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Evolution through European Networks

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FINANCIAL CRISES: HISTORICAL CHALLENGES*

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Abstract

The major challenge in the 21st century is globalisation. It is an historical process underpinned by compression, 'a blurring of national borders,' interlocking of nations, and mounting transnational relations. However, such a vision may be shattered by economic fluctuations which may be induced by globalisation itself.

In this context this paper using historical political economy explores more fully financial crises or shocks-exemplified by the 'Great (Gt) Depression' (1929-33), the 'Great (Gt) Recession' ((2008) and its aftermath, and those in the intervening years (1980's and 1990's). This unfolds the origin, the impact, and the policies to tackle crises. It emerges that the failure of financial markets and financial transactions impacts adversely on the real economy with resolution through the state and/or the market. This is based on competing ideologies. Insights emerge into overcoming instabilities through collective action.

- This paper explores themes discussed in a lecture in the Department of Politics and International Studies, University of Warwick, UK on 11th October, 2011. It draws on research on globalisation and financial crises undertaken by the author at the School of International Relations and Strategic Studies (SIRSS), Jadavpur University, Kolkata, India and seminars on the theme at SIRSS and in the Department of History, Jadavpur University. The researcher is Visiting Senior Research Fellow, School of International Relations and Strategic Studies (SIRSS), Jadavpur University, Kolkata, India. His e mail is sumitroy100@hotmail.com

Globalisation

Globalisation-an historical process- is the context within which economic crises or shocks emerge. It is the major challenge in the 21st century underpinned by compression, a 'blurring of national borders,' and mounting transnational relations. This unfolds tensions between the 'national' and the 'global.' Nations have been interconnecting since the pre-colonial era, and this has been intensified by the spread of capitalism, through flows of trade and investment and migration enabling nations to establish economic, political and socio-cultural exchange. However, this has often been on an unequal basis.

The spread of capitalism forms the backdrop to globalisation. This paved the way for dominant nations to advance their goals of growth and expansion-new markets, sources of raw materials, and cheap labour. This shows the spread of capitalism from the domestic (national) to the international-increasing profits through extraction of surplus value. This is rooted in conflicts and exploitative relations between capital and labour spurred by the process of accumulation-cycles of investment and growth. Exchange ties-trade, investment and migration (often forced)-have been bolstered by military and political power through aggressive and often unjust use of force to suppress weaker nations. This emerges in historical struggles in Africa, India, China and the Middle East. Controversies prevail over periodic 'crises of capitalism' and its capacity to 'reconstitute' or 'reinvent' itself.

Essentially, globalisation is an uneven process marked by instabilities with phases of integration, disintegration, and re-integration of nations into the world economy.

The Historical Context

Overall, the history of the major economic crises in the 20^{th} and 21^{st} century offers useful lessons against a backdrop of the spread of capitalism and globalisation.

Two major crises emerged in the 20^{th} and the 21^{st} century-the Gt Depression of 1929-33 and the financial crisis of 2008 dubbed the 'Gt Recession' and its aftermath-interspersed with ones in intervening years (1980's and 1990's).

A fuller grasp of the crises can emerge from investigating the origin, the impact, and the nature of the policies to tackle them. These capture varying intensities of recession and depression-the former is defined by negative growth over two quarters in a year, and the latter by a prolonged phase of recession. The instabilities were defined by collapse of financial markets and financial transactions, including defaults and fall in credit supply, and adverse effects on the real economy. This reveals a decline in investment, consumption, production, GDP, employment and poverty. This is mired in social distress. There is resort to state and/or market policies stemming from conflicting ideological norms. Initially, crises may be confined to specific nations but are likely to spread to other nations via trade and investment.

Policies to restore economic balance have used a combinations of fiscal and monetary tools. These were informed by political and ideological beliefs of the ruling regime with either 'left' or 'right' leanings-the former having a preference for increasing state expenditure, supported by budget deficits to resuscitate the economy, while the latter focuses on restoring equilibrium through 'balanced budgets.' These were informed by different theories. Strong state intervention was rooted in Keynesian ideas. Market driven ones were shaped by monetarist, and classical, and neo-classical economics. Collective international action is the key to tackling crises.

The 'Great (Gt) Depression' of 1929-33

The crisis has occupied analysts. At the time, however, there was limited critique of capitalism. Its origin can be traced to an unprecedented boom in the US in the early 1920's. This created a false illusion of the future. The sudden, total collapse of the financial system including banks and non banking institutions led to a sharp fall in stock market prices, share prices, and collapse in confidence and consumer wealth and a fall in spending. This was stirred by the desire of savers to withdraw money from their banks with a failure of US banks. They were unable to perform their role in business and supply credit. This curtailed business. Many became bankrupt. Banks faced balance sheet problems due to non-performance of loans. The resulting loss of production and jobs with high unemployment (ie. about 25%) intensified social distress. As banks curbed lending, with a fall in credit, many lost their savings, and reduced their consumer expenditure. This adversely impacted economic confidence. The depression worsened social strife with unemployment, breakdown of families, and homelessness. Indeed, many were put on the breadline. This led to escapism. They found solace in 'going for a drive' or frequenting movies. The harsh effects on the US were transmitted over time to Europe, Latin America, Asia, and Africa, with varying levels of decline in output, employment, and income. This led to diverse policy responses. The following were the core features:

- Access to cheap funds and sustaining an artificial boom before the crisis set in and the pursuit of a rigid gold standard which inhibited monetary policy (ie. increasing money supply)
- The collapse of the banking system-a vicious cycle with a fall in the supply of bank credit, investment, production, and consumption and a decline in GDP and a sharp increase in employment

- Protective trade measures leading to a reduction in imports by the US with adverse effects on the exports of other nations, which in turn responded with similar measures
- Reluctance to use the state to stimulate economic growth and political pressures to pursue a balanced budget over the depression period (ie. 1929-33); however, the state played an active role over 1933-37, though this thrust was abandoned in 1937 with the onset of another recession; state intervention re-emerged when arms had to be supplied for the Second World War (1944-45 onwards).

US banking plunged into a 'meltdown.' There was a shutdown of the whole system in March 1933 after President Franklin Roosevelt took over. He launched the 'New Deal.' The problems stemming from the domestic economy were intensified by the protectionist policies of the US. This was exemplified by the Smoot Hawley Tariffs Act (1930). This raised tariffs on imports by 70%. President Hoover tried to balance the budget in an election year. He pushed and Congress approved a tax increase. This further lowered consumer expenditure. The FED failed to recognize that the rise in interest rates reduced aggregate demand and the average price level.

The impact of the depression shows that by 1932 the US economy had declined by half, and a third of the workforce was unemployed. Industrial production fell by 45% between 1929-32, and in 1933, 37% of industrial workers were unemployed. House building dropped by 80% between 1929-33. Agriculture, too, was badly hit in some regions. This was worsened by drought in 1933. Social distress, deprivation, and poverty emerged. This was seen in lower consumption, poor housing, and worsening of crime. Life style changes, too, exposed the lowering of economic activity. People indulged in going for a ride, smoking, and spending more time at the cinema. Novels such as John Steinbeck's Grapes of Wrath capture the struggle of migrant agricultural workers. They had to sell their land and move from the south west to California to seek farm jobs.

Protective measures of the US spread the depression to other nations. They responded through reciprocal action. This led to an overall decline in world trade, production and employment. The % of industrial workers unemployed in 1933 was 26.6% in Canada and 36% in Germany while, as noted earlier, in the US it was 37% .

Policies to cope with the crisis were informed by state or market led approaches. Republicans had a preference for curbing expenditure and balancing budgets. In contrast Democrats favoured boosting government expenditure through budget deficits to revive growth and curb unemployment. This uncovered a sharp ideological divide between political parties. The Republicans under President Hoover had uncritical faith in the market till 1933. Then Roosevelt was elected as President. His 'New Deal' ushered in an ethos of increasing social welfare expenditure, cutting taxes, and reforming the financial system, to reduce high unemployment over 1929-33. This approach continued till 1937 when a further recession took place with a decline in GDP. The 'New Deal' was buried. However, the onset of the Second World War in the early 1940's saw a revival of the state due to expenditure on armaments to stimulate output and employment.

The concepts underlying the policies aroused debate. Keynesians cited the disequilibrium in real output and questioned the classical model which professed that the economy would automatically restore equilibrium. Monetarists stressed the importance of the money supply. It was alleged that in 1929-33 the Federal Reserve allowed it to fall by a third and that banks were seen as being unsound and allowed to go bankrupt. The fall in money supply was seen as the cause of turning an ordinary recession into a major deflationary depression. Radicals, informed by Marxism, felt that the depression marked the collapse of capitalism. They cited the high levels of unemployment and the inherent instability of the system.

Rival regimes, as stressed earlier, pursued diverse thrusts to cope with the depression. President Edgar Hoover used minimal state expenditure over 1929-33. Democrats, in contrast, argued that measures to lower aggregate expenditure in the economy led to a massive decline in employment and income. Hoover, they felt, might have established a 'near perfect balance' in the budget but this was at a cost of high unemployment. As seen earlier, it was only after President Roosevelt's election in 1933 that the 'New Deal' was adopted as the tool to boost state welfare expenditure along with financial reform.

Keynesians, it should be reiterated, in contrast to the Monetarists, wanted the government to compensate for the slack by stimulating expenditure and reducing taxation. This was slow and painful. Radicals (Marxists) were pessimistic. They were convinced that the depression marked the imminent decline of global capitalism.

The depression, however, failed to harness global leadership to shape a collective international response. There was also limited critique of capitalism and its links with the crisis. As emphasized, the post 1944 era, with the onset of World War II, induced government expenditure to increase output and employment. Such measures continued into the 'boom years'- the 'Golden Age'- of the post war years (the 1950's and the 1960's) which ended in the 1970's with emergence of the 'oil crisis.'

The Intervening Crises

These saw instability in the intervening years-1980's and 1990's-and aroused anxieties on their global effects. But there was limited discussion on the possible links between capitalism and the crises. The one in the 1980's was more prominent underscored by a sharp rise in oil prices in the 1970's and the subsequent 'debt crisis,' while that in the 1990's in East Asia, though intense, was confined to the region.

