Chapter 27 The changing world economy since 1900

SUMMARY OF EVENTS

For much of the nineteenth century Britain led the rest of the world in industrial production and trade. In the last quarter of the century, Germany and the USA began to catch up, and by 1914 the USA was the world's leading industrial nation. The First and Second World Wars caused important changes in the world economy. The USA gained most, economically, from both wars, and it was the USA which became economically dominant as the world's richest nation. Meanwhile, Britain's economy slowly declined, and it was not improved by the fact that Britain stayed outside the European Community until 1973.

In spite of slumps and depressions, the general trend was for the relatively wealthy industrialized countries to get wealthier, while the poorer nations of Africa and Asia (known as the Third World), most of which were once colonies of the European states, became even poorer. However, some Third World countries began to industrialize and become richer, and this caused a split in the Third World bloc. During the last quarter of the twentieth century, new developments came to the forefront. Industrial production and some service industries began to move from the western nations into countries such as China and India, where labour was much cheaper. Western economic systems showed signs of faltering, and there was controversy about which was the most successful type of economy – the US model or the European model. Global warming, caused by the emission of gases such as carbon dioxide, produced problematic climate changes which threatened to do most harm to the poorer countries, which were least able to cope. During the first decade of the twenty-first century, beginning in the USA in 2008, the world suffered an unprecedented financial crisis in which, for a time, the entire capitalist system teetered on the edge of collapse. The US and various European governments saved the banking system with massive bailouts, but could not prevent the world from plunging into recession.

27.1 CHANGES IN THE WORLD ECONOMY SINCE 1900

In one sense, in 1900 there was already a single world economy. A few highly industrialized countries, mainly the USA, Britain and Germany, provided the world's manufactured goods, while the rest of the world provided raw materials and food (known as 'primary products'). The USA treated Latin America (especially Mexico) as an area of 'influence', in the same way that the European states treated their colonies in Africa and elsewhere. European nations usually decided what should be produced in their colonies: the British made sure that Uganda and the Sudan grew cotton for their textile industry; the Portuguese did the same in Mozambique. They fixed the prices at which colonial products were sold as low as possible, and also fixed the prices of manufactured goods exported to the colonies as high as possible. In other words, as historian Basil Davidson (see Further

Reading for Chapters 24 and 25) puts it: 'the Africans had to sell cheap and buy dear'. The twentieth century brought some important changes:

(a) The USA became the dominant industrial power and the rest of the world became more dependent on the USA

In 1880 Britain produced roughly twice as much coal and pig iron as the USA, but by 1900 the roles had been reversed: the USA produced more coal than Britain and about twice as much pig iron and steel. This growing domination continued right through the century: in 1945, for example, incomes in the USA were twice as high as in Britain and seven times higher than in the USSR; during the next 30 years, American production almost doubled again. What were the causes of the American success?

1 The First World War and after

The First World War and its aftermath gave a big boost to the American economy (see Section 22.3). Many countries which had bought goods from Europe during the war (such as China and the states of Latin America) were unable to get hold of supplies because the war had disrupted trade. This forced them to buy goods from the USA (and also Japan) instead, and after the war they continued to do so. The USA was the economic winner of the First World War and became even richer thanks to the interest on the war loans it had made to Britain and her allies (see Section 4.5). Only the USA was rich enough to provide loans to encourage German recovery during the 1920s, but this had the unfortunate effect of linking Europe too closely with the USA financially and economically. When the USA suffered its great slump (1929–35) (see Section 22.6), Europe and the rest of the world were also thrown into depression. In 1933, in the depth of the depression, about 25 million people were out of work in the USA and as many as 50 million in the world as a whole.

2 *The Second World War*

The Second World War left the USA the world's greatest industrial (and military) power. The Americans entered the war relatively late and their industry did well out of supplying war materials for Britain and her allies. At the end of the war, with Europe almost at a standstill economically, the USA was producing 43 per cent of the world's iron ore, 45 per cent of its crude steel, 60 per cent of its railway locomotives and 74 per cent of its motor vehicles (see also Section 22.7(e)). When the war was over, the industrial boom continued as industry switched to producing consumer goods, which had been in short supply during the war. Once again, only the USA was rich enough to help western Europe, which it did with Marshall Aid (see Section 7.2(e)). It was not simply that the Americans wanted to be kind to Europe: they had at least two other ulterior motives:

- a prosperous western Europe would be able to buy American goods and thus keep the great American wartime boom going;
- a prosperous western Europe would be less likely to go communist.

(b) After 1945 the world split into capitalist and communist blocs

- *The capitalist bloc* consisted of the highly developed industrial nations – the USA, Canada, western Europe, Japan, Australia and New Zealand. They believed in private enterprise and private ownership of wealth, with profit as the great motivating influence, and ideally, a minimum of state interference.

- *The communist bloc* consisted of the USSR, its satellite states in eastern Europe, and later, China, North Korea, Cuba and North Vietnam. They believed in state-controlled, centrally planned economies, which, they argued, would eliminate the worst aspects of capitalism – slumps, unemployment and the unequal distribution of wealth.

The next forty or so years seemed like a contest to find out which economic system was best. The collapse of communism in eastern Europe at the end of the 1980s (see Sections 10.6 and 18.3) enabled the supporters of capitalism to claim the final victory; however, communism still continued in China, North Korea, Vietnam and Cuba. This big contest between the two rival economic and political systems was known as *the Cold War*; it had important economic consequences. It meant that both blocs spent enormous amounts of cash on building nuclear weapons and other armaments (see Section 7.4), and on even more expensive space programmes. Many people argued that much of this money could have been better spent helping to solve the problems of the world's poorer nations.

(c) The 1970s and 1980s: serious economic problems in the USA

After many years of continual economic success, the US began to experience problems.

- Defence costs and the war in Vietnam (1961–75) (see Section 8.3) were a constant drain on the economy and the treasury.
- There was a budget deficit every year in the late 1960s. This means that the government was spending more money than it was collecting in taxes, and the difference had to be covered by selling gold reserves. By 1971 the dollar, which was once considered to be as good as gold, was weakening in value.
- President Nixon was forced to devalue the dollar by about 12 per cent and to put a 10 per cent duty on most imports (1971).
- Rising oil prices worsened America's balance-of-payments deficit, and led to the development of more nuclear power.
- President Reagan (1981–9) refused to cut defence spending and tried new economic policies recommended by the American economist Milton Friedman. He argued that governments should abandon all attempts to plan their economies and concentrate on monetarism: this meant exercising a tight control on the money supply by keeping interest rates high. His theory was that this would force businesses to be more efficient. These were policies which Margaret Thatcher was already trying in Britain. At first the new ideas seemed to be working – in the mid-1980s unemployment fell and America was prosperous again. But the basic problem of the US economy – the huge budget deficit – refused to go away, mainly because of high defence spending. The Americans were even reduced to borrowing from Japan, whose economy was extremely successful at that time. The drain on American gold reserves weakened the dollar, and also weakened confidence in the economy. There was a sudden and dramatic fall in share prices (1987), which was followed by similar falls all over the world. In the late 1980s much of the world was suffering from a trade recession.

(d) Japan's success

Japan became economically one of the world's most successful states. At the end of the Second World War Japan was defeated and her economy was in ruins. She soon began to

Table 27.1 **Gross National Product per head of the population in 1992**

Year	*GNP*
1955	200
1978	7 300
1987	15 800
1990	27 000

recover, and during the 1970s and 1980s, Japanese economic expansion was dramatic, as Table 27.1 shows. (For full details see Section 15.2.)

