

International Security Monthly Briefing – February 2009

FROM RECESSION TO SLUMP – CRISIS OR OPPORTUNITY?

Paul Rogers

Introduction

Last September's briefing in this series (*The Financial Crisis and Sustainable Security*) focused on the banking crisis which arose out of the sub-prime problems in the United States but grew to affect the banking sector across much of the world. At that time, the main concerns in western countries were with risks of bank failures and, as a result, a number of governments took highly unusual steps to save individual banks, including nationalisation.

That ORG briefing emphasised the effects that the overall financial downturn would have on poorer communities across the majority world. It drew some comparison with previous experience, especially during the "stagflation" period that followed the 400% increase in world oil prices between October 1973 and May 1974, and the world food crisis of the mid-1970s which threatened famine for 40 million people.

One of the arguments in that briefing was that there was little recognition of the impact of the crisis on the majority of the world's people who are largely marginalised, and that there was a need to address the wider issues of global socio-economic inequalities rather than concentrate on the more narrow problems facing wealthier societies. It pointed, in particular, to the need to place more emphasis on north-south economic relations, especially in relation to fair trade and debt relief, and it also raised the issue that desperate people reacting to impoverishment might be seen as a threat to more elite communities.

At the time, there was still a belief that the problems of mid- and late-2008 were primarily limited to the financial sector. The briefing pointed to the risk that an endemic reluctance to provide credit to manufacturing industry could have considerable consequences, but the evidence was not clear at that time that the financial downturn would spread to a more general decline in industrial activity. Indeed, many analysts were still hopeful that the sheer economic vitality of countries such as China and Japan would insulate the global economic system from the risk of a truly worldwide recession or even a slump.

That was five months ago, and a number of developments during February indicate that the fears expressed then of a knock-on effect from the banking crisis on to manufacturing industry are being realised. It is also the case that the banking crisis itself is far from resolved. Some European banks are coming through the crisis, but there remain substantial concerns in the United States that several major institutions are close to insolvency, and the problems that have proved so dire for Iceland's banks may now be developing for Ireland as well. Whether there will have to be further rescues will probably become apparent this month, but this briefing is concerned with developing last September's assessment in relation to the remarkable downturn in manufacturing and exporting that has become evident in the first two months of 2009, and its impact on poorer communities.

From Crisis to Recession

The extent of the manufacturing downturn is unprecedented in its speed and severity for the past three decades. According to *The Economist* (21 February), in the three months to the end of January, industrial production in the United States fell by 3.6% and in Britain by 4.4%. If annualised, these were equivalent to decreases of 13.8% and 16.4%. The problems were not restricted to these two countries that appeared to have been early casualties of the banking crisis – in the final quarter of 2008, German industrial production shrank by 6.8%, Japan's by 12% and Taiwan's by a remarkable 21.7%. Individual industrial examples include Germany's machine tool industry shrinking by 40% in 12 months to December 2008 and car manufacturing in the United States declining by 60% in the 12 months to January 2009.

The decrease in global trade, not least in terms of exports from apparently robust economies, has been quite startling. Expressed in year-on-year percentage declines to last January, Japan was down 34%, South Korea 28% and Taiwan over 45%. Singapore saw its exports drop by 35% in January alone. China, too, has been badly affected after years of rapidly increasing exports to all its main markets. In the 12 months to January, Chinese exports fell by an average of just under 20%, including a 10% cut to its largest export market – the United States.

In spite of a number of stimulus packages, including a massive \$585 billion injection of central government investment in China, there is widespread agreement that the manufacturing downturn will increase substantially in the coming months, with three effects being felt especially by poorer communities. One will be very large increases in unemployment, especially among poorly paid migrant workers in newly industrialising economies where there are few labour laws and even less welfare provision. Women are likely to be particularly badly affected, especially in the Asia-Pacific region. According to the UN Economic and Social Commission for Asia and the Pacific (ESCAP) 65% of women in employment are in vulnerable informal sectors where there are few benefits, especially maternity leave, or job security.

