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Uneven Development And Crisis under Contemporary Capitalism

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Those who manage current day capitalism exude a new confidence. Underlying that confidence is the performance of the US economy in recent years. As compared with an annual average rate of growth of GDP of 2.9 per cent during the decade 1982-91, the US economy has expanded at an average rate of 3.6 per cent during 1992-99 and 4.2 per cent during the last three years. Moreover, there have been only 2 years during the 1990s (1993 and 1995) when growth in the US has been lower than it had been on average during the 1980s. Such growth has helped reduce unemployment from 7.0 per cent during the 1980s and 7.5 per cent during 1992, to 4.2 per cent in 1999. And despite high growth, inflation in the US runs at 1.2 to 1.5 per cent, as compared with 3.7 per cent during the 1980s. A change in the inner nature of capital, protagonists of the system argue, has made a combination of high growth, low unemployment and moderate inflation the norm under capitalism.

It is not too difficult to discover the obvious flaw in this argument. While the US does constitute the leading power, both economic and political, in the world capitalist system, it is hardly representative of the whole. In fact, a striking feature of the 1990s has been the unevenness of economic advance under capitalism. This unevenness is reflected in both the significant variations in economic performance between the advanced industrial economies, and in the widening of economic differentials between the advanced and underdeveloped regions of the world.

To start with, the world economy in the 1990s has been characterised by slow growth in Japan and across much of the world. According to the World Economic Outlook of the IMF, the average rate of world economic growth during the 1990s was only 3 per cent, which is below the 3.5 per cent average of the 1980s and the 4.5 per cent of the 1970s. The figures for 1982-91 and 1992-1999 stood at 2.6 and 1.9 per cent respectively in the case of the European Union and 4.1 and 1 per cent in the case of Japan. World trade growth,

which accelerated from close to 4 per cent in the year 1992-93 to more than 8 per cent on average over the next four years, rendering national growth rates less significant, is back to its earlier levels over the last two years.

Looked at from the point of view of unemployment, while the US has passed through a phase of almost continuous buoyancy with declining employment rates (from 7.5 to 4.2 per cent) starting in 1992, Japan has recorded a continuous increase in unemployment rates from 2.1 to 4.2 per cent between 1991 and 1999, Germany from around 6 to over 9 per cent and France from 9 to 11-12 per cent. Thus within the developed "triad", the good days seem to be large confined to the workers in the US, and to an extent in the UK.

Further, there are signs of an increase in instability both in the financial and the real realms of the world economy. The instability in the financial sector has been widely reported by the media. Matters have reached such a pass that even George Soros, the much-celebrated financial czar of the "new economy", has announced his decision to retire into philanthropy. The hedge fund master, who through his Quantum Fund, drove market sentiment, placed and quite routinely won big bets in currency and stock markets, and challenged sovereign nations and their governments, has been badly bruised by two developments: the sharp fall of the Nasdaq index and the weakening of the Euro. We must recall that by April 14, 2000 the Nasdaq index fell by 34 per cent from its March 10th peak, and even by the end of April ruled at around 25 per cent of that level. And the euro has depreciated by around 10 per cent over the first four months of year 2000. Unfortunately for Soros, the Fund's managers failed to pull out of technology stocks in time and erred in their judgment on how the euro would move. In the event the Quantum Fund lost around 20 per cent of its value (or around $5 billion) in the just the first four months of year 2000. A chastened Soros has decided to restructure his operations, rename his company Quantum Endowment Fund, invest in less risky assets that promise a stable return, and use the proceeds for his charitable activities. The markets are proving too volatile even for a player who built his empire over three decades by exploiting that volatility to garner annual returns in excess of 30 per cent.