The 1980's Crisis

The shock stemmed from the 'oil crisis' in the 1970's. This led to a quadrupling of the price of oil, first in 1973-74, and then a sharp rise in 1979, adversely effecting the balance of payments of oil importing developed and developing countries. The latter were able initially (ie. early 1970's) to finance their extensive external deficits by access to cheap loans from banks. They recycled the surplus oil revenues of the oil producing countries. The era of 'debt led growth' took root. However, from 1979 onwards, after the second rise in oil prices, there was a sharp increase in interest rates. This worsened the external debts of developing countries. This was intensified by a fall in exports, foreign investment and aid, due to balance of payments deficits and mounting external debts faced by oil consuming developed countries. This paved the way for the 'lost decade' of the 1980's. Subsequently, developing countries could only get loans to finance their deficits at high interest rates. This required compliance with stringent Structural Adjustment Policies (SAP). These stemmed from a resurgence of the market based 'neo-liberalism' shaped by the ideology of the 'Washington Consensus' inculcated by the IMF and the World Bank. The harsh 'conditionalities' of such measures impinged on curbing state intervention and relied on the market while opening up the economy. This called for reducing expenditure through slashing subsidies, encouraging privatization, and devaluation to curb debts and stimulate growth. The impact, especially on Africa, was mired in controversy.

The surplus of the oil producing nations and the deficits of the oil consuming countries led to anxieties over imbalances in the world economy. Alongside, the hope that the oil producing countries would usher in a New International Order, through a re-distribution of income from developed to developing nations, was dashed. The surplus oil revenues of OPEC could not be invested in most of the major oil producing nations. This was due to human and infrastructural obstacles. The surpluses were transferred to western banks to ensure liquidity and safe returns. As creditors they made available cheap loans to oil consuming debtor nations, including oil consuming developing countries, particularly in Africa and Latin America, and to a limited extent in Asia. They could borrow cheap in the early phase of the 1970's, when oil prices tripled, and service their debts. This enabled them to pursue 'debt led growth.' At the same time East Asian nations devised and controlled their own version of 'adjustment.' This had positive effects on growth and poverty reduction. However, the sharp rise in oil prices in 1979 led to inability of developing countries to pursue the earlier 'debt led growth.' This worsened external indebtedness. This was due to an increase in interest rates, inability to get fresh loans, fall in exports (due to cutback by developed oil consuming nations), and a decline in aid and foreign investment, ushering in 'the lost decade' of the 1980's.

The IMF and the World Bank-the major driving force-laid down the terms on which developing nations could borrow. National-international ties were intensified. This was seen in Africa's experience of debt and adjustment to restore equilibrium of the balance of payments. The outcomes were mixed in terms of reducing external debts and stimulating growth and curbing poverty. SAP were subsequently revised in the early 1990's to incorporate criticism of inadequate emphasis on curbing poverty. However, the underlying faith in the market was undimmed.

The 1990's Crisis

The crisis emerged over 1997-2000 in East Asian economies. Initially it was feared that it would spread to other regions. However, it remained confined to the region. It originated from a failure of financial markets and financial transactions. It had harsh effects on the real economies of countries within East Asia. This lead to a fall in output, employment, and income and worsening of poverty underscored by access to cheap loans from unregulated financial markets, and their use for unproductive or worthless projects. This ensued due to lack of adequate vigilance and control over the supply of loans. The rise of such 'free markets' arose from a belief in financial liberalization strongly influenced by the market ethos and the 'Washington Consensus.'

The core problem was ignited by access to cheap finance and its easy supply by creditors. Corruption in granting loans led to investments which either yielded low returns or had little value. Borrowers started defaulting on their loans. There was a squeeze on the supply of credit. This was harmful for the economies with a sharp decline in investment, production, consumption, employment, and income. There was a rise in the level of poverty. This had fallen sharply in preceding years. Indeed, the shock reversed gains in growth in the region.

The crisis was defined by default and the subsequent credit squeeze. The state resorted to drastic steps to arrest the adverse effects on their economy. Fierce debates ensued on the virtues of allowing markets a free reign. Certainly, the crisis reversed progress in growth in previous years under the 'Asian Miracle.' A new phase-the 'Asian Meltdown'-emerged. This enabled insights into the limits of the market and the role of strict state regulations, monitoring, and supervision of financial transactions. The core facets uncover the interaction between the financial and the real economy. Borrowers obtained cheap bank loans. Creditors supplied them with few checks and controls over regulations on their distribution and use. This exposed the limits of financial liberalisation and the need for the state to monitor and supervise the financial-real economy nexus.

Policies based on a judicious use of the state and vigilance over the market through reforms over financial transactions paved the way for recovery by 2000. This was slow and painful. Though the experience did not arouse critical discussion on capitalism and crises, it did initiate doubts about neo-liberal market ideologies, and specially financial liberalization. This reposed questions on the role of the state in financial transactions. Moreover, international financial institutions acknowledged some of the pitfalls of 'free markets.'

The Financial Crisis of 2008 and its Aftermath

The crisis is framed by those in the past and the rapid spread of globalisation and transnational relations. It has, moreover, revived vigorous debates on capitalism and the role of 'neo-liberal' market forces in driving globalisation. Optimists argue that it has been spurred by an 'ethos of capitalism.' It is claimed that this has been galvanized by animal spirits, inventions, high returns and creative spirit-greed and failure, euphoria and panic, and rapid growth and recession. Hence, crises and economic shocks may be integral to capitalism and inevitable as in the 1929-33 depression. This has aroused controversies on capitalism and its reform or replacement by an alternative system.

