with a jobless level of about 700,000 at the end of the year.

As for Japan — 1974 saw the end of the "Japanese Miracle". In mid March the net decline on the country's GNP in 1974 was 1.8%. Reflecting the sharp increase in consumer prices, labour won a wage increase of 32.9% in a labour wage offensive last year. This increase rate was the highest in Japan's history and signals perhaps the collapse of Japanese feudalistic industrial relations. Those industries caught in a slump, including the textile and electric machinery industries, laid off many workers and called for voluntary retirement.

Japan's official forecast for fiscal year 1975 calls for the economy to hit rock bottom before mid-year and then begin a modest recovery.

Developing Countries

While inflation forged ahead among the industrialized market-economies of the West, the more successful of market-economies of Asia plunged in the past 8 months to levels of inflation prevailing some years ago. In several of these countries recession has already caught up while in others it is rapidly approaching.

In Asia the recession axe has fallen very hard on the export oriented countries. In Hongkong over 3,000

businesses had closed down by the end of 1974. The South Korean export boom has gone into reverse gear. Singapore advertised as the image of development in Asia is facing serious economic problems. Rollei of Singapore has plans to sack 3,000 workers and Fairchild has already laid off 2,000 workers.

The South Asian sub continent has had a very bad year because of the economic crisis and has been relegated, in some circles, to a new category called the Fourth World. In India 1974 was a very bad year and 1975 promises to be worse. Factories which are running at 60% capacity are expected to experience further drops in production as the recession bites. Unemployment has been leapfrogging from 6.5 million registered in 1973 to 7.6 million in 1974 and 8.3 million projected for 1975. These of course, do not include the unknown millions who do not register. Overall consumer prices have risen on the average of 30% last year and some food items have increased by as much as 100%. The oil crisis is having its toll on shortages of power and fertilizer for agriculture. Last year the government imported 6 million tons of grain at a cost of 2 million dollars and imports this year are projected between \$ 6 and 7 million. The rise of commodity prices (which are now falling as a response to a cut back in the industrialised countries due to the recession) contributed to an increase of nearly 50% in India's exports. Special mention has been made of sugar. Last year India got its highest "aid" quota from the Western countries giving \$ 1.4 million in credits.

Pakistan had a bad year last year. Its economy declined markedly since it was dismembered in 1971. Bangladesh, the former eastern wing of Pakistan, is facing very severe economic problems that have been described as 'horrendous'.

Possibilities of domestic re-inflation are limited in these countries with the situation deteriorating so badly. Inflation in advanced countries is a somewhat different phenomenon than in the developing world. In most of Asia food accounts for around 50% of weighting in consumer price indexes, which explains

why inflation rates were above world averages in several of these countries.

Unlike the industrialized world the developing countries are being squeezed from two directions. They must meet the increased cost of oil, yet the falling demand in the industrialized world is cutting deeply into their export earnings thus making borrowing increasingly difficult.

The recessionary trends in the world economy have also had their effects on commodity prices and hit many of the developing countries of the world. For these countries world recession is certainly something more than belt-tightening. It has been observed that the developed world would not escape this backlash. Some developing countries have borrowed heavily on the Euro-dollar market on the strength of their earnings from high commodity prices. Should these prices fall there could be major defaults among some big banks and repercussions on the world's financial markets could be serious.

The growing balance of trade deficits of the developing countries as a group could be traced to the recessionary tendencies in industrialized market economies. The deficits for the developing countries as a whole (apart of course from the oil producing countries) is expected to reach \$ 30 billion this year, according to IMF estimates. Last year it was in the region of \$ 22 to \$ 23 billion, which was already a very serious problem. There is grave concern in all quarters on how to finance this gap.

The Socialist Countries

The crisis has affected the socialist countries only marginally and this at points where their economies interact with the capitalist West. Taken as a whole, however, their economies have remained far more stable. The integrated approach to economic development within their systems has left them relatively unaffected. China, for instance, finds itself in a unique economic position. Because of its size, resources and economic isolation from the world market economy, China has been almost immune to the energy crisis, soaring inflation and wild currency fluctuations that have swamped its neighbours.

In the Soviet Union with its recent concern for increased imports of Western machinery and equipment the downturn in the West could possibly affect these imports which have included West German power plants, French engineering units, American foundries, Italian automobile works and hundreds of other smaller items including advanced computers.