This development is more then incidental, because in a world dominated and driven by finance, the change in sentiment that the Soros decision heralds, can be quite damaging. The problem of instability is not restricted to the realm of finance. In the real realm too, besides the two phases of significant slowdown in economic growth (in 1991-93 and 1998-99) over the decade, and the crises in

Mexico, East Asia, Russia and Brazil, the 1990s have closed with extreme weakness in Japan, despite repeated efforts to revive the economy with lower interest rates and large deficits. *Figures reported in April 2000 indicated that restructuring efforts by Japanese firms have not merely taken unemployment to a post-War high of 4.9 per cent, but unemployment among males rose by 0.1 percentage point in March to touch 5.2 per cent and that unemployment among males aged 15-24 rose by 0.8 per cent year-on-year to touch a record 12.5 per cent.*

In the past, such variations in economic performance would have been seen as the basis for an intensification of imperialist rivalry. Nations performing poorly in economic terms would through aggressive State support for their own capitals, both in the domestic economy and abroad, seek to close the gap relative to the hegemonic power. With the collapse of the erstwhile Soviet Union, which did away with a common enemy serving to bind the imperialist powers together, this tendency was in fact expected to aggravate. However, as many commentators have pointed out, a remarkable feature of the current conjuncture under capitalism has been the muted nature of inter-imperialist rivalry. While differences over trade and other macroeconomic problems are periodically visible, they are quickly managed and this process of managing contradictions has sought to be institutionalised through agencies like the World Trade Organisation. This unity within the imperialist camp, in search of means to prop up sagging profits and looking for a vent for its unutilised capacities and unemployed workers, has proved extremely damaging for the underdeveloped countries of the world. Pressure to open up the markets for goods and services, to relax foreign investment rules, to permit the free flow of finance into and out of the country and to keep commodity prices low, has increased substantially in recent times. US and European policy on a range of fronts, including insidious protectionism in trade and demands for unequal multilateral rules for investment illustrates this tendency. The relentless pressure on the developing countries to “reform” also illustrates it. At times the pressure takes obviously crude forms. For example, in the wake of reversal of the oil price decline of 1997-98, ensured by production cuts by OPEC countries, Republican Senator Benjamin Gilman, chairman of the house international relations committee, initiated discussions on legislation aimed at pressurising OPEC by stopping US aid and arms sales to countries seen to be engaged in oil price "fixing". The message was clear. Non-inflationary growth in the US depends on depressed oil and commodity prices, which the US would strive to maintain at any cost, while winning further concessions for its allies, plagued by slow growth and unemployment.

The Role of Finance

The virtually contradictory combination of uneven development and muted rivalry within the imperialist camp, which underlies the new offensive against the underdeveloped regions, is directly related to growing integration between these countries through cross-border flows of foreign capital. Such flows have risen dramatically in recent years, signalling a whole new phase of global economic development.

This process of financial globalisation has now a long history. It began in the late 1970s with a shift to investments in financial sources of profits in the wake of the end of the post-War boom in the developed industrial world. The shift gathered momentum aided by a range of developments. The major industrial capitalist countries first began relaxing controls on currency movements in the late 1960s, and the move to "floating" or flexible exchange rates in the early 1970s hastened the process. In that decade, there were specific developments outside the realm of finance itself that contributed to an increase in international liquidity, such as the surpluses generated by oil exporters after the oil price increases, which were largely deposited with the international banking system. The explosion of the Eurocurrency market in the 1970s reflected this. From the 1980s, there were other real factors which created pressures for the expansion of finance. These included the changing demographic structure in most of the advanced countries, with baby boomers reaching the age when they would emphasise personal savings for retirement. This was accentuated by changes in the institutional structures relating to pensions, whereby in most industrial countries, public and private employers tended to fund less of the planned income after retirement, requiring more savings input from employees themselves. All this meant growing demands for more variety in savings instruments as well as higher returns, leading to the greater significance of pensions funds, mutual funds and the like.