27.2 THE THIRD WORLD AND THE NORTH–SOUTH DIVIDE

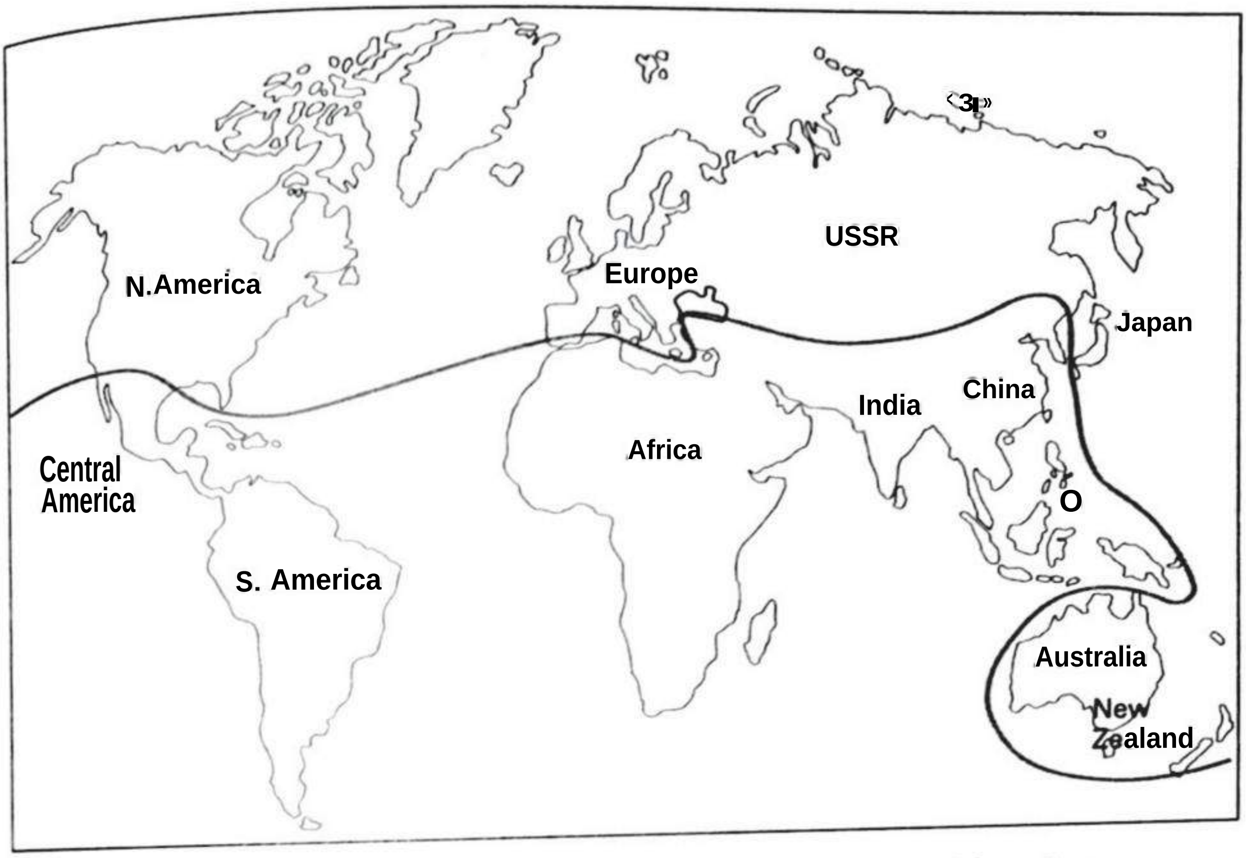
During the 1950s the term *Third World* began to be used to describe countries which were not part of the First World (the industrialized capitalist nations) or the Second World (the industrialized communist states). The Third World states grew rapidly in number during the 1950s and 1960s as the European empires broke up and newly independent countries emerged. By 1970 the Third World consisted of Africa, Asia (except the USSR and China), India, Pakistan, Bangladesh, Latin America and the Middle East. They were almost all once colonies or mandates of European powers, and were left in an undeveloped or under-developed state when they achieved independence.

(a) The Third World and non-alignment

The Third World states were in favour of non-alignment, which means that they did not want to be too closely associated with either the capitalist or the communist bloc, and they were very suspicious of the motives of both. Prime Minister Nehru of India (1947–64) saw himself as a sort of unofficial leader of the Third World, which he thought could be a powerful force for world peace. Third World countries deeply resented the fact that both blocs continued to interfere in their internal affairs (neo-colonialism). The USA, for example, interfered unashamedly in the affairs of Central and South America, helping to overthrow governments which they did not approve of; this happened in Guatemala (1954), the Dominican Republic (1965) and Chile (1973). Britain, France and the USSR interfered in the Middle East. Frequent meetings of Third World leaders were held, and in 1979, 92 nations were represented at a ‘non-aligned’ conference in Havana (Cuba). By this time the Third World contained roughly 70 per cent of the world’s population.

(b) Third World poverty and the Brandt Report (1980)

Economically the Third World was extremely poor. For example, although they contained 70 per cent of the world’s population, Third World countries only consumed 30 per cent of the world’s food, while the USA, with perhaps 8 per cent of the world’s population, ate 40 per cent of the world’s food. Third World people were often short of proteins and vitamins, and this caused poor health and a high death-rate. In 1980 an international group of



Map 27.1 **The dividing line between North and South, rich and poor**

politicians under the chairmanship of Willi Brandt (who [illegible] chancellor of West Germany from 1967 until 1974), and including Edward Heath (prime minister of Britain 1970–4), produced a report (*the Brandt Report*) on the problems of the Third World. It said that the world could be roughly divided into two parts (see Map 27.1).

The North – the developed industrial nations of North America, Europe, the USSR and Japan, plus Australia and New Zealand.
The South – most of the Third World countries.

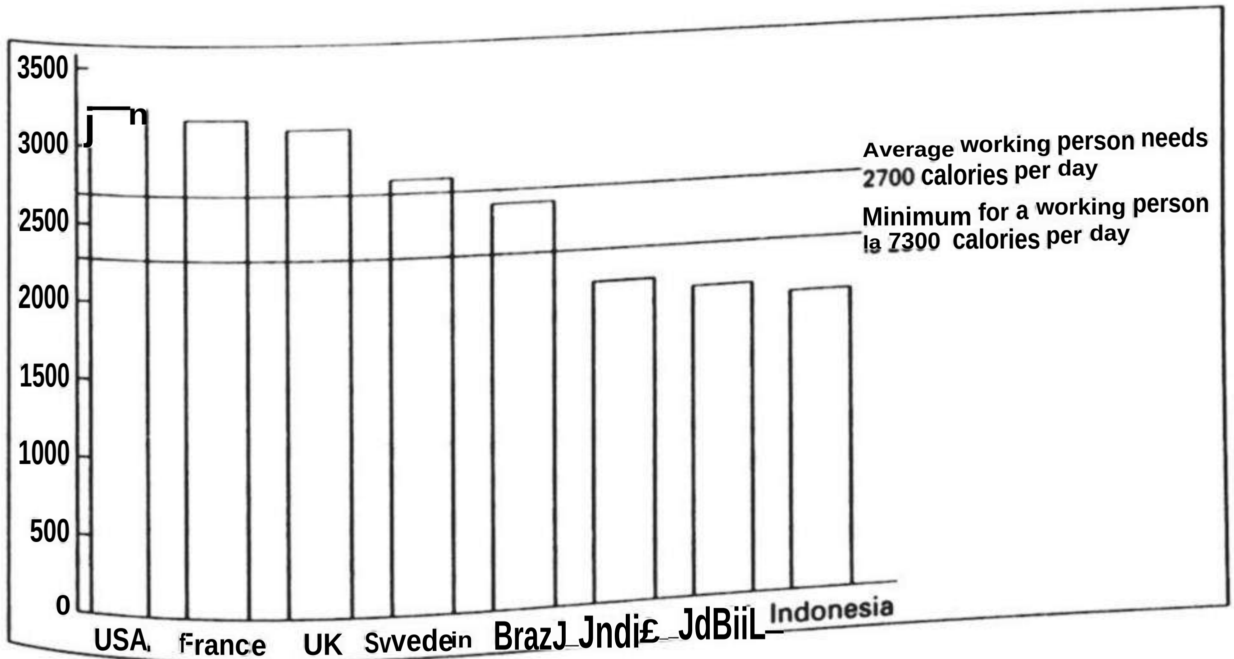


Figure 27.1 Calorie intake per person per day

Table 27.2 **Gross National Product per head of the population in 1992 (in US dollars)**

