



compass

DIRECTION FOR THE
DEMOCRATIC LEFT

RESPONSES TO RECESSION

by Victor Anderson

January 2010

Think
PIECES

Number 58

Think PIECES

Number 58

RESPONSES TO RECESSION

“There are three options now for the way economies emerge from recession. One option is the attempt to return to economic growth on the basis of the current economic structure in terms of technologies and patterns of demand. This will result in the return of stagflation: inflation caused by limitations in supply, leading us back into recession.

This is basically the route which most economies have embarked on.”

Compass publications are intended to create real debate and discussion around the key issues facing the democratic left - however the views expressed in this publication are not a statement of Compass policy.



Ideas and action
for a better world.



Ideas and action
for a better world.



Ideas and action
for a better world.



Ideas and action
for a better world.



Ideas and action
for a better world.

RESPONSES TO RECESSION

by Victor Anderson

There are many views about the causes of the autumn 2008 financial crisis and the economic recession which has followed. But what is more important now are the different views about coming out of the recession. The crucial points to discuss about that, it seems to me, are almost entirely absent from mainstream public debate, for example in Parliament and daily newspapers.

On one level, the tactics of coming out of recession are about getting the level of demand right – too low a level and the recession continues, too high a level and dangerous debt and inflation can build up. This translates into judgements about the right levels of tax, public expenditure, and interest rates and the timing of government debt repayments. This is what the post-recession debate is mainly about in mainstream debate, and it will be central to the coming general election campaign, to some extent echoing past arguments between Labour Keynesians and Tory Monetarists.

We can add to that a greener contribution to the debate. The extra public expenditure needed to combat recession could be focused on a programme to improve energy efficiency in buildings, a smarter national grid based on a more decentralised pattern of energy supply, and improved public transport alternatives to the private car. These are the sorts of policies discussed under the heading of a “Green New Deal”, and they have found supporters ranging from the New Economics Foundation to the United Nations Environment Programme and the South Korean Government, and to some extent Barack Obama.

These policies, valid though they were at the time – very recently – when

governments were looking for good ways to spend more money, are now less relevant because the debate about government borrowing and spending has shifted away from how to spend extra money to an argument about where public expenditure cuts should fall. A second additional layer to the debate, also likely to feature in the general election, is about the financial system. Clearly it has proved dysfunctional. Countries such as the UK with a large financial services sector as a proportion of their economies have suffered a great deal from the irresponsible risk-taking which financial institutions incentivised amongst their employees. Part of the set of policies necessary not so much for emerging from recession, but for trying to ensure it does not happen again, is the putting in place of more sensible arrangements for banking and managing money.

All three of these layers of the debate are important, but they still don't seem to me to touch the fundamental issues and the fundamentals of why the financial crisis hit in the first place. The essential problem is the nature of economic growth. I am not arguing that economic growth is necessarily a bad thing. The term “economic growth” covers many different possibilities and directions of development. However, there are some very serious problems with it.

The essential problem is that economic growth takes place in the context of a finite planet. In a market system, the consequence of this is price increases, as increasing demand for commodities which are used to fuel growth, such as oil, comes into collision with limitations in supply. This is what happened to a very serious extent in spring and summer 2008, and it is unlikely that it was pure coincidence that rapid price rises in oil, metals, rice, and other commodities were followed so soon after by financial crisis, because the markets became increasingly sceptical that financial assets had a sufficiently robust foundation in the real economy. However, a more relevant argument now is what

will happen as recovery from recession progresses. The same mechanisms will come into play.

The International Energy Agency has warned that the return of economic growth will cause higher oil prices, and they are in fact already rising again. “The IEA warns that a quick rebound in global economic growth could again lead to an energy supply crunch similar to the one that helped tip the world into recession in July last year ...”

[‘Financial Times’ 11.11.09]

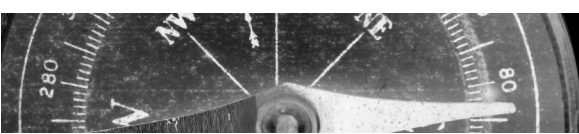
The UN Food & Agriculture Organisation (FAO) has warned that economic pressures, including the shifts in land use implied by rapid urbanisation in many poorer countries, are creating the prospect of rising food prices, leading to increased hunger amongst poorer people.

[See ‘Target to stop hunger taken off summit pledge’, article in ‘Financial Times’ 12.11.09]

This all has military consequences. The West's interventions in the Middle East are mainly about pursuing a geopolitical strategy designed to maintain access to oil supplies and hence keep the price of oil from rising to levels which would be disastrous to the West economically. Adding to this picture, the rise in food prices on the world market creates unrest which also draws the West into conflict. “Policymakers are concerned that high food prices will steadily increase the number of those chronically hungry, triggering political instability in developing countries ... Military strategists are now inviting food experts to discuss the implications of food shortages. Discontent about high food prices in poor countries is a breeding ground for extremists – some food aid officials say this is the case in Pakistan and Afghanistan, for example.”