Financial liberalisation in the developed countries, which was closely related to these developments, further increased funds available in the system. First, it increased the flexibility of banking and financial institutions when creating credit and making investments, as well as permitted the proliferation of institutions like the hedge funds, which, unlike the banks, were not subject to regulation. It also provided the space for "financial innovation" or the creation of a range of new financial instruments or derivatives such as swaps, options and futures that were virtually autonomously created by the financial system. Finally, it increased competition and whetted the appetite of banks to earn higher returns, thus causing them to search out new recipients for loans in different economic regions.

The massive increase in international liquidity that followed found banks and non-bank financial institutions desperately searching for means to keep their capital moving. At first, there were booms in consumer credit and housing finance in the developed industrial nations. But when those opportunities petered out, a number of developing countries were discovered as the "emerging markets" of the global financial order. Capital in the form of debt and equity investments began to flow into these countries, especially those that were quick to liberalise rules relating to cross-border capital flows and regulations governing the conversion of domestic into foreign currency. The result of these developments was that there was a host of new financial assets in the emerging markets, which were characterised by higher interest rates ostensibly because of the greater risks of investment in these areas.

There are a number of features characteristic of the global financial system that evolved in this manner. Principal among these is the growing importance of unregulated financial agents, such as the so-called hedge funds, in the system. Many years back the Group of 30 had cautioned governments that these funds were a source of concern because they were prone to "undercapitalisation, faulty systems, inadequate supervision and human error". Though hedge funds first originated immediately after the Second World War, they have grown in number and financial strength in recent times. Their number is currently placed at between 3000 and 4000 and they are estimated to be managing $300-400 billion of investors' money. These investors include major international banks, which are themselves forced by rules and regulations to avoid risky transactions promising high returns, but use the hedge funds as a front to undertake such transactions.

The operations of the now infamous Long Term Capital Management illustrate this. LTCM operated out of the US, as most hedge funds do, and was well known not only because of the two Nobel prize-winning economists who had helped to found it, but because its list of investors read like a virtual "Who's Who" of international capitalism, with almost every large bank and important individual wealth-holder being represented. The fund’s principal trading activity was based on exploiting the differentials in interest rates between different securities. It was to the credit of LTCM, it was argued, that it indulged in such trades by investing primarily in sovereign debts in emerging markets which were more secure, and yet garnered returns as high as 40 per cent on capital. What was less praiseworthy was the extent to which its operations were based on borrowed capital. On an equity base of a little less than $5 billion, LTCM had borrowed enough to undertake investments valued at

$200 billion or more. This was possible because there was nothing in the regulatory mechanism that limited the exposure of these institutions relative to their capital base. Yet when several of its own investments came unstuck in 1998 and LTCM therefore faced major repayment problems of its own, it had to be rescued by the US Federal Reserve, because the costs of its collapse were seen to be too major.

Such flows of credit to a few institutions are significant because in a world of globalised and liberalised finance, when countries are at different phases of the business cycle and characterised by differential interest rates, capital will tend to flow in the direction of higher returns in the short term. Nothing illustrates this better than the "yen-carry trades" of the period 1995 to 1997, discussed below, which involved borrowing in yen, selling the yen for dollars, and investing the proceeds in relatively high-yielding US fixed-income securities. The implications of these and other flows to the US was that international liquidity "was intermediated in US financial markets and invested abroad through purchases of foreign securities by US investors ($108 billion) and by net lending abroad by US banks ($98 billion)." America was sucking in capital from the rest of the world to be invested across the globe.

There are a number of points to note from these examples. To start with, the current global financial system is obviously characterised by a high degree of centralisation. With US financial institutions intermediating global capital flows, the investment decisions of a few individuals in a few institutions virtually determines the nature of the "exposure" of the global financial system. Unfortunately, unregulated entities making huge profits on highly speculative investments are at the core of that system.