The second effect stems from the indirect impact of a decrease in the informal sector, especially when migrant labour is involved where there is a severe impact on rural economies. In many of the Southern industrialising economies, manufacturing is highly dependent on many tens of millions of migrant labourers coming into the cities. They, in turn, send part of their relatively low wages back to their families in the rural areas. Those families may often be subsistence farmers, frequently women, who depend on the remittances for access to health, education and other services.

There is also a strong international aspect to this, as many millions of migrant workers have moved to work overseas. While this has included substantial numbers from eastern into western Europe, much larger numbers of people are involved across Asia and Central America, the former most frequently moving to the Western Gulf states such as the United Arab Emirates, Qatar and Kuwait, and other regions of recent economic growth and the latter attracted to the United States. With a major economic downturn the tendency is for legal migrant workers to be sent back first in preference to locally recruited workers, and for police action to be taken against illegal migrant workers. Alternatively, because of the precarious circumstances of both groups, there is strong pressure on them to accept deep cuts in what are already low wages and poor working conditions. The end result of all these trends is a sharp fall in remittances back home, with direct social effects as well as an impact on the economies of their home countries.

The third effect will be a further collapse in commodity prices. Metals will be particularly hard hit because of the decline in demand from manufacturing industries, but food, beverages and fibres will also be affected. Most southern countries are still in the very early stages of industrialising and remain dependent for the majority of their export earnings on primary commodities – everything from sugar, coffee, cocoa, tea and spices through to copper, tin, natural rubber and bauxite. Any decline in commodity prices, especially when there is no equivalent decline in the price of manufactured goods means a further decrease in the terms of trade for many of the poorest countries of the world. A UNESCO report at the end of February estimated that the financial downturn has already cost sub-Saharan Africa's poorest people \$18 billion.

Impact of the Recession

As the recession approaches the severity of a slump, the increase in unemployment is far greater than predicted even six months ago. In the United States, unemployment hovered at around 4.3% to 4.8% in the two years to February 2008. This has increased to 8.1% in February 2009, with most of the increase in the last four months of the period, 2.6 million jobs having been lost in that period alone. Such a rapid downturn is being experienced in many other industrialised countries, but it is far worse in the majority world. In China, for example, much of the rapid economic growth of recent years has been dependent on cheap migrant labour coming into the cities from the countryside. The migrants may live in cramped labour

camps and their wages may be low, but they are still able to send money back to their towns and villages and thereby help alleviate the more severe symptoms of rural poverty.

It is common practice for labourers to return to their villages and families for a two-week holiday around the Chinese New Year. Chinese government officials estimate that of around 150 million labourers, over 20 million will have no jobs to come back to. This is a matter of profound concern to the Chinese authorities who fear increased social unrest, bearing in mind that in the recent boom years China has already experienced many thousands of riots, strikes and other forms of social unrest.

Across India, Pakistan and the Philippines, migrant workers are returning to their homes having lost their jobs, and in India this has exacerbated the deep divisions in wealth and poverty that have been the largely unreported results of the concentration of the fruits of economic growth with a minority of the people. In one weekend in February, there was a graphic example of this. One of India's retail success stories of recent years was the Subhiksha chain of discount food stores, growing to 1,650 branches in little more than two years. Early in February the chain ran into financial difficulties, could not pay the sub-contractors who provided security guards, and 600 of the stores were looted in a single weekend.

The Subhiksha experience is just one example of the impact of the sharp economic downturn, with this impact being very much greater than anything happening in the North. It is probable that many tens of millions of people will lose their jobs in the South, where there is virtually no welfare system. They and their families will then face all the problems of lack of access to education and health facilities and even the provision of enough food to prevent malnutrition. As this happens, the risk is that governments will visualise a "threat from within" as desperate people who are only too well aware of their marginalisation resort to social unrest and possibly violence as they respond to their predicaments. The response, especially in the face of fear among the emerging middle classes, is likely to be a determination to crack down on dissent by means of much tougher forms of public order control.