Japan	28 220	Libya	5 310
Taiwan	10 202	Uganda	170
Hong Kong	15 380	Rwanda	250
Singapore	15 750	Tanzania	110
South Korea	6 790	Kenya	330
North Korea	943	Zaire	220
Thailand	1 840	Ethiopia	110
Vietnam	109	Sudan	400
China	380	Somalia	150
		Zimbabwe	570
		Zambia	290
Peru	950	Nigeria	320
Bolivia	680	Mozambique	60
Paraguay	1 340	South Africa	2 670
Brazil	2 770	Algeria	2 020
Argentina	2 780		
Colombia	1 290		
Chile	2 730	India	310
Venezuela	2 900	Pakistan	410
Uruguay	3 340	Bangladesh	220
		Sri Lanka	540
Germany	21 000	Russian Fed.	2 680
France	22 300	Poland	1 960
Britain	17 760	Romania	1 090
Italy	20 510	Czechoslovakia	2 440
Switzerland	36 230		
Greece	7 180		
Spain	14 020		
Portugal	7 450	USA	23 120
Norway	25 800	Canada	20 320
Sweden	26 780	Australia	17 070
Belgium	20 880	Haiti	380
		Dominican Rep.	1 040
		Guyana	330
		Jamaica	1 340
		Trinidad & Tobago	3 940

Source: **World Bank statistics, in *Europa World Year Book* 1995.**

The report came to the conclusion that the North was getting richer and the South was getting poorer. This gap between the North and South is well illustrated by the statistics of calorie intake (Fig. 27.1) and by the comparison of Gross National Products (GNP) of some typical North and South countries, or 'developed' and 'low and middle' economies (Table 27.2).

GNP is calculated by taking the total money value of a country's total output from all units of production, wherever production is situated; and it includes interest, profits and dividends received from abroad. This total value is divided by the population figure, and this gives the amount of wealth produced per head of the population. In 1989–90 the GNP of the North averaged over 24 times that of the South. In 1992 a highly developed and efficient country like Japan could boast a GNP of over $28 000 per head of the population, and Norway $25 800. On the other hand, among poor African countries, Ethiopia could manage only $110 per head, the second lowest GNP in the world.

(c) Why is the South so poor?

- The South was and still is economically dependent on the North because of neocolonialism (see Sections 24.4 and 24.7). The North expected the South to continue providing food and raw materials for them, and expected them to buy manufactured goods from the North. They did not encourage the South to develop their own industries.
- Many states found it difficult to break away from the one-product economies left behind from colonial days, because governments lacked the cash needed to diversify. Ghana (cocoa) and Zambia (copper) found themselves facing this problem. In states like Ghana, which depended for its income on exporting crops, it meant that too little food would be left for the population. Governments then had to spend their scarce money on importing expensive food. A fall in the world price of their main product would be a major disaster. In the 1970s there was a dramatic fall in the world price of such products as cocoa, copper, coffee and cotton. Table 27.3 shows the disastrous effects on the incomes, and therefore the buying power of countries such as Ghana and Cameroon (cocoa), Zambia, Chile and Peru (copper), Mozambique, Egypt and the Sudan (cotton), and Ivory Coast, Zaire and Ethiopia (coffee).
- At the same time, prices of manufactured goods continued to rise. The South had to import from the North. In spite of the efforts of the United Nations Conference on Trade and Development (UNCTAD), which tried to negotiate fairer prices for the Third World, no real improvement was achieved.
- Although a great deal of financial aid was given by the North to the South, much of it was on a business basis – the countries of the South had to pay interest.

Table 27.3 **What commodities could buy in 1975 and 1980**

	Barrels of oil	*Capital ($US)*
Copper (1 tonne could buy)		
1975	115	17 800
1980	58	9 500
Cocoa (1 tonne would buy)		
1975	148	23 400
1980	63	10 200
Coffee (1 tonne would buy)		
1975	148	22 800
1980	82	13 000
Cotton (1 tonne would buy)		
1975	119	18 400
1980	60	9 600

Sometimes a condition of the deal was that countries of the South had to spend aid on goods from the country which was making the loan. Some countries borrowed directly from banks in the USA and western Europe, so that by 1980 Third World countries owed the equivalent of $500 billion; even the annual interest payable was about $50 billion. Some states were forced to borrow more cash just to pay the interest on the original loan.

- Another problem for Third World countries was that their populations were increasing much faster than those in the North. In 1975 the total world population stood at about 4000 million, and it was expected to reach 6000 million by 1997. Since the population of the South was growing so much faster, a larger proportion of the world's population than ever before would be poor (see Chapter 28).
- Many Third World countries had suffered long and crippling wars and civil wars, which ravaged crops and ruined economies. Some of the worst wars were in Ethiopia, Nicaragua, Guatemala, Lebanon, the Congo/Zaire, Sudan, Somalia, Liberia, Sierra Leone, Mozambique and Angola.
- Drought was sometimes a serious problem in Africa. Niger in West Africa was badly affected: in 1974 it produced only half the food crops grown in 1970 (mainly millet and sorghum), and about 40 per cent of the cattle died. As global warming gathered pace towards the end of the century, droughts became more frequent and many countries were dependent on overseas aid to feed their people.

(d) The Brandt Report (1980) was full of good ideas

For example, it pointed out that it was in the North's interests to help the South to become more prosperous, because that would enable the South to buy more goods from the North. This would help to avoid unemployment and recession in the North. If just a fraction of the North's spending on armaments was switched to helping the South, vast improvements could be made. For example, for the price of one jet fighter (about $20 million), 40 000 village pharmacies could be set up. The Report went on to make some important recommendations which, if carried out, would at least eliminate hunger from the world:

- the rich nations of the North should aim to be giving 0.7 per cent of their national income to poorer countries by 1985 and 1.0 per cent by the year 2000;
- a new World Development Fund should be set up in which decision-making would be more evenly shared between lenders and borrowers (not like the International Monetary Fund and the World Bank, which were dominated by the USA);
- an international energy plan should be drawn up;
- there should be a campaign to improve agricultural techniques in the South, and an international food programme should be drawn up.

Did the Brandt Report change anything? Sadly, there was no immediate improvement in the general economic situation of the South. By 1985 very few countries had reached the suggested 0.7 per cent giving target. Those that did were Norway, Sweden, Denmark, the Netherlands and France; however, the USA gave only 0.24 per cent and Britain 0.11 per cent. There was a terrible famine in Africa, especially in Ethiopia and the Sudan in the mid-1980s, and the crisis in the poorer parts of the Third World seemed to be worsening. Throughout the 1990s the US economy boomed under the Clinton administration, whereas the plight of the Third World became even more serious. At the end of 2003 the UN reported that 21 Third World states, 17 of them in Africa, were in crisis because of a combination of natural disasters, AIDS, global warming and civil wars (see Section 25.15). Yet the richest 1 per cent of the world's population (around 60 million) received as much income as the poorest 57 per cent. Norway was top of the UN's league table for human development: Norwegians had a life expectancy of 78.7 years, there was a literacy rate of virtually 100 per cent, and annual income was just under $30 000. In Sierra Leone life expectancy was about 35, the literacy rate was 35 per cent and annual income averaged $470. The USA seemed to attract the most hostility and resentment on account of this imbalance of wealth; it was widely believed that the growth of terrorism – especially the 11 September attacks on the USA – was a desperate response to the failure of peaceful attempts to bring about a fairer world economic system (see Sections 12.1 and 12.2).

