TACKLING THE GLOBAL ECONOMIC MALAISE

By Mohamed Ariff

My take on the impending global economic crisis is that it is going to be far more severe than many seem to think. We are about to experience the worst economic disaster the world has witnessed since the end of World War II. All indications suggest that a perfect storm is in the making with all its manifestations, including painful credit crunch, huge job losses, plummeting prices and currency turmoil.

The United States, European Union, Japan, Taiwan, Singapore and New Zealand are in recession, and many more economies are on the verge of recession. Attempts by some to downplay it as "international" recession rather than "global" recession, on the premise that not all countries will succumb to it, are naïve.

Isolated economies like Myanmar are, of course, less likely to feel the pinch. There is hardly any doubt that none of the major economies that really matter will be spared.

The situation now is clearly much worse than what East Asia had faced a decade ago. The 1997-98 financial crisis would pale in comparison, as the mitigating factors that helped East Asia then are absent now.

Quite unlike the last time, North America and Europe are in bad shape this time around. The strong commodity sector, which helped cushion the impact ten years ago, is now ailing.

The social impact of the current crisis is likely to be more painful than was the case previously, as the rural sector will not be spared.

To be sure, this time around, the contraction is unlikely to be as sharp as what East Asia experienced in 1998. By this token, neither are we facing any prospect of a sharp recovery. The chances are that the recession will last for at least two years if not longer, with a flat U-shaped trough compared to the kinky V-shaped contraction in 1998.

It is not difficult to explain why the upcoming recession is likely to last so long. First, the strength of the US dollar will delay economic recovery in the United Stares by making US exports more costly. Second, the demand for tighter regulations in the face of corporate fiascos during economic contraction can be counterproductive. Third, the space for fiscal pump priming and monetary easing is limited, as years of budget deficits have led to fiscal fatigue, and prolonged low interest rate regimes have rendered monetary policy somewhat impotent.

The scale and intensity of the crisis is such that no country can afford to handle it on its own. The situation calls for collective global and regional efforts.

The G20 meeting early last month (November 2008) was a good beginning, although it has not accomplished much to allay the fears. In any case, market expectations about G20 were low, given the transition in the US Administration. The next G20 summit in April 2009 under President Barack Obama's leadership will be worth watching.

Although East Asia cannot go it alone, there is a need for East Asian countries to complement global efforts. It is a pity that East Asia, which has the resources and wherewithal to handle the situation, has not done much thus far.

Regional efforts must include macroeconomic consultation and cooperation. Coordinated fiscal and monetary measures may be more effective than ad hoc initiatives by individual countries. There is certainly a need for coordinated interventions in the foreign exchange market to ensure the stability of East Asian currencies.

It is important to make a distinction between short-term and long-term measures. The former relates to immediate actions to douse the fire and to undertake repairs, while the latter refers to preventive measures, which must include institutional reforms. Put another way, we need an action plan to stimulate the economy and a road map to bring about changes in the international financial architecture.

The action plan may include tax cuts, increased public expenditure, reduced interest rates, buying toxic mortgage-based securities, and recapitalising banks.

Care must however be taken to ensure that moral hazard is minimised. If not, governments may inadvertently be sowing the seeds of the next crisis.

In the final analysis, it is the taxpayers who will bear the burden of counter-recessionary measures, especially fiscal stimulus and company bailouts, which amount to socialising losses during bad times and privatising profits during good times.

The road map is more about preventing future crises and less about fixing the current crisis. Some of the reforms are best undertaken when the going is good. The road map may include the establishment of a new global regulator to force financial institutions, hedge funds, commodity traders, and currency traders to be more transparent and accountable, to have greater capital cushions and to exercise restraint on payments of bonuses and dividends during goods times.

The top priority is prevention of job losses. This will not only minimise the social impact of the crisis but also arrest the downward spiral. Job losses will lead to not only loan defaults and bank failures, but also consumption cutbacks and negative growth, and consequently more job losses. The prospect of snowballing job losses is really scary.

While job creation is absolutely critical for economic recovery, care must be taken to avoid beggar-thy-neighbour policies. There are fears that protectionism will rear its ugly head when the going get tough, which will only serve to prolong the crisis.

Adapted from "The priority must be to prevent job losses", New Straits Times, 4 December 2008