

## **THE ROYAL INSTITUTE OF INTERNATIONAL AFFAIRS**

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"THE GLOBAL ECONOMIC CRISIS: WILL 1988 BE ANOTHER 1928?" Mr. Chairman; Ladies and Gentlemen, I am pleased to have been invited to speak at this Institute today. I am indeed honoured to be able to share my views with members of this prestigious Institute which has made a tremendous contribution towards a better understanding of international affairs.

2. Making speeches is the favourite occupation of politicians. In the course of years of doing this, one develops a fondness for certain quotes. For me the favourite quote is George Santayana's "Those who do not learn the lessons of history are condemned to repeat their mistakes over and over again". I would like to repeat this quote in this speech because it deals mainly with the current economic situation and for those who have gone through the recession of the late twenties or at least read about it, they must have this "deja vu" impression when studying the present world economic situation and its political consequences.

3. A great book to read and to remind us about the Depression or the Great Slump of the late twenties and early thirties is H.V. Hodson's "Slump and Recovery, 1927 - 1937" published by your Institute in 1938. Perhaps quoting a few paragraphs from this book would explain why I said that we have gone through it all before. I quote:-

" The fall in commodity prices ..... proceeded with only intermittent relief. The pressure upon debtor countries to sell at cut prices had been grievously enhanced by the reduction in lending. " The abrupt curtailment of international lending - however wasteful and unjustifiable some of the previous loans may have been - had dislocated world trade and depressed commodity prices ..... " The combination of different or harrassed lenders and weak or even bankrupt borrowers automatically prevented the revival of international lending on the scale of earlier years.

Let me continue to quote:

" In general, the prices of raw produce fell more rapidly than those of goods at the later stages of manufacture, a fact which temporarily assisted industrial countries ... but which could not do so for long, since their markets abroad were being concurrently impoverished. " The purchasing power of raw-material producing countries enormously diminished. Markets contracted, profits fell, production was curtailed, buying of stocks was restricted, and prices dropped still further ..... " The fluctuations in international lending, the embarrassments of debtor countries, the fall in prices, the depressed conditions in the creditor countries, all naturally had a profound effect upon the volume and distribution of world trade ..... " The slump, once started, continued a swift and snowball career. "

Ladies and Gentlemen,

4. One may be excused if on hearing these quotes one gets the impression that some present-day writer was writing about the present world economic situation.

5. Mr. Hodson wrote a great deal on the causes and the course of the Great Depression, not much on the political consequences. But he did write on the social changes and political upheavals, including the growth of extremism in Germany. Writing as he did in 1938, Mr Hodson might be forgiven for not having a clue at all about the profound meaning of the ascendancy of Adolf Hitler and the Nazis in Germany. Mr. Hodson was no specialist on Asia and Latin America. He can therefore also be forgiven for having little inkling of the almost immediate effects outside Europe.

6. Let me make myself perfectly clear. I am not predicting that the world will enter another global Great Depression, although I feel that for most of the countries of the South, that second Great Depression descended quite some time ago.

7. Some people have seen close parallels between the New York Stock Market boom of 1929 and recent developments in Wall Street. Certainly the world has not seen in the last two years such a bull run or so many American banks going bankrupt since 1929. I am told that there is this Kondratieff economic long wave cycle theory which seeks to explain the great depressions of the 1830' s, the 1890' s and the 1930' s in terms of a cycle of 45 to 55 years; according to which we should have a great depression descending upon us any moment now.

8. But the economy of the world is not governed by the movements of the stars or the planets. It is created and managed by men. In this day and age we do not consult astrologers or astronomers before adopting economic policies. We study and we plan. Surely no one would plan for a slump. What has happened is that we have forgotten the lessons of history and we repeat our mistakes. If the same people lead for longer periods, perhaps mistakes will not be repeated. But, of course, there will be other prices to pay.

9. In the years after the First World War, the victors forced vanquished Germany to pay huge war reparations. Obviously if Germany had to pay out so much, it must also earn so much or borrow the required sum. Thus the beginnings of economic distortions were set in motion by the leaders themselves; leaders who had apparently not read history.

10. Germany, perhaps more than any other country was thoroughly disorganised industrially after the World War. Hodson pointed out that "the economic history of the whole of the first post war decade is a tale of attempts to meet or to defy the disorders that the war had wrought in the World' s economic system." The 1919 boom which was followed by a collapse in 1920 was symptomatic of the economic disorder and it must be indicative of the economic disorders that were to follow. But the leaders of the period continued with their punitive approach against Germany. The result was the 1929 slump and the rise of extremism as portrayed by Nazism.

11. Partly as a result of that experience there was less desire to punish the

defeated countries after the second World War. Except for dismantling the huge industrial conglomerates thought to have been responsible for sustaining the war machines, the Allies adopted a more liberal attitude towards Japan and Germany. The result was a very quick recovery for these two dynamic countries, which in time posed a threat to the economies of the U.S. and some European countries.