The surge in the price of raw materials has however helped to turn the Soviet trade balance from 0.8 million roubles deficit at the six month point of 1973 to a 1.3 billion roubles surplus in June 1974. The resulting trade surplus is giving the Soviets the ability to import increasing quantities of Western products.

Summing up

It is apparent that the economic crisis is biting hard all round the non-socialist world (except of course the oil rich countries, yet even here inflation has been high) and that its effects are going to increase further. The present crisis is unique in that, unlike all the post war downturns in capitalist economies, it has gripped the economies of practically all developed capitalist countries at the same time. In the past, for example, when output in Britain and France was going down production in Germany and Italy would be rising and provide a boost, through bigger imports, to the economies of the slump ridden nations. But just as all the Western countries were booming together in 1972 and 1973 now nearly all are in recession and helping to pull each other down.

The Roots of the Crisis

An impression has been created that it was the quadrupling of oil prices that brought on the economic crisis. It is clear, however, that a turning point in the world market economies had been reached much before the boycott organised by the Oil Producing and Exporting Countries (OPEC) in 1973. The contribution of the revised prices of oil to world inflation is small; according to Iran's estimate, only 1.7% in 1974, against an overall inflation of 14%. A world inflation, acute since 1971, long antedated the increases in oil prices. The progressive inflation plaguing the world, which dealt the final blow to the monetary system and has brought several countries

to the brink of bankruptcy, fully explains the roots of the present crisis. The oil crisis has of course worsened an already grave situation.

Although 1974 and 1975 are witnessing a crisis of near tragic proportions, its roots and some of its major symptoms stretch back 5 to 7 years or more. The cries of gloom have been persistently heard from economists, social scientists and the like in many industrialized countries over the last several years. Henry C. Wallich, the U.S. economic commentator writing in *Newsweek* in 1966 said "It is a peculiar feeling, when something unpleasant is ahead and nothing can be done about it, but that is precisely what the economy faces. We seem to have manoeuvred ourselves into a box, where unless the Vietnam war accelerates, only two choices are left—*inflation or recession*. With a little bad luck, we might have both. We cannot even be sure that inflation will stop if there is a recession, and the farther the inflation is allowed to travel, the nastier will be the ultimate crash". Some of the elements which Wallich identified in 1966 seem in hindsight to have been crucial and what the world is experiencing today seems very near the ultimate crash, he predicted.

STRAINS ON THE SYSTEMS?

The major steps in the growth of the present crisis especially as it affects the leading market economy, the U.S., could be traced back to the mid sixties when the world had entered a period of dollar surplus in the international economy. This was coupled with a high growth in the economies of Germany, Italy, France and Japan with the U.S. lagging badly. These signs of trouble for the leading capitalist economy, the U.S. was brushed aside as a temporary phenomenon which it was thought would right itself in the late sixties. But this was not to be. Following the massive American intervention in Vietnam in the late sixties the dollar surplus turned out into a dollar glut. These military expenditures far in excess of the U.S. earnings in foreign trade caused massive amounts of dollars to pile up in the creditor countries. Even at that time the crisis was partly staved off by the willingness of European Central Banks to hold and

accumulate paper dollars and not encash them in the U.S.

In 1971, however, a crucial turning point was reached when for the first time, in the 20th century the U.S. had a deficit on its foreign trade account and the overall deficit on its capital account in the third quarter reached the formidable figures of \$ 12 billion. The European Central Banks found themselves virtually drowned with paper dollars and wanted no more of them. Pressure on the dollar rose dramatically and on August 15, 1971 the U.S. officially abandoned the convertibility of dollars to gold. The European Central Banks ceased to support the scheme of international exchange rates and major currencies were now allowed to float. This meant the collapse of the international monetary system that had grown up since World War II.

The Western money markets outside the U.S. now hold more than 100 billion Euro dollars which has often been the subject of much speculative activity. Many multinationals based mostly in the U. S. have often switched money from country to country to gain on the continuing differences in exchange rates. This has only further heightened the general instability in the monetary system and prompted German Chancellor Herr Schmidt to state sometime ago that the "wobbly international monetary market might totally collapse tomorrow". With this uncertainty has come the rush for gold which sold in recent weeks at more than 4 times the official U.S. convertible figure of \$ 42.2

The New Third World Militancy

The new militancy in the Third World specially its determination to reverse the trends since the Second World War, (which saw its terms of trade continually worsening) has added to the instability. The "economic miracles" of the West during the post-war period and the growth of the consumer society in these countries were but a necessary adjunct to the pauperization of the Third World.

