

Politics and the Global Economic Crisis

Within a week it has erupted all over.

The US and China had a scrap about alleged currency manipulation, with even the Chinese premier entering the fray; the US Congress is toying with a Buy America provision in the Obama stimulus package (at the time of writing it was unclear whether they had abandoned it); UK workers went on a wildcat strike protesting the employment of foreign migrant workers; an Indian migrant was set alight during anti-migration protests in Italy. Everywhere, economic strain is leading to popular pressure in favour of protectionism.

Many commentators have been warning over the past months that the economic crisis may generate anti-free trade and anti-open economy sentiments which will be to the detriment of growth and recovery. It is happening.

Precisely how politicians deal with this, is of the utmost importance in getting the world out of its economic pain. Political failure may well exacerbate the crisis.

Protectionism

Resisting protectionism is an enormous political challenge. The biggest global danger is an all-out clash between the US and China.

The US believes that China is manipulating its currency in an effort to increase its exports, and that this is the reason for the huge trade imbalance between the two countries. The Chinese retort that the trade balance exists because the Yanks save too little and consume too much. The danger is that the US may start restricting Chinese imports, that the Chinese retaliate, and that we end up in a fully-fledged trade war with very destructive consequences for growth. The Buy America proposal in Pres Obama's stimulation package is precisely the wrong kind of thing that Congress may resort to.

Mr Obama has not shown his true colours on this question yet. But he does believe, according to his Treasury secretary, that the Chinese are manipulating their currency for unfair advantage. Mr Obama's party, the Democrats, are not natural free traders. Bill Clinton dragged them kicking and screaming to support free trade agreements. Will that support hold? A lot depends on which way Mr Obama swings.

Linked to protectionism is the danger that the pendulum might swing too far towards state control and regulation of the economy in individual countries.

In Davos last week, a warning in this regards came from a most unexpected source. Mr Putin, ex-KGB head and certainly not an economic liberal, cautioned against an over-correction towards protectionism and state control. After all, his country has been there and it is not recommended.

Global politics are indeed upside-down if the Americans and Britons are nationalising and imposing trade protection and the Russians are warning against it!

From blame to solutions – co-ordination needed

Also at Davos, Mr Putin had a go at the Americans. Apportioning blame is understandable, but a solution needs something more constructive.

The four biggest economies in the world, the US, Japan, China and Germany (also the EU) are not co-operating sufficiently to deal with this crisis. Many questions remain unanswered:

Should banks be re-capitalised (i.e. nationalised with taxpayers money) or should a “bad bank” take the toxic assets off banks’ balance sheets (also with taxpayers’ money)? What will it all cost?

(It is quite clear that we have not reached the end of the banking saga yet. In Dec 2006 the total amount of derivative “assets” were estimated at \$400 trillion (Niall Ferguson, Dec 2008). Cees Bruggemans reckons that to date actual financial losses stand at about \$2 trillion. That would be good news if it would cover the whole bill, but?!)

Are only the US & China going to implement stimulus packages of meaningful size? Are those packages sufficiently targeted and directed to ensure maximum impact?

Even if they are, will it be enough to pull the world economy back from the edge of recession? Are we employing enough force to deal with this crisis? What are the other big economies bringing to the party to ensure maximum bang for a buck?

In principle, is it correct to pursue a cheap money policy when it was cheap and easy money that got us into the problem in the first place? It is probably what needs to be done now, but it will not succeed without a credible plan to restore fiscal and monetary sustainability in the medium term.

The Risk

There are two major risks in this global picture.

The first is that the engine that has brought prosperity through the ages, free trade and globalisation, could go into reverse, or at least be interrupted, as happened during World War I. Globalisation is not new, only the word is. SA developed as a mining economy in the 19th century, thanks to the globalisation processes of the time. China was a formidable force in the 15th century because of openness and an outward-looking attitude (globalisation) and then lost it all because those attitudes were abandoned. If globalisation, by whatever name, goes seriously into reverse, prosperity will also go into reverse.

The second risk, related to the possibility of countries turning inward, lies in a lack of co-ordination. Co-ordination of effort is needed now as seldom before. The developed countries cannot do it on their own, because global reserves sit in the developing economies. The latter, on the other hand, desperately need the developed countries as those are the markets they sell to. That is after all how they

accumulated those reserves. Gone are the days of cosy meetings of a Club of 8 or a small Club of Rich Nations.

Dealing with protectionism and co-ordinating efforts by different sovereign governments to find answers to the above questions could very well mean that politics will play a bigger role than economics in getting us out of this quagmire. Democracy is about bringing people along, developing consensus, and avoiding excess. Can global politics deliver on this? We will know over the next few months.