UN economic advisers were clear about what needed to be done. It was up to the West to remove trade barriers, dismantle its over-generous system of subsidies, provide greater debt relief, and double the amount of aid from $50 billion to $100 billion a year. This would enable poor countries to invest in clean water systems, rural roads, education and proper healthcare.

27.3 THE SPLIT IN THE THIRD WORLD ECONOMY

During the 1970s some Third World states began to become more prosperous, sometimes thanks to the exploitation of natural resources such as oil, and also because of industrialization.

(a) Oil

Some Third World states were lucky enough to have oil resources. In 1973 the members of the Organization of Petroleum Exporting Countries (OPEC), partly in an attempt to conserve oil supplies, began to charge more for their oil. The Middle East oil-producing states made huge profits, as did Nigeria and Libya. This did not necessarily mean that their governments spent the money wisely or for the benefit of their populations. One African success story, however, was provided by Libya, the richest country in Africa thanks to its oil resources and the shrewd policies of its leader, Colonel Gaddafi (who took power in 1969). He used much of the profits from oil on agricultural and industrial development, and to set up a welfare state. This was one country where ordinary people benefited from oil profits; with a GNP of £5460 in 1989, Libya could claim to be almost as economically successful as Greece and Portugal, the poorest members of the European Community.

(b) Industrialization

Some Third World states industrialized rapidly and with great success. These included Singapore, Taiwan, South Korea and Hong Kong (known as the four 'Pacific tiger' economies), and among others, Thailand, Malaysia, Brazil and Mexico.

The GNPs of the four 'tiger' economies compared favourably with those of many European Community countries. The success of the newly industrialized countries in world export markets was made possible partly because they were able to attract firms from the North who were keen to take advantage of the much cheaper labour available in the Third World. Some firms even shifted all their production to newly industrialized countries, where low production costs enabled them to sell their goods at lower prices than goods produced in the North. This posed serious problems for the industrialized nations of the North, which were all suffering high unemployment during the 1990s. It seemed that the golden days of western prosperity might have gone, at least for the foreseeable future, unless their workers were prepared to accept lower wages, or unless companies were prepared to make do with lower profits.

In the mid-1990s the world economy was moving into the next stage, in which the Asian 'tigers' found themselves losing jobs to workers in countries such as Malaysia and the Philippines. Other Third World states in the process of industrializing were Indonesia and China, where wages were even lower and hours of work longer. Jacques Chirac, the French president, expressed the fears and concerns of many when he pointed out (April 1996) that developing countries should not compete with Europe by allowing miserable wages and working conditions; he called for a recognition that there are certain basic human rights which need to be encouraged and enforced:

- freedom to join trade unions and the freedom for these unions to bargain collectively, for the protection of workers against exploitation;
- abolition of forced labour and child labour.

In fact most developing countries accepted this when they joined the International Labour Organization (ILO) (see Section 9.5(b)), but accepting conditions and keeping to them were two different things.

27.4 THE WORLD ECONOMY AND ITS EFFECTS ON THE ENVIRONMENT

As the twentieth century wore on, and the North became more and more obsessed with industrialization, new methods and techniques were invented to help increase production and efficiency. The main motive was the creation of wealth and profit, and very little attention was paid to the side effects all this was having. During the 1970s people became increasingly aware that all was not well with their environment, and that industrialization was causing several major problems:

- Exhaustion of the world's resources of raw materials and fuel (oil, coal and gas).
- Massive pollution of the environment. Scientists realized that if this continued, it was likely to severely damage the ecosystem. This is the system by which living creatures, trees and plants function within the environment and in which they are all interconnected. 'Ecology' is the study of the ecosystem.
- Global warming – the uncontrollable warming of the Earth's atmosphere caused by the large quantities of gases emitted from industry.

(a) Exhaustion of the world's resources

- Fossil fuels – coal, oil and natural gas – are the remains of plants and living creatures which died hundreds of millions of years ago. They cannot be replaced, and are rapidly being used up. There is probably plenty of coal left, but nobody is quite sure just how much remains of the natural gas and oil. Oil production increased enormously during the twentieth century, as Figure 27.2 shows. Some experts believe that all the oil reserves will be used up early in the twenty-first century. This was one of the reasons why OPEC tried to conserve oil during the 1970s. The British responded by successfully drilling for oil in the North Sea, which made them less dependent on oil imports. Another response was to develop alternative sources of power, especially nuclear power.

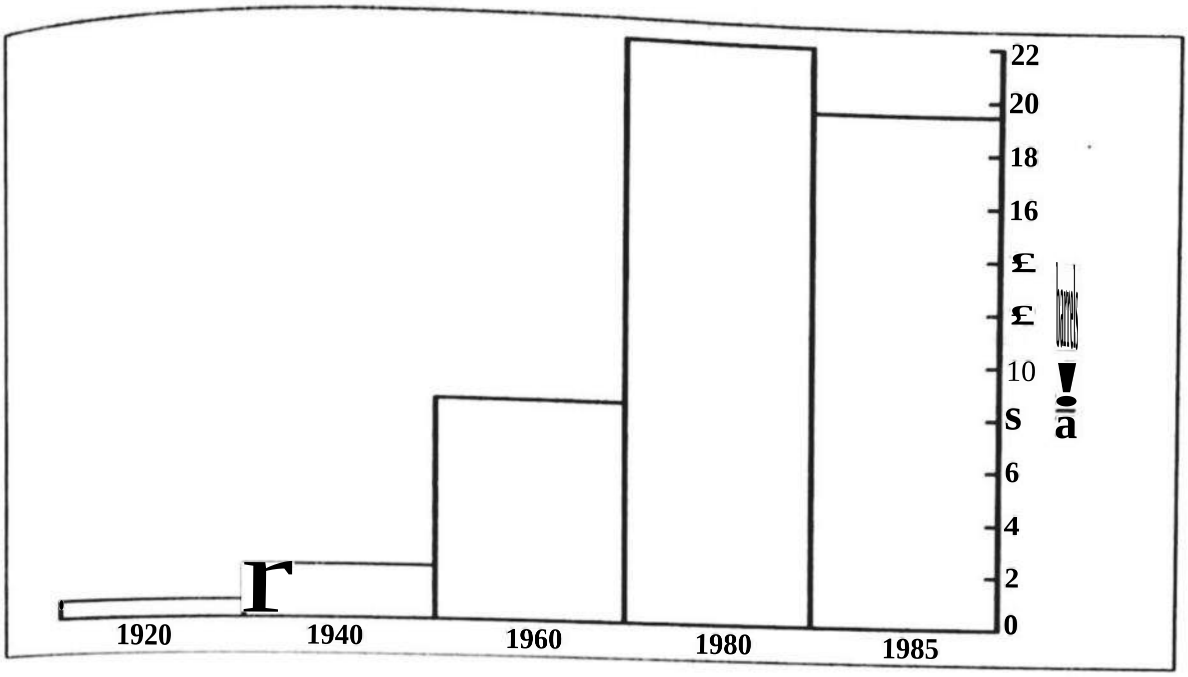


Figure 27.2 **World oil production in billions of barrels per year**

- Tin, lead, copper, zinc and mercury were other raw materials being seriously depleted. Experts suggested that these might all be used up early in the twenty-first century, and again it was the Third World which was being stripped of the resources it needed to help it escape from poverty.
- Too much timber was being used. About half of the world's tropical rainforests had been lost by 1987, and it was calculated that about 80 000 square kilometres, an area roughly the size of Austria, was being lost every year. A side effect of this was the loss of many animal and insect species which had lived in the forests.
- Too many fish were being caught and too many whales killed.
- The supply of phosphates (used for fertilizers) was being rapidly used up. The more fertilizers farmers used to increase agricultural yields in an attempt to keep pace with the rising population, the more phosphate rock was quarried (an increase of 4 per cent a year since 1950). Supplies were expected to be exhausted by the middle of the twenty-first century.
- There was a danger that supplies of fresh water might soon run out. Most of the fresh water on the planet is tied up in the polar ice caps and glaciers, or deep in the ground. All living organisms – humans, animals, trees and plants – rely on rain to survive. With the world's population growing by 90 million a year, scientists at Stanford University (California) found that in 1995, humans and their farm animals, crops and forestry plantations were already using up a quarter of all the water taken up by plants. This leaves less moisture to evaporate and therefore a likelihood of less rainfall.
- The amount of land available for agriculture was dwindling. This was partly because of spreading industrialization and the growth of cities, but also because of wasteful use of farmland. Badly designed irrigation schemes increased salt levels in the soil. Sometimes irrigation took too much water from lakes and rivers, and whole areas were turned into deserts. Soil erosion was another problem: scientists calculated that every year about 75 billion tons of soil were washed away by rain and floods or blown away by winds. Soil loss depended on how good farming practices were: in western Europe and the USA (where methods were good), farmers lost on average 17 tons of topsoil every year from each hectare. In Africa, Asia and South