Further, once there are institutions that are free of the now-diluted regulatory system, even those that are more regulated are entangled in risky operations. They are entangled, because they themselves have lent large sums in order to benefit from the promise of larger returns from the risky investments undertaken by the unregulated institutions. They are also entangled because the securities on which these institutions bet in a speculative manner are also securities that these banks hold as "safe investments". If changes in the environment force these funds to dump some of their holdings to clear claims that are made on them, the prices of securities the banks directly hold tend to fall, affecting their assets position adversely. This means that there are two consequences of the new financial scenario: it is difficult to judge the actual volume and risk of the exposure of individual financial institutions; and within the

financial world there is a complex web of entanglement with all firms mutually exposed, but each individual firm exposed to differing degrees to any particular financial entity.

Entanglement takes other forms as well. With financial firms betting on interest rate differentials and exchange rate changes at virtually the same time, the various asset markets relating to debt, securities and currency are increasingly integrated. Crises, when they occur, do not remain confined to one of these markets but quickly spread to others, unless stalled by government intervention. Finally, the rise of finance in the manner described above feeds on itself in complex ways. The explanation for the liberalisation wave in the developing countries is that this pyramidal growth of finance, which increased the fragility of the system, was seen as an opportunity. Enhanced flows to developing countries, initially in the form of debt and subsequently in the form of debt and portfolio investments were the consequence.

The Consequences

One consequence of the breakdown of the Bretton Woods arrangement, the emergence of a world of floating exchange rates, and the rise of finance was that any effort at pursuing Keynesian-style policies in any one country threatened a collapse of the currency, as the Social Democrats under Mitterand realised in the early 1980s in France. Any effort to pump-prime the system generated inflation, rendered domestic goods less competitive in world markets, widened the trade deficit, weakened the currency and encouraged a flight of capital that threatened a currency collapse. This reduced manoeuvrability of the State meant that attempts to protect domestic economic space and pursue “beggar-thy-neighbour” policies were ruled out. Some other means of trying to spur growth was required, and working on such alternatives required greater collaboration rather than rivalry between the advanced nations.

Further, in the new environment, interest rate differentials accelerated capital movements in a world of increased cross-border financial flows. Higher interest rates in one country (say, the US) relative to another (say, Japan), result in capital flows to the former with two consequences: first, it increases financial asset prices; second, it results in an appreciation of the exchange rate. This combination of an asset price boom and currency appreciation, which delivers larger returns, on dollar-denominated assets for example, is self-reinforcing, till such time that expectations of a decline in asset prices or of currency values comes to dominate

investor behaviour. As the prolonged asset-price boom in the US which went through to July 1998 indicated, expectations of asset price and exchange rate buoyancy can influence investor sentiment for relatively long periods of time, thereby sustaining the boom.

Observers attribute much of the dollar's momentum prior to July 1998 to abundant liquidity in international financial markets that had disproportionately been funnelled into the dollar markets, especially dollar-denominated fixed-income markets. But of particular significance were the higher interest rates in the United States versus Japan and Germany. The interest differential between yen- and dollar-denominated fixed-income securities had been especially large. For example, at the short end of the yield curve, the differential between three-month yen and dollar rates stood at 4.5 percentage points in January 1996 and exceeded 5 percentage points in May 1997. This, together with the 'flight-to-safety' factor, triggered a large inflow of capital into the US. The US became a major target of non-US based investors. Foreign purchases of US Treasury and government agency bonds are reported to have reached $293.7 billion in 1996, and there was a further $78 billion of foreign purchases of corporate bonds. This trend persisted through 1997. According to the IMF a significant part of these investments were based on borrowed yen funds, aimed at taking advantage of interest rate differentials. Based on the belief that the Japan would not want the yen to appreciate given the slow growth in the Japanese economy, some large global hedge funds went in for a profitable operation. They indulged in what are called yen-carry trades, which involved borrowing in yen, selling the yen for dollars, and investing the proceeds in relatively high-yielding US fixed income securities. This proved to be a very lucrative way of recycling Japanese current account surpluses to finance the US deficit, inasmuch as the Yen depreciated continuously between May 1995 and May 1997, which reduced the yen liability relative to the investment it financed. To quote the IMF Capital Markets Report of 1998: "With available data, it is difficult to determine the scale of yen-carry trades implemented over the past two years. It is noteworthy, however, that while Japanese banks reduced total cross-border assets by $20 billion in 1996, they increased lending by almost $19 billion to non-bank entities located just in the Cayman Islands (British West Indies) - a home for some of the major hedge funds. Over the same period, entities located in the British West Indies accumulated $20 billion of U.S. long-term bonds. Further, lending by Japanese banks to U.S. non-bank entities expanded by an additional $28.8 billion during 1996. Viewed in light of the significant contraction in total cross-border assets of Japanese banks in 1996, the fact that Japanese banks increased their cross-border claims on non-banks in the