The new mood in the Third World as it demands an increased share of the world's wealth was most dramatically reflected in the "oil crisis".

The massive about-turn in terms of trade between the West and the Third World this brought about, seeing it in its historical context, is the first major separation of the association of capital from people of West European stock since the growth of the world economy in the sixteenth century. This cataclysmic event has led to major shocks in the world system.

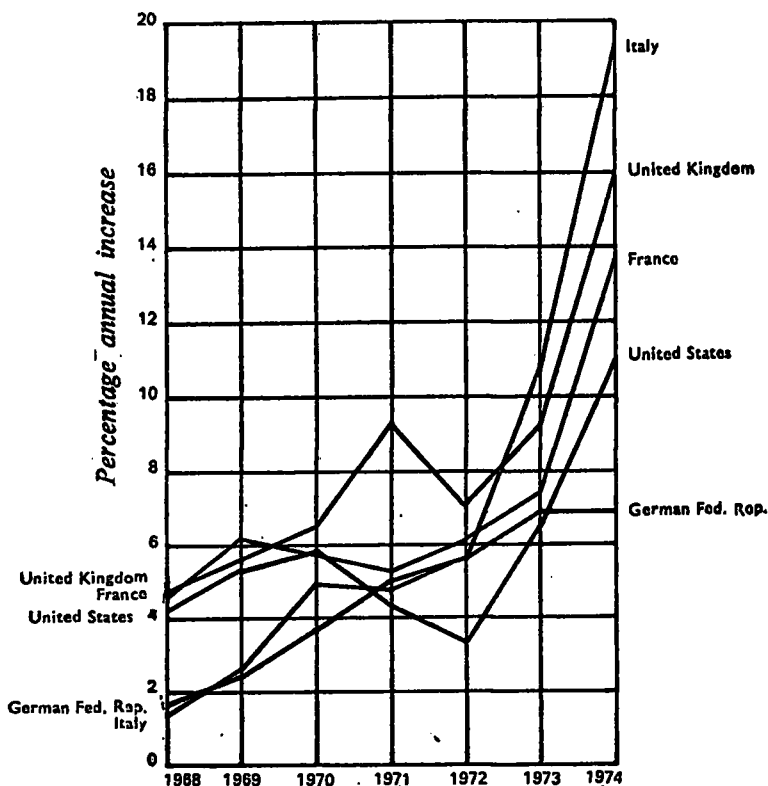
Professor Kindleberger of California analysing the roots of the earlier capitalist depression has stated that for the world economy to be stabilized there has to be a stabilizer, meaning a single country or a set of countries dominating the rest of the world. With the new mood of the Third World denying such "stabilizing" roles for rich countries of the world, we are in for a continued period of "instability". Thus the major sign of this new mood, the oil price hike, has resulted in the fact that the oil producers will run a balance of payments surplus of \$ 60 to 80 billion this year. This means that the rest of the world will run an equal balance of payment deficit, leading to further strain on the economic system.

RESPONSE

The responses to the crisis by the market economies have depended on their ability to control the main economic forces. It is the major countries, principally the U.S., that has been exporting the recession. Countries dependent on the economic well being of the metropolitan countries (like Singapore, Hongkong etc.) have the least control of the situation.

Yet unlike in the immediate post-war period any individual country's dominance over its own economy is no longer complete. One factor has been the growth of large monopolistic multi-national corporations whose operations and interests now transcend national boundaries. (In fact the action of multi-nationals in switching their assets from country to country in search of better exchange rates was one contributing factor to the present crisis). Secondly major changes in the positions of the dominated and dominant are occurring as the Third World increasingly flexes its muscles, as the oil situation has indicated. Kindleberger who analysed the causes of the last depression argued strongly for a

TREND IN THE CONSUMER PRICES IN SOME LEADING WESTERN COUNTRIES



"stabilizer" or dominant country. Recent attempts in Western economies to move out of the depression are largely to be seen in this light.