The crisis of 2008 is certainly the major shock after the one in 1929-33. It hinges on interaction between nations and the role of collective policies to wield more control over economic instabilities.

There are similarities between the beginning of the recent crisis (to April 2008) and the Gt Depression (1929-33) according to two leading economists, Eichengreen (University of California) and O'Rourke (University of Dublin):

First, global industrial output tracks the decline in industrial output during the Gt Depression to dropping closely. With Europe the decline in the industrial output of France and Italy was worse than at this point in the 1930's while that of the UK and Germany was about the same. The decline in the US and Canada was also close to those in the 1930's. But Japan's industrial collapse was far worse than in the 1930's despite recent recovery.

Second, the collapse in the volume of world trade was more intense than during the first year of the Gt Depression. Indeed, the decline in world trade in the first year was equal to that in the first two years of the depression. This was not due to production. It stemmed from a collapse in the demand for manufactures.

Third, despite a bounce, the decline in world stock markets was far worse than in the corresponding period of the Gt. Depression.

The authors concluded that "globally we are tracking or doing even worse than the Gt Depression. This is a Depression sized event." This was premature. Steps were taken to stimulate recovery at the national and the international level from the close of 2008 onwards.

The crises in the 1980's and the 1990's, too, furnish useful comparison in terms of the nature of financial and economic instabilities. The one in the 1980's aroused anxiety on the impact of imbalances between creditor and debtor nations. This arose from the surplus of the oil producers and the deficits of the oil consuming developed and developing countries. The recycling of the surplus oil revenues through the banks was able to satisfy oil producers and enable oil consuming countries to finance their deficits. This minimized imbalances in the world economy. In the 2008 crisis similar fears re-surfaced but international agencies (eg. IMF) came to the rescue. They supported countries which faced mounting deficits in the balance of payments due to decline in both capital flows (FDI) and exports. The 1980's crisis intensified the role of market forces through liberalization. This aimed to establish balance of payments equilibrium and restore growth. The impact was harsh for many developing countries. However, the crisis uncovered the weakness of markets and the need to re-think the role of the state.

Reflections on the 1990's crisis, too, show the limits of liberalisation, and especially of finance, and the adverse effects on the real economy of nations (ie. East Asia) due to lack of regulations. The scope of the state in monitoring financial transactions was emphasised spurred by a sharp critique of the 'Washington Consensus.' State intervention to resuscitate economies was seen as being critical. Possibly, due to the crisis being confined to a specific region, the implications for a globalising world were bypassed. Policy makers failed to learn from this experience to exercise more caution and monitor financial transactions.

The origins of the 2008 crisis in the US need to be investigated. The conditions in the nation prior to the 'sub-prime crisis' in the housing market in 2007 were critical. The default ratio that occurred in 2007 was preceded by an enormous increase in home purchase loans and a rise in home mortgage credit. Over 2002 to 2005 the Federal Reserve should have been more vigilant in controlling the spiralling mortgage credit expansion. Theoretically, banks can expand credit supply and hence have to be controlled and supervised by the central bank. This could explain the reason for leaving alone non banking institutions. They got their loanable capital by selling new types of financial assets to parties outside the financial system. This made possible the so called 'money multiplier' which increased sharply enabling the massive credit expansion of the pre-crisis years. By holding each others debt assets financial companies were virtually based on a 'shadow banking system.' The bursting of the sub prime bubble in 2007 exposed the larger (absolute) value of the money multiplier world. There was a massive credit squeeze. It exposed poor regulation of financial markets exemplified by sub-prime mortgage credit. Borrowers took loans beyond their legitimate capacity and defaulted. Suppliers, alongside, including banking and non banking ones, made them easily available. There were no stringent controls or checks over rules, regulations, and procedures.

Basically, when borrowers stopped repaying loans all the markets, stocks, bonds and derivatives collapsed. This is because these were closely tied. Such markets had the same participants, the only difference being the level of their exposures. Big investment banks chased a chimera called 'credit derivatives.' This was a tradeable investment that got its value from cheap loans to people with poor credit histories. A major factor underlying the crisis was excessive dependence on a real estate boom triggered by credit unworthy people being given loans. This resulted in large scale loan defaulting leading to a lowering of demand, output and employment. Hence, there was significant loss of income in US.

The 'contagion' effects of the financial crisis spread to other sectors of the US economy and then to the rest of the world. Countries which were more open were more exposed to the vagaries of external fluctuations. The crisis was transmitted from the US to developed and developing countries through exchange relationships-trade (exports and imports) and finance (portfolio loans, bank loans, and remittances), and investment (foreign direct investment). The failure of major financial institutions in the core financial systems froze interbank and credit markets. This led to a revision of the price of risk upwards and sparked a global liquidity shortage. The subsequent search for liquidity worldwide led to the sale of liquidity and debt securities and the withdrawal of capital from the emerging markets. This destabilized banking systems far from the centre of the crisis. The retreat of capital from developing nations led to a rise in the cost of finance. This had adverse effects on investment and growth.