America, the loss was 40 tons a year. On steep slopes in countries like Nigeria, 220 tons a year were being lost, while in some parts of Jamaica the figure reached 400 tons a year.

An encouraging sign was the setting-up of *the World Conservation Strategy* (1980), which aimed to alert the world to all these problems.

(b) Pollution of the environment – an ecological disaster?

- Discharges from heavy industry polluted the atmosphere, rivers, lakes and the sea. In 1975 all five Great Lakes of North America were described as 'dead', meaning that they were so heavily polluted that no fish could live in them. About 10 per cent of the lakes in Sweden were in the same condition. Acid rain (rain polluted with sulphuric acid) caused extensive damage to trees in central Europe, especially in Germany and Czechoslovakia. The USSR and the communist states of eastern Europe were guilty of carrying out the dirtiest industrialization: the whole region was badly polluted by years of poisonous emissions.
- Getting rid of sewage from the world's great cities was a problem. Some countries simply dumped sewage untreated or only partially treated straight into the sea. The sea around New York was badly polluted, and the Mediterranean was heavily polluted, mainly by human sewage.
- Farmers in the richer countries contributed to the pollution by using artificial fertilizers and pesticides, which drained off the land into streams and rivers.
- Chemicals known as chlorofluorocarbons (CFCs), used in aerosol sprays, refrigerators and fire extinguishers, were found to be harmful to the ozone layer which protects the Earth from the sun's harmful ultraviolet radiation. In 1979, scientists discovered that there was a large hole in the ozone layer over the Antarctic; by 1989 the hole was much larger and another hole had been discovered over the Arctic. This meant that people were more likely to develop skin cancers because of the unfiltered radiation from the sun. Some progress was made towards dealing with this problem, and many countries banned the use of CFCs. In 2001 the World Meteorological Organization reported that the ozone layer seemed to be mending.
- Nuclear power causes pollution when radioactivity leaks into the environment. It is now known that this can cause cancer, particularly leukaemia. It was shown that of all the people who worked at the Sellafield nuclear plant in Cumbria (UK) between 1947 and 1975, a quarter of those who have since died, died of cancer. There was a constant risk of major accidents like the explosion at Three Mile Island in the USA in 1979, which contaminated a vast area around the power station. When leaks and accidents occurred, the authorities always assured the public that nobody had suffered harmful effects; however, nobody really knew how many people would die later from cancer caused by radiation.

  The worst ever nuclear accident happened in 1986 at Chernobyl in Ukraine (then part of the USSR). A nuclear reactor exploded, killing 35 people and releasing a huge radioactive cloud which drifted across most of Europe. Ten years later it was reported that hundreds of cases of thyroid cancer were appearing in areas near Chernobyl. Even in Britain, a thousand miles away, hundreds of square miles of sheep pasture in Wales, Cumbria and Scotland were still contaminated and subject to restrictions. This also affected 300 000 sheep, which had to be checked for excessive radioactivity before they could be eaten. Concern about the safety of nuclear power led many countries to look towards alternative sources of power which were safer, particularly solar, wind and tide power.

One of the main difficulties to be faced is that it would cost vast sums of money to put all these problems right. Industrialists argue that to 'clean up' their factories and eliminate pollution would make their products more expensive. Governments and local authorities would have to spend extra cash to build better sewage works and to clean up rivers and beaches. In 1996 there were still 27 power-station reactors in operation in eastern Europe of similar elderly design to the one which exploded at Chernobyl. These were all threatening further nuclear disasters, but governments claimed they could afford neither safety improvements nor closure. The following description of Chernobyl from the *Guardian* (13 April 1996) gives some idea of the seriousness of the problems involved:

> At Chernobyl, the scene of the April 1986 explosion, just a few miles north of the Ukrainian capital Kiev, the prospect is bleak. Two of the station's remaining reactors are still in operation, surrounded by miles of heavily contaminated countryside. Radioactive elements slowly leach into the ground water – and hence into Kiev's drinking supply – from more than 800 pits where the most dangerous debris was buried ten years ago.

Nuclear reactors were also at risk from natural disasters. In May 2011 a huge tsunami hit the north-east coast of Japan. As well as killing thousands of people, it flooded a nuclear power station in Fukushima. First the six nuclear reactors were battered by high waves, and then the basement, where the emergency generators were situated, was submerged, disabling the entire plant. Again the ongoing problem was how best to deal with the widespread radioactive contamination. There was a great outburst of anti-government feeling when it later emerged that the authorities had ignored and then lied about reports of design weaknesses in the reactors.

(c) Genetically modified (GM) crops

One of the economic issues that came to the forefront during the 1990s, and which developed into a political confrontation between the USA and the EU, was the growing of genetically modified crops. These are plants injected with genes from other plants which give the crops extra characteristics. For example, some crops can be made to tolerate herbicides that kill all other plants; this means that the farmer can spray the crop with a 'broad-spectrum' herbicide that will destroy every other plant in the field except his crop. Since weeds use up precious water and soil nutrients, GM crops should produce higher yields and require less herbicide than conventional crops. Some GM crops have been modified to produce a poison which kills pests that feed on them, others have been modified so that they will grow in salty soil. The main GM crops grown are wheat, barley, maize, oilseed rape, soya beans and cotton. Advocates of GM crops claim that they represent one of the greatest advances ever achieved in farming; they provide healthier food, produced in a more efficient and environmentally friendly way. Given the problem of the growing world population and the difficulties of feeding everybody, supporters see GM crops as perhaps a vital breakthrough in solving the world food problem. By 2004 they were being grown by at least 6 million farmers in 16 countries, including the USA, Canada, India, Argentina, Mexico, China, Colombia and South Africa. The main supporters of GM crops were the Americans, who were also the world's largest exporter.

However, not everybody was happy about this situation. Many people object to GM technology on the grounds that it can be used to create unnatural organisms – plants can be modified with genes from another plant or even from an animal. There are fears that genes might escape into wild plants and create 'superweeds' that cannot be killed; GM crops might be harmful to other species and also in the long term to the humans who eat them. Genes escaping from GM crops might be able to pollinate organically growing crops, which would min the organic farmers involved. These unfortunate farmers might find themselves being sued for having GM genes in their crops, even though they had not knowingly planted such seeds. The main objections came from Europe; although some European countries – Germany and Spain for example – grew GM crops, the amounts were small. Scientists on the whole tended to reserve judgement, claiming that there should be long field trials to show whether or not GM crops were harmful, both for the environment and for public health. Opinion polls showed that around 80 per cent of the European public had grave doubts about their safety; several countries, including Austria, France, Germany, Italy and Greece, banned imports of individual GMs either for growing or for use as food. Americans, on the other hand, insisted that the crops had been thoroughly tested and approved by the government, and that people had been eating GM foods for several years without any apparent ill effects.