American Reaction

Within the U.S. itself economic policies have been very unsuccessful at checking the situation and both the Congress and people are increasingly getting dissatisfied with the Ford regime, as a consequence. The London *Economist* said a few weeks ago that Ford's presidency was such that management of the economy during his seven months of office have "for practical purposes been wasted and that economic management bids fair to be the decisive presidential campaign issue in 1976". In last October, Ford proposed that inflation was the main enemy and brought in income tax surcharges combined with cuts in Federal spending. He urged the people to tighten their belts and promised that the U.S. government would equally do so.

However, recently Ford has taken a right about turn and has started stimulating the economy and has proposed tax cuts. Yet his attempts to spur the economy have failed and although interest rates have been cut the demand for money far from picking up has dropped dramatically. In New York alone, bank loans to business have fallen \$ 2.9 billion since the start of the year. Apparently attempts to tempt industry to get moving again by an easy money policy are not proving a success.

Ford's many advisors, especially Greenspan and Arthur Burns, the latter Chairman of the Federal Reserve Board, have been increasingly criticised in the last few weeks for their policies. These criticisms have come from right wing economists like Friedman, as well as liberals like Samuelson, labour leaders, the Congress and editorial writers.

In Europe standard Keynesian policies have been followed to no avail specially as its recession arose from ripple effects of the U.S. recession. As inflation rises and real incomes are cut, demands by militant workers have been increasing. General strikes have occurred in France, West Germany and Japan. Virtually all European countries

have attempted some form of incomes policy and indirect wage restraint to hold down workers wages. These have largely failed.

The International Context

At the international level the U.S. and other Western countries have been making renewed efforts to re-establish their hegemony so that "stabilization" could again be brought about. (Price rises, currency gyrations and heavy balance of payments deficits caused by higher oil bills and world commodity shortages have thrown the Americans and Europeans together again.) In January there was feverish activity among the Common Market countries who decided with the I. M. F.'s interim committee of its Board of Governors to continue and enlarge the "oil facility" for 1975. Running for shelter, the Nine (ECM) and the United States have agreed to a 6 billion petro-dollar money box at the I. M. F. as well as in principle, to the \$ 25 billion "solidarity" fund pushed by Henry Kissinger.

Fear that a deep crisis gripping all the capitalist countries at once might lead to economic disaster and the fear of the new Third World militancy might lead to further reversals of Western economic primacy are what have apparently united the developed Western countries at the moment. An additional factor has been the desire "to win the money game" by using the OPEC countries' oil earnings for long-term investment in the crisis-stricken Western economies. It appears that hope in the Western capitals is that the establishment of a "single bank" will make it possible to conduct the dialogue with the oil producers from a position of maximum strength or to use Kindleberger's phrase, 'the re-emergence of a stabilizing dominant country'.

Observers have pointed out that the worsening crisis will see an increase of government planning and other semi-"socialist" measures being adopted as a means of getting out of the crisis. (See our section on *Banking and Finance* where we have pointed out some of these tendencies). But the crisis of today cannot be managed by just one or two countries' action alone as in the

Thirties. Even the United States does not have control over its multinationals which are a major part of the problem.

Further, as the Western countries again seem to draw together (one result of which is apparently the recent drop in oil consumption) and attempt to re-establish a new hegemony on their terms, the Third World is not standing idle. Emboldened by the success of the oil exporting countries, Third World countries have been making increasing demands for a new economic order. Various resolutions have been moved in many decisive bodies from the U.N. to the Law of the Sea Conference, all having the common theme of a more equitable distribution of the world's wealth.

As the crisis deepens in the months and years to come Western nations have a crucial choice to make. Either they could attempt to re-establish world hegemony by militarist and other means (recent hints by Kissinger and Ford have indicated that this colonialist course has not been ruled out) with all the danger that it entails. Or the Western economies could offer a New Deal to the Third World and help all afflicted economies get out of the crisis.

The New Deal of the Thirties helped get the U.S. out of the crisis by giving purchasing power and work to the unemployed and the poor of the U.S. In the mid 1970's the world is too deeply integrated for any within its borders alone to get it out of its mess although such actions too are necessary. The integrated world economy can only get out of the present situation by giving purchasing power to the poor and unemployed of the world economy that are today in the Third World. In concrete terms this would mean an accommodation of the new demands of the Third World and reversal of the post-war trends in the terms of trade of the Third World which has led to the latter's pauperization and growth of unemployment.

Such a dramatic change seems to be the most plausible way out of the crisis. But such moves will only be adopted by the West only at the resort. Centuries of colonial habits die hard.