Developed nations, in comparison with developing ones, faced more risk due to their significant trade and investment links and similar structures (ie. dependence on manufactured goods and FDI). But developing nations, too, have been opening up their economies. Hence, they were also sensitive to changing external conditions though the impact on them was uneven. Their development, especially in Africa, was undermined. The crisis impacted on the 'Emerging Giants'-China and India-but they were able to confront it much more effectively than developed nations. They recorded relatively higher growth rates. Indeed, they became major players in reviving the world economy.

The effects of the crisis on the real economy-the rate of growth and trade-have to be seen on three fronts-world, developed, and developing. The % rate of growth of GDP started falling from the close of 2008, declining sharply in 2009, and only started to revive from early 2010 with forecasts of a gradual rise in the future. However, the US and Europe started facing new crises from early 2011 onwards, and this continues in 2012, with pessimistic forecasts of the future.

The 2008 crisis had the following impact:

World (Rakshit, 2010):

At the world level the % rate of growth of GDP was 2.9% (2nd Quarter 2008), 1.7% (3rd Quarter 2008), -1.0% (4th Quarter 2008), -3.4% (Ist Quarter 2009), -3.2% (2nd Quarter 2009), and -2.0% (3rd Quarter 2009).

- The rate of growth of exports and imports also reveals sharp falls: exports fell by 2.9% (3rd Quarter 2008), -5.8% (4th Quarter 2008), -15.4% (Ist Quarter 2009), -15.5% (2nd Quarter 2009), and -11.5% (3rd Quarter 2009) while imports fell by 2.3% (3rd Quarter 2008), -4.5% (4th Quarter 2008), -15.6% (Ist Quarter 2009), -17.3% (2nd Quarter 2009), and -14% (3rd Quarter 2009). WTO Secretariat estimates indicated that the rate of growth of world trade fell by over 12% in 2009-the lowest since the 1929-33 depression though they forecasted that this would increase by over 9% in 2010. Unemployment, too, increased sharply over the same period for developed nations exemplified by the US unemployment rate of about 10% in 2009.

Developed (Rakshit, 2010)

- Developed nations were badly hit. This is captured in the experience of the US. Its % rate of growth of GDP fell sharply: 2% (Ist Quarter 2008), 1.6% (2nd Quarter 2008), 0% (3rd Quarter 2008), -1.9% (4th Quarter 2008), -3.3% (Ist Quarter 2009), -3.8% (2nd Quarter 2009) and -2.3% (3rd Quarter 2009). The % rate of growth of exports and imports also shows a sharp decline: % rate of growth of exports was 9.3% (Ist Quarter 2008), 11% (2nd Quarter 2008), 5.4% (3rd Quarter 2008), -3.4% (4th Quarter 2008), -11.6% (Ist Quarter 2009), -15% (2nd Quarter 2009) and -11.2% (3rd Quarter 2009); the % rate of growth of imports was -0.8% (Ist Quarter 2008), -1.9% (2nd Quarter 2008), -3.3% (3rd Quarter 2008), -6.8% (4th Quarter 2008), -16.2% (1st Quarter 2009), -18.5% (2nd Quarter 2009) and -14.9% (3rd Quarter 2009).

- OECD countries were badly hit with a rate of growth of GDP of about 2.4% (Ist Quarter 2008), 1.7% (2nd quarter 2008), 0.4% (3rd Quarter 2008), -2.1 % (4th Quarter 2008), -4.7% (Ist Quarter 2009), -4.6% (2nd Quarter 2009), and -3.4% (3rd Quarter 2009). The % rate of growth of exports was 6.7% (Ist Quarter 2008), 5.6% (2nd Quarter 2008), 2.5% (3rd Quarter 2008), -6% (4th Quarter 2008), -15.8% (Ist quarter 2009), -15.9% (2nd Quarter 2009), and -11.7% (3rd Quarter 2009); the rate of growth of imports was 4.5% (Ist Quarter 2008), 2.7% (2nd Quarter 2008), 0.6% (3rd Quarter 2008), -5.6% (4th Quarter 2008), -15.4% (Ist Quarter 2009), -16.7% (2nd Quarter 2009), and -13.1% (3rd Quarter 2009).

Developing

- Developing countries were less affected than developed ones due to the nature of their links with the world economy. But African ones faced a fall in their rate of growth. This slowed down their pursuit of the Millenium Development Goals to curb poverty which fell from 5% in the pre-crisis to 2.5% in the crisis era (ie. at the close of 2008) as a result of a decline in inflows of capital (including a credit squeeze), FDI, exports, and aid. However, from early 2010, the rate of growth started rising to about 4% with the hope that the upward trend would continue. Alas, the re-emergence of the problems from 2011 onwards in the US and Europe are causing much concern.