Cayman Islands and the United States by almost $48 billion is consistent with parties in these regions instituting significant yen-carry trades. The volume of international inflows into U.S. bond markets in 1996 is by far the largest ever - 70 percent larger than the previous record set in 1995. Net foreign purchases of U.S. government bonds alone ($294 billion) accounted for 250 percent of the increase in the stock of privately held public debt securities in 1996. This pushed the share of foreigners' total ownership to one-third of the stock of public debt securities, up from 26 percent in 1995."

The close involvement of foreign agents in the American market obviously implies that they have a stake in the performance of the US dollar and the US capital market. This provides a second basis for collusion between the advanced industrial nations, since they are all jointly implicated in a speculative boom centred on the US.

Needless to say, such speculative foreign capital inflows have been crucial during the years of the American boom. One consequence of such flows has been steep asset-price inflation. Stock values, property prices and the values of other financial assets have risen sharply. This triggers a "wealth-effect" known to be strong in the US. Rapidly rising asset values which increases the wealth-holding of households encourages them to go out and spend, triggering a boom. Add to this the effects of the large inflows of capital on liquidity in the system in the form of easy credit. The boom in consumer spending and housing starts fuelled by an easy credit and low interest rates situation strengthens the "wealth effect" and spurs the American boom based on money from economies which are ostensibly not doing well.

If past experience is any guide, an American boom should spur growth elsewhere in the world as well. Yet, as noted earlier, the phase of globalisation has been accompanied by remarkable unevenness in development across the developed countries. Among the many factors contributing to this unevenness is the American transition away from an era of budgetary deficits to surpluses. America's post-War economic hegemony and the associated fact that the dollar was the world's leading reserve currency ("as good as gold") had meant that the United States government faced no national budget constraint on its expenditures. It could print as much of the dollar as it wanted to and spend it anywhere in the world, where it was unquestioningly received. In the past, the US government had used this advantage to finance large deficits, which helped sustain both US and world economic growth.

Government deficits, however, are anathema for finance capital. They not merely intervene with “market determined” financial rates of return, but since they are potentially inflationary if relevant circumstances obtain, they threaten the real value of financial assets. For finance to rule, the government must be in retreat. Thus the rise of finance has been accompanied by two tendencies: first, a sharp reduction in government deficits the world over; and second, inflation rates that are the lowest in 40 years. By the mid-1990s, pressure to reduce the US budget deficit had begun to work. In the event, precisely during the years when capital was being sucked from across the globe to finance an American boom, and partly because of this way in which the boom has been sustained, a major change has occurred in the fiscal stance of the US State. The deficit of the United States government has been on the decline since financial year 1992 and turned into a budget surplus of around half of a percentage point relative to GDP in financial year 1998. The surplus rose to 1 per cent in 1999.