Another European objection was that the GM industry was controlled by a few giant agriculture businesses, most of them American. In fact, by 2004 the American company Monsanto was producing more than 90 per cent of GM crops worldwide. The feeling was that such companies had too much control over world food production, which would enable them to exert pressure on countries to buy their products and force more traditional farmers out of the market. The controversy came to a head in April 2004 when the USA called on the World Trade Organization (WTO) to take action. The USA accused the EU of breaking WTO free-trade rules by banning GM imports without any scientific evidence to support their case.

However, by no means does everybody in the USA support GM farming. An organization called the Centre for Food Safety (CFS) has launched several cases in the Supreme Court, most notably in 2006 when a group of organic alfalfa farmers sued Monsanto for growing GM alfalfa, without first carrying out safety checks. They were afraid that their organic alfalfa would be cross-pollinated by GM alfalfa, which would make their organic alfalfa unsaleable in countries where GM crops were banned. The judgement was that the planting of GM alfalfa should stop until a full-scale investigation into possible ill effects had been carried out. A spokesman for Monsanto stated that they were confident that tests would be completed in time for the autumn planting in 2010. Encouraged by this result, the CFS organized another lawsuit against Monsanto in 2009, this time against the growing of GM sugar beet. In August 2010 a similar judgement halted the planting of GM sugar beet until the necessary tests had been completed.

At the same time not everybody in Europe was against GM farming. In Britain, for example, at the Rothamsted Agricultural Research Centre at Harpenden, experiments were being carried out with GM wheat which is resistant to several kinds of insects and should therefore need fewer pesticides. In June 2012 a group of protesters calling themselves ‘Take the Flour Back’ threatened to destroy the crop. Several hundred protesters, including some from France, attempted to invade the research centre, but were prevented by a large police presence. Fortunately they were persuaded to call off their plan and meet the research team for discussions. At the end of June 2012 it was revealed that recent tests in China on GM cotton crops showed that some insects were developing increased resistance to these crops, and that an increasing number of other pests were developing in and around the cotton crop, and these were affecting surrounding crops too. In other words, the early benefits were now being replaced by unexpected problems. And so the basic problem still remains: how is agriculture going to produce enough to feed the steadily growing world population, given that the amount of land suitable for agricultural production makes up only about 11 per cent of the earth’s surface, and that a lot of this land is being contaminated by salt (salination), and therefore unsuitable for agriculture? Continuing global warming and rising sea levels are not likely to improve the situation (see the next section). At least there was one piece of good news in 2012 – in March it was announced that

Australian scientists had tested a new strain of wheat that could increase yields by 25 per cent in saline soils. Perhaps in the end, if the world is to survive, we shall have no choice but to accept GM produce. On the other hand it could be that scientists will succeed in producing new non-GM strains of all foodstuffs, like the Australian wheat, which will give higher yields from the same size of land area.

27.5 GLOBAL WARMING

(a) Early concerns

In the early 1970s scientists became concerned about what they called the 'greenhouse effect' – the apparently uncontrollable warming of the earth's atmosphere, or 'global warming', as it became known. It was caused by large amounts of carbon dioxide, methane and nitrous oxide, three gases produced during various industrial processes and by the burning of fossil fuels, being released into the atmosphere. These gases acted like the glass roof of a greenhouse, trapping and magnifying the sun's heat. Opinions differed about exactly what its effects would be; one alarming theory was that the ice caps, glaciers and snow in the polar regions would melt, causing the level of the sea to rise, and flooding large areas of land. It was also feared that Africa and large parts of Asia could become too hot for people to live in, and there could be violent storms and prolonged drought.

Some scientists dismissed these theories, arguing that if indeed the world was becoming warmer, it was a natural climatic change, not a man-made one. They played down the threats of flooding and drought, and accused those who suggested them of being anti-West and anti-industrialization. Industrialists themselves naturally welcomed these sympathizers, and as the debate between the two camps developed, nothing was done to reduce or control emissions of greenhouse gases.

Gradually the scientific evidence became more convincing: the Earth's average temperature was definitely increasing significantly, and the fossil-burning habits of humans were responsible for the changes. The evidence was enough to convince US vice-president Al Gore, who in 1992 wrote a pamphlet advocating international action to combat the greenhouse effect. President Clinton later proclaimed: 'We must stand together against the threat of global warming. A greenhouse may be a good place to raise plants; it is no place to nurture our children.' In June 1992 the UN organized the Earth Summit conference in Rio de Janeiro (Brazil) to discuss the situation. Representatives of 178 nations attended, including 117 heads of state; it was probably the largest gathering of world leaders in history. Most of them signed a range of treaties undertaking to protect the environment and reduce emissions of greenhouse gases.

However, signing treaties was one thing, enforcing them was quite another. For example, in 1993 when President Clinton introduced a bill to tax energy, the Republican majority in the Senate, many of whose supporters were industrialists and businessmen, threw it out. By this time many other countries were showing concern at the worsening situation. In 1995 an Intergovernmental Panel on Climatic Change produced a report outlining the probable effects of global warming and concluding that there could be little doubt that human actions were to blame.

(b) The Kyoto Convention (1997) and after

In 1997 another large international conference was held, this time in Kyoto (Japan), to work out a plan for reducing harmful emissions. It was appropriate that the conference was held in Kyoto, since, of all the industrialized countries, the Japanese had achieved most success in limiting their carbon emissions; and they had achieved it by heavy taxation on power and petrol. Statistics were worked out to show how much carbon each country was producing. The USA was by far the biggest culprit, emitting an average of 19 tons of carbon per head a year; Australia was not far behind with 16.6 tons per head. Japan emitted 9 tons per head a year, while the countries of the EU averaged 8.5 tons. On the other hand, the countries of the Third World emitted very modest amounts per head – South America 2.2 tons and Africa less than one ton.

The target set was to return global emissions to their 1990 levels by 2012. This meant that countries would have to reduce their emissions by different amounts to comply with the regulations; for example, the USA was required to reduce by 7 per cent, whereas France needed no reduction, since by 1997 the French were producing 60 per cent of their energy from nuclear power. In the end, 86 nations signed the agreement, which became known as the Kyoto Protocol. However, over the next few years this seemed to have little effect; in 2001 the Intergovernmental Panel on Climatic Change reported that climatic conditions were getting steadily worse. The 1990s was the hottest decade of the millennium and 1998 was the hottest year. In March 2001 the Kyoto Protocol was dealt a fatal blow when newly elected US President Bush announced that he would not ratify it. 'I will not accept a plan that will harm our economy and hurt American workers', he said. 'First things first are the people who live in America. That's my priority.'

Thus, early in the twenty-first century the world found itself in a situation where the USA, with no more than 6 per cent of the planet's population, was emitting a quarter of all the greenhouse gases, and would continue to do so, whatever the consequences for the rest of the world. In 2003 the effects of global warming were increasingly worrying. The UN calculated that at least 150 000 people had died during the year as a direct result of climate change – prolonged drought and violent storms. During that summer, 25 000 people died in Europe because of the unusually high temperatures. The increased warmth and the storms provided ideal breeding conditions for mosquitoes, which were spreading into mountainous areas where it had been too cold for them. Consequently the death rate from malaria increased sharply, especially in Africa. Droughts caused famine and malnutrition, so that people were more prone to catch life-threatening diseases.

(c) What happens next?