Beyond such responses there also lies a more general bitterness and resentment across the South. This is at the ability of Northern states to provide grant aid or loans at the level of many hundreds of billions of dollars in order to rescue banks, insurance corporations, car manufacturers and other aspects of their economies. These are financial packages that utterly dwarf all that is required to meet the UN Millennium Development Goals, yet there is little talk of increased assistance to the countries of the South, even if the recession originated in a financial crisis that was the almost exclusive province of the North Atlantic countries.

Responding to Crisis

As the severity of the economic crisis impacts on the more powerful governments, there is a widespread recognition of the need to respond in a coordinated manner, with the forthcoming G20 summit in London being one example. At present, though, the indications are that the main focus will be on joint action to ensure financial stability together with some measures to try and encourage the greater availability of credit and a more general boost to consumer spending. There have been a number of calls for aid to poorest communities but these have hardly figured in the intended responses of western government. Although the length of the current recession and the risk of its degenerating into a global slump are both unknowns, there are indications that the least that should be expected is a period of several years of very high levels of unemployment and increases in poverty, especially in countries with a very limited welfare system.

This has a much longer-term relevance. A central feature of the Oxford Research Group's approach to sustainable security has been the conviction that a combination of socio-economic divisions and environmental constraints will, if not countered, lead to a global predicament of deep insecurity. The response to this will be centred on ensuring the well-being of wealthier sectors of society that see themselves threatened by a much larger majority of people that are progressively marginalised, what has

been termed "liddism" – keeping the lid on dissent – of the control paradigm. The time-scale for this prognosis is only 10-30 years but there are many policies that can be developed to prevent such a circumstance and ensure a more emancipated, stable and peaceful world.

The current economic downturn is a result of failed financial and economic policies, but its effects are to provide a marker for what might be a much more enduring and far more dangerous world in the relatively near future. In other words, what we see now is an early indicator of what is to come if present economic and environmental trends continue. It also follows that how we respond to the current crisis, and the consequences of that response, provide an indicator of longer-term trends and responses.

If, in the coming months, the major effort is concentrated on a relatively small group of economically advanced countries, together with richer elites in emerging economies, then there may eventually be a climbing out of recession. At the same time there will also be deep social unrest right across the world which will mostly likely be met with vigorous and violent responses from those in authority. Behind this will be much suffering and hardship as the majority of the world's people seek to survive in times of unemployment, shortages and poverty.

If, on the other hand, the major governments recognise that the current crisis requires international responses that go far beyond resolving their immediate problems and see the need to engage with a much more far-reaching reform of financial and trading relationships, then the current crisis could be a turning point in North-South relations. Such a response would involve substantial immediate aid for the most impoverished communities, endeavouring to provide some degree of welfare support in circumstances where it is mostly non-existent. It would then go on to engage in a renewed programme of international debt relief together with fundamental reforms to the world's trading system, especially in the areas of international commodity agreements and other major improvements in the terms of trade of the poorest states.

The economic climate is seen as a global crisis but the emphasis in the countries of the North Atlantic community is on their own predicaments. If it is possible to rise above this, and the forthcoming G20 Summit provides one opportunity, then some good might come out of the current crisis. Such an outcome may require an unusual degree of wisdom in the political leadership, but that will be much more likely if there is a singularly powerful and united voice from civil society.

Paul Rogers is Professor of Peace Studies at the University of Bradford and Global Security Consultant to Oxford Research Group (ORG). His international security monthly briefings are available from the ORG website at www.oxfordresearchgroup.org.uk, where visitors can sign-up to receive them via email each month. These briefings are circulated free of charge for non-profit use, but please consider making a donation to ORG if you are able to do so.