The changed fiscal stance of the US has meant that a major stimulus to global growth has now been undermined. This explains the fact that through much of the 1990s there has been a loss of synchrony in the business cycles encountered by differed advanced industrial nations. When during the 1970s and the early 1980s, the complacent view that industrial capitalism was finally rid of the business cycle had to be discarded, a noticeable feature of the recessions (triggered by contractionary responses to the oil shocks) was their virtually synchronised occurrence in all the major industrialised countries. However, matters seem to have changed considerably in recent times. While it is true that crises still remain an abiding feature of capitalism, a lack of synchrony in the phase of the business cycle in different countries appears to the principal feature of the current period.

In this period, the experience of Europe has been special, inasmuch as it had to face up to two compelling circumstances: German unification and preparations for monetary union. This compelled governments to hold expenditures firm. Since 1993 the fiscal deficit in the EU has fallen continuously from 6 per cent of GDP to touch 1.1 per cent in 1999. Part of the reason was the need to keep the current account deficit from rising beyond a level that violated the conditions set for the realisation of monetary union. However, this involved a cost. Fluctuations in the fiscal deficit below the self-imposed ceiling obviously proved inadequate to prevent the steep and consistent rise in unemployment that the region has been witnessing.

As compared with the EU, Japan was not constrained by its current

account at all, having notched up huge surpluses right through the 1990s. It was this factor that allowed Japan the freedom to experiment with periodic bouts of fiscal pump-priming, which took its fiscal deficit from 1.5 per cent of GDP in 1992 to 5.9 per cent in 1999. If despite this the strong recovery of 1996 in Japan was aborted, the reason lies in the currency crisis in East Asia (generated by financial liberalisation) and the inability of Japan to help moderate its consequences for output and trade growth in the region. Being far more dependent on East Asian markets than the US or Germany, the impact of the crisis on Japan has been sharp enough to stall the recovery the Japanese government had managed to engineer in 1996.

The damaging effects of these developments could have been neutralised or at least partially overcome if the US continued to play the role of global locomotive, exploiting the reserve currency status of the dollar stemming from America's persisting hegemony. But it did not, because it was less affected by the Asian crisis and followed the lead of its own financial capital. The Asian crisis did not matter as much to the US, since the transformation of the budget deficit into a surplus has been accompanied by a sharp rise in consumption expenditure, which kept domestic demand buoyant even as world trade growth slowed. Given the large direct and indirect (through pension funds, for example) investments of personal savings in equity in the US, the stock market boom enhanced the wealth of American citizens, reducing incentives to save. The net result has been a sharp increase in private consumption expenditure and a collapse of private savings in the US. Personal savings as a percentage of disposable personal income in the US fell from 1.2 per cent in 1997 to 0.5 per cent in 1998, turned negative in the first quarter of 1999 and touched a remarkably high negative level of 1.3 per cent in the second quarter ending June 1999.

Most observers attribute this low rate of savings, which would have been considered dismal in any developing country with much lower levels of per capita income, to the fact that the value of household assets have risen to record highs because of rising equity values. Faced with the rising value of their financial assets, households were not merely saving less but also incurring larger debts, convinced that the value of their past savings was more than adequate to finance their future requirements. This consumption-inducing effect of the stock market boom was strong in the US given the important role played by financial assets in the incomes and wealth of American households. In 1997, household equity holdings were 143 per cent of disposable income in the US, up from an average of around 50 per cent in the early 1980s. The corresponding ratios for Canada and

Britain in 1997 were above 80 per cent and close to 75 per cent respectively. As a result, capital gains made by American households amounted to 36 per cent of their disposable income. These features of the wealth and income profile of American households affected their consumption directly by affecting incomes and indirectly by influencing the propensity to save.

It should be obvious that, in time, the consumption-led boom in the US would spill over into the world economy. That this has been occurring is clear from trends in the deficit in the trade in goods and services on the US balance of payments. That deficit has risen more than seven-fold from $37 billion in 1992 to $267.6 billion in 1999. This magnitude of increase in the trade deficit accounts for almost 80 per cent of the increase in the current account deficit in the US balance of payments from $50.6 billion to $338.9 billion during this period. This rising deficit did not matter for long, since capital inflows more than neutralised the effects such a deficit can have on the value of the dollar. Not only did money flow into US equity, but outstanding amounts of international debt securities originating in the US rose sharply to $946 billion at the end of the first quarter of 1999.