- The 'Emerging Giants'-China and India-were not able to avoid the adverse effects of the crisis but unlike the developed nations they were able to pursue a positive rate of growth, and gradually revive their pre-crisis rate of growth (Rakshit, 2010). Thus, the % rate of growth of GDP in China fell from 11.2% in the 4th quarter of 2007 to 6.8% in the 4th Quarter of 2008 but there was an upward trend with a rise to 7.1% in the 2nd Quarter of 2009 and 8.9% in the 3rd Quarter of 2009. This continued with a marked rise of over 10% in 2010. India's % rate of growth of GDP fell from 9.5% in the 4th Quarter of 2007 to 4.8% in the 4th quarter of 2008. But there was a rise to 6.7% in the 3rd Quarter of 2009. As in the case of China this trend continued in 2010 with the % rate of growth of GDP of about 7.9% in 2010. Both nations, and specially China, faced a fall in their exports due to the sharp decline in the GDP of developed nations. But the large domestic markets in both were the impetus for growth during the crisis.

Policies to tackle the 2008 crisis in all nations stemmed from an urgency to boost growth through state fiscal and monetary expenditure. The influence of Keynesian economics became more prominent with deficit financing being initially used to boost expenditure in the major developed nations –the US and Europe-with a call for supporting developing nations in Africa through international loans. This could compensate for a decline in their rate of growth due to a fall in exports of commodities, credit supply, remittances aid, and foreign investment.

A premise which informed policies in the US was that under capitalism agents should be responsible for their own behaviour. Hence, it was argued that they should be responsible for the consequences of their action even if it leads to bankruptcy. It was felt that such agents may not deserve the support of taxpayers as the logic of "profits being private" could not be reconciled with "losses having to be social." However, the crisis in the US was viewed as being exceptional due to "systemic risks" with the collapse of one big institution creating big ripples. This endangered the entire financial system. The interlocking of the financial system meant that the 'contagion' effect led to the transmission of the crisis across financial markets, the real economy and nations.

Ideologically, in spite of the shift in emphasis from the market to the state in the period immediately after the 2008 crisis, from 2010 onwards, there was a call in the US and Europe to revert to the market. This stemmed from anxiety over rising budget deficits to meet immediate goals. However, in the long term this could lead to a rise in interest rates, a fall in investment, growth and employment. This is exemplified by the political clamour of the Republicans in the US to curb the role of the state as their power re-emerged in the House of Representative and the Senate.

The US continued to face many challenges. This is exemplified by the curbs in its budget deficit made by President Obama's 2011 budget. This aimed to cut $ 1.1 tn (690 billion pounds) from the US budget over the next decade. Obama stated that it was important to live within ones means but at the same time stressed "we can't sacrifice our future with drastic cuts." However, the Republicans did not think that the budget cuts went far enough in coping with debts as deficits were expected to increase to $1.64 tn in 2011.

The backdrop to Obama's budget throws light on the contrast in the perception of Democrats and Republicans. The inflexibility of Republicans was blamed for the "debt crisis" in the US from late 2010 onwards. The majority in the Congress were reluctant to allow the raising of the legal limit or ceiling on 'debt' before spending cuts were imposed. In May 2011 the Federal government reached the legal debt ceilings level of US $ 14.3 trillion. The Obama administration was unsuccessful in eliciting adequate support of the Republicans to raise it. A Congressional deadlock could have had far reaching consequences. This is because the Obama administration would have had to implement expenditure cuts including postponement of debt repayment. This had implications for disruption of capital flows globally. The new Budget Control Act of 2011 agreed to raise the debt ceiling by US 2.1 to US $ 2.4 trillion (in 2 stages) subject to the deficit reduction programme being spread over a decade up to 2021.

Domestic policies in the US have critical repercussions for the rest of the world. In terms of % of debt, China accounts for approximately $ 1.2 trillion out of US external debt of $ 4 trillion. Hence, inability to curb US debts could adversely effect China. India is also anxious as a decline in the US economy could reduce its exports and its rate of growth.

Europe, too, faced political pressure from the 'right' leaning parties to tackle the 2008 crisis by cutting back rising debts (as a % of GDP) and budgets deficits (as a % of GDP). This impinged on curbing demand, investment, and social welfare expenditure with adverse effects for employment. There was stiff resistance from organized labour as in Greece, Ireland, Spain and France.

The EU's convergence criteria rested on adopting as part of economic and monetary policies government: debt ratio not to be > (greater than) 60% at the end of the fiscal year and annual government debt not to exceed 3% of GDP. The obstacles could be identified in the data for 2009. This revealed that only two of the 16 Eurozone countries-Luxembourg and Finland- managed to stick to both rules. Overall, Greece was a major offender with total debt as a % of GDP of 115.1% and deficit as a % of GDP of 13.6%. Among the larger economies Italy faced problems-with a total debt as a % of GDP of 115.8%. Spain's deficit, too, as a % of GDP was 11.2% of GDP. If UK had been in the Eurozone it would have fallen short of the criteria as it had a debt of 68.1% of GDP and a deficit of 11.5% of GDP (Economic Policy, April 2010).