It was clear to climatologists that drastic measures were needed if dire consequences were to be avoided. Sir John Houghton, the former head of the British Meteorological Office, compared climate change to a weapon of mass destruction: 'like terrorism, this weapon knows no boundaries. It can strike anywhere, in any form – a heatwave in one place, a drought or a flood or a storm surge in another.' It was also being suggested that the Kyoto agreement, designed when climate change was thought to be less destructive, would be insufficient to make much difference to the problem, even if it were fully implemented. The tragedy is that the world's poorest countries, which have contributed hardly anything to the build-up of greenhouse gases, are likely to be the ones most seriously affected. Recently published statistics suggested that in 2004 some 420 million people were living in countries which no longer had enough crop land to grow their own food; half a billion people lived in areas prone to chronic drought. The threats are exacerbated by the pressure of the growing world population (see Sections 28.1–3). A number of measures have been suggested:

- Professor John Schnellnhuber, director of the UK-based Tyndall Centre, which researches climate change, believes that an adaptation fund should be set up under the auspices of the UN and financed by wealthy polluters through levies based on

the amount of emissions they make. The fund would be used to help poorer countries to improve their infrastructures, water industries and food production, and to cope with changes such as higher temperatures, rising river and sea levels, and tidal surges.
- A World Environment Court should be set up to enforce global agreements like the Kyoto Protocol. States must face fines large enough to deter them from breaking the rules.
- At national level, companies should be fined heavily for polluting rivers and dumping hazardous waste.
- An all-out effort should be made to develop new technologies so that 'green' power – solar, wind, tide and wave – will replace fossil fuels. Some people have suggested expanding nuclear power, an option which the French have chosen to take.

The main objections to all these alternatives are that they require fundamental changes in the way people live, and organize their countries' economies, and they will cost a lot of money to secure returns that will only become apparent in the future. A few scientists have suggested that the best thing is to do nothing at all at present, and hope that future scientists will find new and cheap methods of reducing greenhouse gases. However, in the words of Murray Sayle, 'long before that happy day, Miss Liberty may well be up to her bodice in New York harbour'. There were further worrying developments: in 2007 and 2008 a series of Gallup polls were held in 127 countries. These showed that over a third of the world's population were unaware of global warming. A survey in the USA in October 2009 showed that only 35 per cent of Republicans thought there was any reliable evidence that global warming was actually taking place. More Gallup polls in 111 countries in 2010 showed a disturbing fall in the USA and Europe in the percentage of people who thought that global warming was a serious threat. However, in Latin America the opposite was happening: an increasing number of people were worried about the effect that global warming was going to have on their families.

It was fitting that Latin America hosted the next two important conferences: the UN Climate Change Conference in Cancun, Mexico at the end of 2010, and the UN Conference on Sustainable Development in Rio de Janeiro, Brazil in June 2012. There was little to show from the Cancun Conference. There was simply an agreement, not a binding treaty, that member states would aim, as a matter of urgency, to reduce emissions of greenhouse gases sufficiently to limit global warming to 2° C. Delegates from 190 nations attended the 2012 Conference in Rio de Janeiro. Brazilian president Dilma Rousseff told the conference that Brazil had made significant progress in reducing emissions, and was now providing 45 per cent of its energy from renewable sources, mainly hydropower. UN secretary-general Ban Ki-moon pointed out that the world had not yet risen to the challenge of reducing greenhouse-gas emissions by concentrating on sustainable development. The outcome of the conference was disappointing: no specific reduction targets were set and a proposed fund of $30 billion to help the transition to a green economy was dropped from the final agreement. Koomi Naidoo, the international director of Greenpeace, described the conference as an epic failure. 'It has failed on equity, failed on ecology and failed on economy.' Ban Ki-moon summed up the situation well. He pointed out that 20 years ago there were 50 billion people in the world; today there are 75 billion. By 2030 we shall need 50 per cent more food and 45 per cent more energy than we need today. 'Let us not forget the scarcest resource of all – time. We are running out of time.' As if to underline his concern, it was announced in September 2012 that sea ice in the Arctic had shrunk to its smallest extent ever recorded. Scientists were predicting that within 20 years the Arctic Ocean would be completely ice-free in the summer months. John Sauven, the head of Greenpeace UK, warned that 'we are on the edge of one of the most significant moments in environmental history as sea ice heads towards a new record low. The loss of sea ice will be devastating, raising global temperatures that will impact on our ability to grow food, and causing extreme weather around the world.'

27.6 THE WORLD ECONOMY AT THE TURN OF THE MILLENNIUM

Since the USA was unquestionably the most powerful state economically during the last decade of the twentieth century, it was natural that the US economic system should come under close scrutiny. The EU, which some people saw as a rival power bloc to the USA, had a rather different view of how a market economy and society should be organized, in terms of international trade, care of the environment, aid and debt relief. According to British analyst Will Hutton, in his book *The World We're In* (2003): 'the relationship between the two power blocs is the fulcrum on which the world order turns. Managed skilfully, this could be a great force for good; managed badly, it could give rise to incalculable harm.'

(a) The American economic model

The US economic system evolved out of American traditions of freedom and the sanctity of property. The American right-wing attitude was that the law of private property and the freedom from government interference should be supreme. This was why the USA came into existence in the first place; people emigrated to the USA so that they could enjoy that freedom. It followed that the US federal government should interfere with people's lives as little as possible, its main function being to safeguard national security.

On the question of social welfare – to what extent the state should be responsible for the care of the poor and helpless – attitudes were divided. The right-wing or conservative attitude was based on 'rugged individualism' and self-help. Taxation was viewed as an invasion of private property, and government regulations were seen as restraints on freedom and prosperity. The liberal attitude was that 'rugged individualism' should be tempered by the idea of a 'social contract'. This held that the state should provide basic welfare in return for the respect and obedience of its citizens. Hence Roosevelt's New Deal and Johnson's Great Society – programmes introduced by Democrat administrations, which included large elements of social reform. For 16 out of the 24 years preceding 2005, the US had Republican governments which favoured the right-wing approach.

Both schools of thought had their supporters and champions in the USA. For example John Rawls, in his book *A Theory of Justice* (Oxford University Press, 1973), put forward a theory of 'justice as fairness'. He argued in favour of equality and claimed that it was the duty of government to provide welfare and some redistribution of wealth through taxation. In reply, Robert Nozick, in his book *Anarchy, State and Utopia* (Harvard University Press, 1974), argued that property rights should be strictly upheld, that there should be minimal government intervention, minimal taxation and minimal welfare and redistribution. Nozick's theories had a great influence on the New Right and were taken up by the neo-conservative branch of the Republican party. They were seen in action during the Reagan administration (1981–9), and even more so under George W. Bush (2001–9), when both taxes and welfare programmes were reduced. With neo-conservatism in the ascendant in the USA, it was only to be expected that, as the USA assumed the role of world leadership, the same principles would be extended to American international dealings; hence American reluctance to become involved in initiatives to help the Third World – on issues such as debt relief, international trade and global warming. There was no denying that the American economic system in its different variants had achieved remarkable success over the years. However, in the early twenty-first century the New Right approach was clearly faltering (see Section 23.6(d)); many liberal Americans were looking towards the European model as a potentially better way of providing a just economic and social order.

(b) The European economic model

The economic and social systems of western, democratic Europe, which took shape after the Second World War, varied from country to country. But they all shared certain basic characteristics – provision of social welfare and public services, particularly education and health, and a reduction in inequality. It was expected that the state would take an active role in regulating business and society and in operating a tax system that redistributed income more fairly and provided the revenue to finance education and healthcare. There was also the assumption that big business had a part in the social contract – it had responsibilities to society and so must function in a socially acceptable way, looking after its employees, paying fair wages and taking care of the environment. Whereas in the USA the interests of shareholders were paramount, in most parts of Europe the perception was that the interests of the entire business must come first; dividends were kept relatively low so that high investment was not neglected. Trade unions were stronger than in the USA, but on the whole they operated responsibly. This system produced highly successful companies and relatively fair and just societies.