Unfortunately, the burgeoning deficit, which necessitates capital flows in the first place, could also undermine confidence in the dollar. This is precisely what happened during the period starting July 1998, when equity markets in US and Europe peaked. A number of subsequent events resulted in investor reassessment of the sustainability of the boom. First, evidence that the Asian crisis and the recession in Japan were affecting output growth and corporate earnings in the US and Europe. Second, the damaging impact that the August devaluation in Russia and the Russian government's decision to restructure debt had on a number of financial institutions, particularly in the US. And finally, the damage that weakening investor sentiment and asset sell offs had on institutions like LTCM, which would have gone bankrupt except for intervention by the New York Federal Reserve Bank.

These developments not only affected capital markets, but the US dollar as well. To quote the IMF: "As the emerging market crisis took on global dimensions, however, the dollar began to weaken amid increased concerns about the downside risks to U.S. growth and a shift in market expectations about the direction of U.S monetary policy from modest tightening to significant easing. These developments, combined with signs in Japan of greater progress with long-awaited bank reform and additional moves there toward fiscal and monetary stimulus, significantly altered the balance of risks

perceived by investors with yen-denominated exposures. The initial weakening of the dollar was relatively orderly; it fell by less than 10 percent against both the yen and the deutsche mark between mid-August and early October. However, the situation changed in the week beginning October 5 when the dollar fell by about 15 percent against the yen in the space of three days, including the largest one-day movement in the yen/dollar rate since the collapse of the Bretton Woods system."

Though interest rate cuts by the Federal Reserve and efforts on the part of G-7 governments, concerned about the implications of a collapse of the dollar for their own financial interests, did stall the dollar's decline and prevent it from turning into a collapse, the experience during the second half of 1998 does reflect the fragility of the process that underlies US buoyancy. That fragility is once more visible in the first signs of a likely collapse of the recent speculative rush into US stock markets, led by unwarranted optimism regarding the future of "high technology" companies and their stocks. These developments have two implications. First there is a real danger that the one-way flow of money, which helps America flourish while other advanced nations languish or grow slowly could come to an end. Second, in that event, the consumption boom led by the wealth effect could collapse. Even the IMF has tended to hold this view. Around September 1999, a public information notification issued by the IMF after its Executive Board concluded Article IV consultations with the US noted that: "the strength of demand, including corporate investment as well as household consumption, had been underpinned by the high level of stock prices - a level that was difficult to explain". This, the IMF held, would mean that a sharp market decline could wipe out illusory wealth, lead to an abrupt adjustment in the household savings rate from its current historic low, and massively squeeze consumption demand. American assets are widely acknowledged as being substantially overvalued. For example, the conservative Economist magazine had also argued that America's financial bubble could "suddenly burst, causing financial instability, destroying wealth and bringing about a recession." The era of high growth and large current account deficits could come to an end. That prognosis is now a real possibility, though developed country governments and the international financial institutions are pinning their hope on a "soft-landing" in the US. Whatever the actual outcome, there is a strong possibility that the world may witness a return to an era of synchronised sluggishness or recession in the leading imperialist nations.

Implications for Developing Countries

This “narrowing down” of growth differentials between the developed nations does not, however, presage an end to a phase of extreme unevenness in development. Integration through finance has affected economic performance not just in the developed, but the developing countries as well. For purposes of analysis, the latter can be grouped into two. Those like India, which after a period of rapid import substituting development, in the immediate post-War years, entered a phase of stagnation and policy paralysis in the 1960s and 1970s. And, others, like the East Asian Economies, which assisted by special circumstances including a special relationship with imperialist powers, pursued a strategy that helped them engage and benefit from the rapidly growing world market during the post-War years.