[‘Financial Times’ 10.11.9]

Current arrangements for energy and food therefore have military and foreign



policy implications, as well as environmental and economic ones. The process of recovery from global recession is essentially self-defeating. This is because of a cycle which runs (to take the example of oil) – economic growth requires more oil, more demand for oil in a context of limited supply causes a higher price for oil, and a higher price for oil depresses the economy because firms and individuals can't afford to buy so much of it, and this brings economic recovery to a halt. The same cycle applies to metals, and (in a more complex way) to land and food.

The problem basically is that a pattern of economic growth which depends on resources limited in supply cannot be sustained for very long. Technological change has to some extent got us out of this problem, but the innovation and change which have taken place so far have not moved the world economy fast enough from an unsustainable to a sustainable path for growth.

There are three options now for the way economies emerge from recession. One option is the attempt to return to economic growth on the basis of the current economic structure in terms of technologies and patterns of demand. This will result in the return of stagflation: inflation caused by limitations in supply, leading us back into recession. This is basically the route which most economies have embarked on.

A second option is to call a halt to economic growth, ending the whole idea of emerging from recession. Few governments and political parties are likely to voluntarily opt for that solution. The third option is the attractive one of pursuing economic growth but in a different way – for example, fuelled by renewable energy and promoting energy efficiency innovation, and seeking to reduce the throughput of materials. Up to now, this option has been argued for on environmental grounds, because it would be better for the climate and ecosystems. However, it is important to see that this

can also be an economic argument. It is the only way that economic growth can be sustained long-term.

The problems with this option, however, come when we consider the rates of improvements in energy and resource efficiency which would be necessary. For a starting-point, it is clear that the intensity of energy and resource use, i.e. the amount of energy/resource required per million pounds of GDP, must fall as rapidly as the economy grows just in order to keep energy and resource use at the levels they are currently. This is way beyond the rates of change in energy and resource intensity which have actually been achieved in recent decades. Simply, for example, improving resource intensity by 0.5% a year when the economy is growing at 3% is not going to solve the problem.

Hence “green growth” is dangerously attractive as an abstract idea because, although it “squares the circle” between the benefits of growth and avoiding its usual negative consequences, it is extremely difficult to actually implement to an extent sufficient to solve the basic problem, the unsustainability of current patterns of growth. In this situation, all routes seem to lead back to recession – the pursuit of continued growth on the present basis is self-defeating. The deliberate pursuit of no-growth strategies will obviously halt economic growth, and the pursuit of the “green growth” slogan in a way which is ultimately unserious is just a slight variation on “business as usual”, which is unsustainable.

In these circumstances, it is disappointing that there has been so little serious debate about how to come to terms with the no-growth economy we have recently found ourselves in, and may find ourselves back in again before very long. This is not some far-off environmentalists' dream or economists' nightmare. It is the recent experience of the British economy, and many other economies.

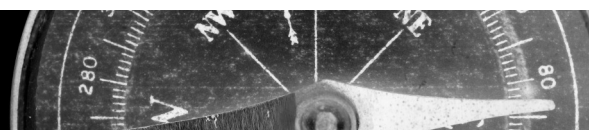
The world's economies are all based on the premise of continuing economic growth. To take the simplest example, technological change increases labour productivity in the UK by about 2% a year. So long as annual economic growth runs at about 2%, current employment levels are maintained. But a year of no growth means unemployment rises. A long period of no growth will mean that unemployment rises disastrously. It does not have to be like that. The labour market could function differently, so that for example, a 2% increase in labour productivity in the absence of economic growth resulted in a 2% fall in everyone's working hours rather than a 2% fall in employment.

This is simply an example. There are much more difficult problems about what happens in a no-growth economy to company profits, government revenue and government spending.

The point I am making here is simply that there is a need for some thought and debate about these problems of how to manage a no-growth economy. Unless there is a very serious shift to a far more energy and resource efficient economy, a long-term no-growth economy is what we are moving towards, and we had better think about how to cope with that situation, rather than always imagining that no-growth is simply a very temporary interruption to a general pattern of continuing economic expansion.

The debate about economic recovery therefore needs to include – in addition to the layers about government spending and borrowing - the possible greening of fiscal stimulus, and the future of financial institutions, the more challenging long-term questions of the sustainability of economic growth, the practicalities of what would be involved in a serious “green growth” strategy, and the policies which will be needed to cope with the consequences if growth cannot be sustained for long and the recovery from recession comes to a halt.

20.11.09.



“

Compass is the democratic left pressure group,
whose goal is to debate
and develop the ideas for a more equal
and democratic world, then
campaign and organise to help ensure
they become reality.

”



Join today and you can help change the world of tomorrow -
www.compassonline.org.uk/join.asp

compass

Southbank House, Black Prince Road, London SE1 7SJ
T: +44 (0) 207 463 0633 M: +44 (0) 7900 195591 gavin@compassonline.org.uk
www.compassonline.org.uk