12. So far, so good. The lessons of the post World War One were well learnt and applied. But the U.S. and the Western Allies then began to feel threatened by the economic power of the two former enemies, and an easy solution was looked for. First interest rates were raised and the American dollar was effectively revalued upwards. Much money flowed to the U.S. but, at the same time, U.S. goods and services became uncompetitive. This in turn resulted in more foreign goods being imported while American industry declined and unemployment consequently increased. Shortly after, there was a contraction in the purchasing power of the Americans which must affect adversely new investments and production. The economy deteriorates further. As the American economy deteriorates, raw material exporters began to lose their markets. Prices and earnings went down. To earn more the commodity producers produced more and prices went down further.

13. Elsewhere the oil producers were smarting over the minimal royalties they earned from the strategic commodity they produced. The conduct of the Arab-Israeli War gave them the excuse for raising oil prices. Suddenly the world was flooded with petro-dollars. Such huge sums of money cannot but destabilise the world's financial system. Extravagant as the oil producers were, they still could not spend all their money. All kinds of restriction prevented them from buying into the major industries of Europe and America. Inevitably the petro-dollars found their way into the vaults of European and American banks. The stage was even reached when Arab oil producers had to pay to keep their money in the bank.

14. The petro-dollars must be lent out. Only nations can borrow huge sums. And so sovereign loans became the main business of western banks. Nor were the Arabs allowed to withdraw their deposits because it would disrupt the financial stability of the western countries. On the other hand the fall in commodity prices undermined the capacity of the borrowing countries to repay their loans.

15. Simultaneously the United States discovered that a strong dollar and high interest rates was not helping its economy. The balance of trade was very much in favour of the old foes -- Germany and Japan. It was decided that it was better to devalue the U.S. dollar against the Yen and the Deutschmark in order to reduce Japan's and Germany's exports to America. The idea did not work for the U.S. as predicted by many economists and international decision makers. Japanese and German goods kept pouring into the U.S. Meanwhile commodity producers, including oil producers, who sell in dollars suffered as the dollars earn less in terms of purchasing capacity. The oil producers not only earned less but find their external reserves much diminished in value. Of course, countries that borrow in Yen or Deutschmark suddenly found themselves even more indebted

than before.

16. Since the U.S. is not getting much benefit from the de facto devaluation of the dollar, protectionism began to look more and more attractive. The target is Japan but the developing countries are dragged willy-nilly into the maelstrom. The U.S. now talks of balanced trade even with its smaller developing country trading partners.

17. Economic policies cannot be expected to yield only one desired result. Just as Germany cannot be made to pay reparations after the First World War without disrupting the world's economy, so today there can be no single remedy for the economic ills of a rich state which will not have undesirable effects on itself and on other states. The more drastic the solution, the greater the side-effects on itself and on others. This being so, it is important that powerful economies do not devise economic policies in the absence of the weak.

18. Multilateralism has now become a bad word among developed countries. The disillusionment with the United Nations has led to the setting up of exclusive rich men's club. The Group of Five is an alliance of the rich which must inevitably work against the interest of the poor. The five has now become the Group of Seven, again unrepresented by the poor countries.

19. Although in Venice the seven discussed the problems of the poor, it is doubtful that they fully appreciate these problems. It is even doubtful that they take into account that the increasing poverty of the poor will adversely affect their own economic performance. It is worth while remembering that the Third World accounts for 40% of the exports of the world's biggest economy. As a market the non-socialist third world is bigger to the U.S. than Western Europe, Eastern Europe, the Soviet Union, Australia, New Zealand and China put together. Economic depression in the Third World is one reason why the U.S. will continue to have difficulties in reducing its trade deficit.

20. If we are going to find a solution that will work somewhat better than the currency manipulation which is the main result of the Group of Seven meetings so far, we must return to Multilateralism. If having 150 different countries sitting together to formulate a solution is impractical, then there should at least be the presence of a few representatives of the poorer countries when the Group of Seven meet. No action should be taken until the representatives of the poor have been given a hearing.

21. For a long time the South or the developing countries begged for a New International Economic Order. The North saw in this another attempt to extract aid from them. Accordingly they formed the Group of Seven and imposed a New International Economic Order of their own. It must be painfully obvious that it is not working. It fails to solve even the problems between the members of the Group. Why else should the U.S. clamour for its very own protectionist policy if the currency manipulation and other measures adopted by the Group of Seven had worked?

22. Indeed, far from solving the problems, the exchange rate adjustments have worsened the situation. Developing countries unable to service debts now simply refuse to pay. There was much protest by the banks in the North but finally they are forced to provide for these bad debts. And weak banks are going bankrupt by the dozens.

Ladies and Gentlemen,

23. The South admits that they cannot do without the North. But then they cannot hope to be heard if they speak with a hundred voices. And so the South have decided to set up a Commission. The South Commission, as it is called, is presided over by Dr. Julius Nyerere and is given the task of mapping out the areas and manner of cooperation between the countries of the South so as to reduce dependence on the North. But it should be within the scope of the work of the Commission to formulate effective representation for the South in any North-South forum intended to correct the world's economic problems.

24. Admittedly the record of the attempts to cure the economic ills of the world is not very encouraging. Certainly what has been done lately has not had the desired effects. As we can see strengthening the American dollar and raising interest rates has been no more effective than weakening the dollar and lowering interest rates. Protectionism has not been successful. The EEC economic policies simply resulted in mountains of butter, sugar and meat due to artificially high prices and costly subsidies.