In the case of the former, three factors combined to put them in a state of stagnation. First, the State in these countries, given its class nature, failed to generate a mass market by breaking land monopoly and redistributing assets and incomes. As a result, growth came to depend on large expenditures by the State aimed at closing crucial infrastructural gaps as well expanding directly, through its purchases, and indirectly, through the incomes it generated, the market for private enterprise. However, its own class character and the important role it provided to private capital in the development process, limited the ability of the State to garner the surpluses required to finance these expenditures. In the event, this contradiction between the need to spend and the inability to finance that expenditure substantially eroded growth prospects. Second, the failure of the State to discipline private capital, ensured that even while the latter derived a range of benefits from the State, it failed to contribute adequately to savings, on the one hand, and foreign exchange earnings on the other. This contributed to the external vulnerability of the system. Third, inequality combined with the post-colonial ambience in these societies constantly generated consumption demands of a kind, which resulted in a divergence between the ability to produce and the capacity to consume. In the event, the problem of external vulnerability was aggravated leading to periodic balance of payments crises.

In these countries, the global rise to dominance of finance in the 1980s appeared to provide an opportunity, since State expenditures could be financed by accessing capital from the international system. In India, for example, the State pump-primed the system with deficit expenditures financed with international borrowing, to restore growth in the 1980s. But soon, unable to meet its interest and

amortisation commitments payable in foreign exchange, the country was once again plunged in a balance of payments crisis. Having turned to the IMF for balance of payments finance, the government had to not merely curtail its expenditures, but dismantle State regulation, liberalise trade and open up the financial sector.

In the East Asian economies, success on the trade and economic growth fronts, rather than failure, led up to financial liberalisation. They opened up their financial sectors partly under pressure from the developed countries, as a quid pro quo for access to developed country markets, and partly with the hope of becoming either financial centres in the region or of attracting relocative foreign investment that would use them as sites for world market production. The consequences of such liberalisation in terms of hot money flows that went to finance a speculative stock and real estate boom, and the collapse that ensued, are now well known. What is important is that the collapse resulted in further opening up of the trade and financial sectors, in these countries as well.

Thus, by the mid-1990s, most developing countries were also integrated through finance into the world system. The effects of the integration have been a substantial weakening of the domestic capitalist class, a process of deindustrialisation, rising unemployment and worsening poverty and standard of living indicators. Further, with developing countries under pressure to earn the foreign exchange needed to finance their larger import bills under more open regimes, they have been desperate to push out primary products into the world market. As a result, the world market for most primary commodities has been characterised by chronic oversupply resulting in a collapse of primary commodity prices. Only, in the case of oil, where OPEC has been able to once again agree on production cuts and the regulation of supply has the downward trend in commodity prices been halted and partially reversed.

The end-result has been that while at the beginning of the 1990s, many developing countries, especially those in East Asia, where characterised by high growth when the advanced capitalist countries were faced with recessionary conditions, in subsequent years most developing countries have been performing extremely poorly even though the US has been experiencing a boom. If the US boom comes to an end, as it is widely expected to, these sluggish trends could be aggravated on two counts: first, a slow down in world trade growth which would adversely affect manufactured exports from developing countries and further depress commodity prices; and, second, a protectionist wave in the developed countries, aimed at appeasing

their own workers, that would intensify the downturn in world trade. Clearly, the rise to dominance of finance in the international capitalist system results in unevenness in development not only because of the divergence in performance between the hegemonic power, the US, and the other developed capitalist nations, but more so because of the growing divide between the developed metropolitan centres and the underdeveloped periphery. In fact, even if the degree of unevenness in development between the imperialist powers reduces, that between the imperialist camp and the underdeveloped world is bound to intensify. That reality defines the fundamental challenge faced by the working people in the underdeveloped countries, and must inform strategies aimed at their emancipation from global subordination.