The resurgence of debt problems in Europe–coined the 'Eurozone crisis'- started unfolding from early 2011 onwards. Many economies face uncertainty and instability. This was exemplified by Greece. It was heavily indebted, and on the verge of defaulting on its loans owed to European and in particular German and French banks. It turned to the EU and the IMF to seek loans based on strict 'conditionalities.' This was based on heavy curbs in public expenditure. Portugal, too, in October 2011, faced the likelihood of default and having to take loans on stringent terms from the EU and the IMF. Italy followed a similar path. Bailing out debt ridden countries through financial support of the EU and the IMF is the core of national and European parliamentary debates. Inability to repay debts impacts on the lenders and their economies. Growth forecasts in the Eurozone area have been lowered. Its high unemployment rate (ie. 10%) poses a major challenge. Indeed, Europe may confront a 'lost decade.' This is likely to result in economic, social and political instabilities. This has been stirred by the ongoing (February 2012) discussion on Greece being given a loan of 130 bn Euros ($ 170 bn) by the EU and the IMF to avoid default by repaying its debts. This was on condition that it sharply curbs its public expenditure-including slashing pensions and civil service jobs despite extensive demonstrations and protests. After much controversy Eurozone finance ministers sealed the bailout on 21st February 2012 to avert a chaotic default in March after forcing Athens to commit itself to unpopular cuts and private bondholders to accept deeper losses. The agreement was hailed as a step forward for Greece but doubts immediately surfaced as to whether it would do much more than deal with its most pressing debt problems. It is expected that Greece will need more support if it is to bring its debts down to the level envisaged in the bailout. In this respect, it is likely to remain "accident probe" in the future. The nature of policies in Europe to cope with the crisis is underlined by its summit in January 2012. This emphasized the need to strike a balance by focusing on growth and "smart" budget discipline. Twenty-five of the EU's 27 member states agreed to join a fiscal treaty to enforce budget control.

The US and the Eurozone crisis from 2011 onwards have re-kindled fears of a 'second recession' (ie. after the 'Great Recession' of 2008) with lowering of growth and a rise in unemployment in the regions and the world. This has led to a revival of the debate on boosting expenditure to stimulate growth versus austerity and cutting back budget deficits. The aim is to create long term investment, consumption and employment. Fierce controversies have raged over the choice of strategies to control the economic crisis. The protests set out to pressurize governments to seek equitable solutions. An era of social and political unrest awaits Europe.

IMF assessment of the crisis and their forecasts of the future highlight the urgency of tackling economic distress through national and global solutions. Forecasts have tended to fluctuate. But generally there has been a tendency to lower the early predictions of the rates of growth. For instance, the world economy was expected to grow at about 4 and a half percent a year in both 2011 and 2012. But advanced economies were set to grow at only 2 and a half percent a year while emerging and developing economies were to achieve a much higher growth rate of 6 and a half percent a year. Such forecasts are being revised downwards. Output in most advanced economies is still below potential with high unemployment and low growth. Pessimists argue that such conditions could persist for 3-5 years.

Fiscal consolidation is the key. This should incorporate market worries about fiscal unsustainability against a backdrop in many countries of banks struggling to achieve high capital ratios in the face of increasing non-performing loans. Emerging markets compensated for shortfalls in external demand through domestic demand, and saw a rise in capital inflows, due to better prospects and higher interest rates than in developed countries. The financial crises in the US and Europe could be worsened by other global problems-oil supply and oil price fluctuations, stemming from Middle East political frictions, and rising food prices.

China and India pursued their own 'stimulus packages' in the aftermath of the crisis (2008) by re-focussing on the state and curbing the market, and especially the financial one, while emphasizing their large domestic markets. The policies to stimulate their economies were strongly influenced by Keynesian ideas. However, the crises in the US and Europe, from 2011 onwards, may lead in the future to a fall in their rate of growth. The 2008 crisis showed the pivotal role of China and India in not only pursuing their growth but also easing recovery of the world economy. Responsibility has been placed on China in particular to use policies to curb imbalances in global finance between debtors (developed countries) and creditors (eg. China). There are pressures on it by developed nations, and especially the US, to revalue the Yuan. This is based on the premise that the currency is overvalued and has unfairly boosted its exports while curbing imports from developed ones. This has also led to pressures on the nation to re-focus on boosting domestic demand and reducing its reliance on exports, and in turn increasing its imports. Such thrusts have been intensified since the 2011 crisis. Developed nations are turning to China to use its surplus to support the debt ridden Eurozone nations.

The Future

Lessons have to be drawn from the history of financial crises in the context of a changing and unpredictable world in which capitalism and 'neo-liberal' market forces continue to reign. Controversies over the virtues of capitalism versus socialism may have become redundant. But the recent crisis (2008) and its aftermath have reignited discussion on the extent to which the capitalist system, driven by individualistic motives, exemplified by the urge to make profits, can sustain development and satisfy socio-economic visions. The role of globalisation is interlinked to this debate. Despite its professed virtues nations are now more vulnerable to changes in the world economy. The history of crises of financial markets and their impact on the real economy unfold in this realm.

The crises were evidenced by falling investment, output, GDP, trade, employment and incomes and policy responses, and the socio-economic plight of the majority. Conflicting ideologies of the ruling powers have motivated the use of the state and/or the market to guide policies. These have led to a stalemate on choice of appropriate policies to minimize recessions and depressions. In this respect, insights emerge from the 1929-33 depression, as well as the ones in the 1980's and the 1990's, and the crisis in 2008. However, the last took place in the frame of an advanced stage of globalisation with mounting transnational relations unfolding major challenges. These are beyond the capacity of individual states. This has been reinforced by the likelihood of a 'second recession' induced by mounting economic problems in the US and Europe from early 2011 onwards. This requires collective democratic action through international institutions.