25. Yet we have had boom times in the world's economy. The 1960's and 1970's were definitely prosperous years for most of the world. Even the poorest and least efficient economies suffered less because prosperous countries were prepared to give them aid. We must also remember that we did come out of the massive slump after the First World War. We must have done something right to be able to prosper after a period of economic slump. If we study carefully the situation before and during the prosperous years, there is bound to be something which happened to help the recovery and the subsequent boom.

Ladies and Gentlemen,

26. Situations have changed, of course. The solutions of yesterday cannot be the solutions of today. But there must be some lessons from the historical past. Human ingenuity is such that we cannot just be fatalistic and accept the theory of 50 year cycles.

27. But how many of the people who determine economic policies which affect the world really study the depression of the late twenties and the subsequent recovery?. Is war the answer? But we know that the economies of all belligerents suffered as a result of both the first and the second World Wars.

28. Somewhere in the prosperous years there is a solution waiting to be found. And it is more likely to be found if the North can sit with the South and listen to each other. If the Group of Seven had heard Malaysia's views they would not

have forced the value of the Yen up so much that suddenly our external debt is doubled.

29. I am not saying that the mere listening to the views of the developing countries would result in a foolproof plan for economic recovery. Some countries of the South are possibly irresponsible and extreme. But the participation of a small representation from the South would help in highlighting the effect of any policy on the South, and the subsequent effect on the North if the South prospers or it is impoverished.

Ladies and Gentlemen,

30. At the beginning of this talk I said something about not learning from history, implying that the situation now is like that during the slump of the late twenties. The fact is, of course, the present situation is not identical with the late twenties. We do not have a full-blown depression now. We have a very odd mixture of prosperity amidst poverty or poverty amidst prosperity within countries, between countries, and between regions.

31. We see for example economic growth taking place while unemployment increases. We see countries with massive trade surpluses yet with high cost of living and high unemployment rate. Some countries accumulate huge reserves trading with countries with huge deficits. Where normally prosperity in developed countries have beneficial effects on poor countries, now we see rich countries getting richer at the expense of poor commodity producing countries.

32. In the developed countries, stock market prices go through the ceiling even as record numbers of banks go through the floor. Companies make little profit but their shares go up in value quite independently. Billions of dollars boost the value of junk bonds while real business suffer because they are considered not creditworthy.

33. Obviously this is not a slump. It is a case of the world' s economy going haywire. We are in a madhouse. The need is for sanity. Confrontationism, isolationism or protectionism are about as helpful as a hole in the head. More than at any other time we need to sit down and talk to each other as sane people.

34. Democracy is wonderful. Leaders should be elected by the people, or at least the majority of the people. But this need to be popular has resulted in some Governments losing their political will. European leaders, for example, have little time for economic principles or historical lessons. They are busy pandering to the views of the farmers who are illiterate in economics or history, but whose votes determine whether the politicians get seats or not. And so, despite their better judgement they subsidise and protect farmers; thus giving rise to the butter, meat and sugar mountains.

35. Democracy is great and we must have it even if it kills us. I am reminded of the American who said, "I don' t agree with what you said, but I will die to defend your right to say it" or words to that effect. It is very noble but if everyone dies,

including the person you disagree with, what is the benefit to be derived? A dead man who is free to speak is not much use because he cannot exercise that freedom anyway.

36. We must have democracy. But we must define its limits. We cannot allow democracy to kill us. If democracy prevents leaders from doing the right thing for the good of mankind, then let us redefine it. If we are to save this world from the economic chaos we are in, leaders must be able to free themselves from the pressure of the need to be popular and take the necessary action.

37. This is heresy, of course. But let us remember that the sacrosanct ideologies we believe in today are the heresies of yesterday.

Ladies and Gentlemen,

38. Coming from the developing world, I cannot help but be biased in favour of the Third World. But the fact remains that we are interdependent, now more than ever before. Just as the economic performance of the rich North will affect the performance of the South, so will the prosperity or poverty in the South affect the North. If I talk for and of the South, interdependence implies that I am also talking for and of the North.

39. As Hodson said, "In general the prices of raw produce fell more rapidly than those of goods at the later stages of manufacture, a fact which temporarily assisted industrial countries ..... but which could not do so for long, since their market abroad (in the raw material producing countries) were being concurrently impoverished". What Hodson means is that if there is a slump in the Third World, sooner or later there will be a slump in the developed countries.

40. There is a slump in most of the Third World countries now. The question is, will there be a slump in the developed countries next year or the year after -- in other words will there be a Global Recession in 1988 or after? If we believe in the 50-year cycle, then there must be a recession soon. But if we don' t, then it is imperative that we -- and here I mean not just the economists but also the world leaders -- must learn the lessons of past slumps and booms and devise ways of avoiding the impending recession. The will to do this must be exhibited and we must get away from the pressure exerted by narrow sectarian interests even if it means ignoring some of the current interpretations of democratic rights.

41. The present recessionary economic situation is man-made and it must be unmade by man.