In this context, pursuing such goals has to be induced through 'global governance.' This has to be genuinely democratic. This calls for revamping the Bretton Woods system-the IMF, the World Bank and the IMF-while reforming the UN, and nurturing the newer G 20. Alas, in spite of the rhetoric, developed countries still wield power in the institutions. For instance, there has been a paring down of their voting power in the IMF by a mere 2.6% from 57.9% to 55.3%. Democratic change in these institutions is essential. This should reflect the aspirations of nation states, and specially the shift in power towards the emerging nations, as well as catering for the poor nations (eg. African), and non state actors- especially civil society as well the values of the corporate sector. BRICS (Brazil, Russia, India, China and South Africa), which are asserting mounting influence in international affairs, could buttress the goals of international reform.

Insights

The historical experience of financial crises offers powerful insights into the nature of forces which create imbalances in the world economy. This has to be seen in the context of capitalism and globalisation, and go beyond technical debates on the virtues of the state versus the market. This should usher in critical debates on the scope of the capitalist system, spurred by individualistic motives, to meet long term goals of growth and sustainable development.

Ideology and politics which galvanize policies to tackle crises have to be unveiled. This calls for integrated international strategies based on truly democratic ‘global governance’ to enable the pursuit of cooperation between nations, supported by ‘traditional’ inter-state relations, and non state actors. Tensions between these levels are inevitable. This should encompass shifts in world economic and political order and the priorities of diverse nation states, and especially those of the rising powers, and the needs of the majority. This should encapsulate the voice of non state actors, especially civil society movements, while incorporating the relevance of corporate values. Such a vision requires revamping the Bretton Woods institutions. They can take the lead, supported by other actors, to cope with economic crises and instabilities. This can pave the way for a new and more democratic world order.

NOTES

1.See Stiglitz, 2002 for a critical study of globalisation. Roy, 2010, Spring 2007 and 2005 discusses aspects of this process. For critiques of capitalism see Brewer, 1980 and Amin, 1998

2. On the Depression of 1929-33 see Bernanke, 2004, Galbraith, 1997, Kindleberger, 1986, Romer, 1992, and excellent study by Eichengren, 2004. The author draws from his seminars in the School of International Relations and Strategic Studies (SIRSS) and the Department of History, Jadavpur University, Kolkata, India over 2010

3.On the 1929-33 depression studies by Bernanke, 2004 and Galbraith, 1997 offer powerful insights

4. See Killick, 1986, 1990 and Stewart, 1985 and Roy, September 1998 on neo liberalism. Also see Ziya and Fikret, 2005 on re-thinking the ‘Washington Consensus.’ George, 1988 offers a polemic study of the debt crisis of the 1980’s. Singer and Roy, 1993 present a historical study of the world economy and developing countries covering the ‘Golden Age’ (1950’s and 1960’s), the era of ‘Debt led Growth’ (1970’s) and the era of the ‘Lost Decade’ (1980’s). Roy, 1998 discusses the relevance of the IMF in relation to structural adjustment and the Asian financial crisis in the 1990’s

5. A range of studies assess the 2008 financial crisis and its aftermath. See for example Corden, 2009, Deeg, 2009, Germain, 2009, Reinhert and Rogoff, 2009, White, 2009, Wells and Krugman, 2010, Nayyar, 2011, Banerjee, 2010, and Rao, 2011. Rakshit, 2010 the reknown statistician presents excellent data on the impact of the 2008 crisis at the world, developed and developing country level (cited in the text) drawing from many sources including the IMF and the OECD. On the impact of the 2008 crisis on Europe see Economic Policy, April 2010, CEPR and OECD, 2010 for a brief review of the problem. On financial internalization see Haggard and Maxfield, 1996. Nayyar, 2011 offers a useful assessment of the 2008 financial crisis and its impact on developing countries in a world context. The media including the BBC World Service covered the issues including the re-emergence of the crisis in the US and Europe in 2011 and 2012

6. Krugman, 2010, Wells and Krugman, 2010, and Cassady, 2010 offer different views on the role of the US government in tackling the financial crisis. Dutta, 2010 discusses austerity and the global financial crisis. The author discussed the crisis when it was in its early stage (October 2008) along with other commentators on the issue. See BBC World Service News, ‘ How Did All Go Wrong,’ http://www.bbc.co.uk/ worldservice/news/2008/10/081024/What Went Wrong.Shtml

7. On the financial crisis and China-Africa ties see mbiriri at http://www.consultancyafrica.com, UNECA, 2009, Roy, May 2010, The New York Times at http://nytimes.com; Haifang, 2009 and allafrica.com

8.See The New York Times at http://www.nytimes.com on the financial crisis and China-Africa. Also see Haifang, 2009 on the future of China-Africa programmes discussed at meeting of FOCAC, Forum on China-Africa Cooperation, held in Egypt in November 2009. See Sharma, 2009 on the financial crisis and India-Africa ties and Mazumdar at http://www.mg.co.za and the Economic and Political Weekly, November 2008 and December 2009.

9.See paper by Fang et al, 2010 on growth and employment in China after the financial crisis (2008).

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