Outstanding examples of successful European companies include the German car and truck manufacturer Volkswagen: some 20 per cent of the company's shares are owned by the state government of Lower Saxony, shareholders' voting rights are limited to 20 per cent and the company pays only 16 per cent of its profits as dividends – none of which would be allowed to happen in the USA. Michelin, the French tyre manufacturer, and the Finnish company Nokia, the world's largest manufacturer of mobile phones, are high-performance organizations run on similar lines to Volkswagen. Another European success story is the joint German, French and British Airbus, which can claim to be the world's most successful aircraft manufacturer, surpassing even the USA's Boeing company. Western European states have generous welfare systems financed by a combination of taxation and social security contributions, and a high standard of public health and education. Even in Italy, Spain, Greece and Portugal, with their history of fascism and military dictatorships, the social contract exists, and unemployment insurance is the highest in Europe.

Many American analysts were critical of the European system, since during the 1990s unemployment rose in Europe, while the USA enjoyed an economic boom. The Americans claimed that European problems were caused by high taxation, over-generous welfare systems, the activities of trade unions and too much regulation. Europeans blamed their difficulties on the need to keep inflation under control so that they would be able to join the single currency launched in 1999. Europeans were confident that once that hurdle had been surmounted, economic growth and job creation would recover. European confidence in their system received a boost during the Bush administration, when it was observed that all was not well with the US economy.

(c) The American system in action

Even during the Clinton administration, the USA extended its economic principles into its global dealings. American interests usually came first, so much so that many people complained that globalization meant Americanization. Some examples were:

- During the 1990s the USA gained control of the International Monetary Fund (IMF), which meant that the Americans could decide which countries should receive aid, and could insist that governments adopted policies of which the USA approved. This happened to many Latin American countries as well as Korea, Indonesia and Thailand. Often the conditions imposed made recovery harder instead of easier. In 1995, when the World Bank suggested that debt relief was vital for some poor countries, it met stiff opposition from the USA, and its chief economist felt compelled to resign. Basically these developments meant that the USA could control the world's financial system.

- In 1994 the USA used the General Agreement on Tariffs and Trade (GATT) to force the EU to open all its voice communications (post, telephone and telegraphs) to international competition. In 1997 the World Trade Organization (WTO), which succeeded GATT in 1995, agreed that 70 countries should be opened up to US telecoms companies on American terms. By 2002 there were 180 commercial satellites orbiting in space, and 174 of them were American. The USA all but controlled the world's communications systems. It was to counter this that the EU insisted on launching its own Galileo space satellite system (see Section 10.8(d)).
- In March 2002 the Bush administration imposed import duties on foreign steel in order to protect the American steel industry. This brought bitter protests from the EU, since the function of the WTO was to encourage free trade. The USA resisted the pressure until December 2003; then, faced with threats of retaliatory duties on a wide range of American goods, President Bush cancelled the steel tariffs. In the same month, however, the US announced new tariffs on imports of textiles and television sets from China.
- In 2003 there was one positive step which benefited poorer countries: responding to worldwide protests from states suffering the worst ravages of HIV/AIDS, President Bush agreed that the patents controlling the necessary drugs should be overridden, allowing far cheaper versions to be produced for sale in the worst affected states. There was an ulterior motive, however: in return, the Americans were hoping to gain access to African oil and to set up military bases in strategic parts of the continent.

There was a long way to go before globalization produced a fair and just world in which wealth was more evenly distributed. Some observers believed that the way forward was in a reinvigorated and strengthened UN; others saw the newly enlarged EU as the best hope. The participation of the USA – the world's richest nation – was still thought to be vital. As Will Hutton put it: 'We badly need the better America back – the liberal, outward-looking and generous US that won World War II and constructed a liberal world order that in many respects has sustained us to this day.' South African president Thabo Mbeki summed up the world situation admirably in July 2003 when he wrote: 'The progressive politicians must demonstrate whether they have the courage to define themselves as progressive, recovering their historic character as champions of the poor, and break the icy ideological grip of right-wing politics. The African masses are watching and waiting.' Sadly, what happened next can hardly have been more disappointing for them. The participation of the USA was still very much in evidence, but not quite in the way the commentators hoped for.

27.7 CAPITALISM IN CRISIS

(a) Meltdown – the Great Crash of 2008

On 15 June 2007 Ben S. Bernanke, chairman of the American Federal Reserve Bank, made a long speech in which he extolled the virtues of the American financial system:

In the United States, a deep and liquid financial system has promoted growth by effectively allocating capital, and has increased economic resilience by increasing our ability to share and diversify risks both domestically and globally.

There was, he said, no possibility of a financial crisis in America. Yet, little over a year later the American system and the whole global economy seemed to be on the verge of total collapse. In fact some experts had been predicting collapse for some years, but had been proved wrong. However, in March 2008 the unthinkable happened – it was revealed that one of the oldest and most respected Wall Street investment banks, Bear Stearns, was in serious trouble. It had lost $1.6 billion when some affiliated hedge funds collapsed, but much worse, it had a problem with bad debts estimated at $220 billion. Reluctantly, US treasury secretary, Henry Paulson, decided that Bear Stearns could not be allowed to collapse, since that might inconvenience or even ruin many of the rich citizens who had entrusted their wealth to the bank. There was a rule that the US government should never bail out an investment bank, so it was arranged that another bank, J. P. Morgan, should be provided with Federal Reserve funds to enable it to take over Bear Stearns. This indirect Federal Reserve bailout of Bear Stearns saved the system from collapsing. Unfortunately, it also left the impression that any other bank that got itself into difficulties would always be able to rely on a government bailout. In financial circles this was described as 'moral hazard' – the idea that there are some investors who believe that they are 'too big to fail', and who therefore take reckless risks.

The fourth largest bank on Wall Street, Lehman Brothers, had been struggling for over a year with problems of bad debts and a shortage of capital. In August 2008 it too was on the verge of bankruptcy and no other bank was willing to bail it out. In September its European branch based in London was put into administration, but there was wide expectation in the USA that the government would come to the rescue with a Bear Stearns-type deal. But this time there was to be no bailout – Tim Geithner of the Federal Reserve of New York state announced that there was 'no political will' for a Federal rescue. Lehman Brothers was allowed to go bankrupt; it was the largest US company until then ever to go bust. The collapse sent shock waves around the world, and share prices plummeted. Why was Lehman Brothers allowed to collapse? Government and state financial bosses like Paulson and Geithner were determined that there should be no such thing as 'moral hazard' – state takeovers should not become a habit, because it was seen as state capitalism. In a country that almost worshipped free-market capitalism, the idea that private companies and banks should be subsidized or taken over by the government was sacrilege. One leading financier remarked: 'I just think it is disgusting; this is not American.'

Unfortunately, the crisis worsened rapidly and the government found it impossible to maintain its free-market stance. Another struggling investment bank, Merrill Lynch, was taken over by the Bank of America (BOA). Then came the biggest sensation so far: a giant insurance company, American International Group (AIG), asked the government for a loan of $40 billion to stave off bankruptcy. Like the failing investment banks, AIG had too many bad or 'toxic' debts, as they were now being called. The government was in a dilemma: AIG was so big and had done so much business with most of the major financial institutions worldwide, that if it were allowed to collapse the repercussions would be catastrophic. Consequently it was decided that AIG should be bailed out with a government loan of $85 billion, although the state took an 80 per cent stake in the company. In effect, the US government had nationalized AIG, though the word itself was never used.

The UK banking system was already in trouble before the US crisis began, mainly because the Bank of England was reluctant to pump money into the system and failed to reduce interest rates on borrowing. The UK mortgage bank, Northern Rock, which had been forced to reduce its lending because of its own dependence on short-term borrowing (see below **(b)3**), collapsed in September 2007. It was eventually nationalized at a cost of some £100 billion. In September 2008 Halifax Bank of Scotland (HBOS) was saved from collapse when it was taken over by Lloyds TSB for £12 billion in a deal arranged by British prime minister Gordon Brown. However, its share price fell rapidly, so that only a few weeks later its value had slumped to £4 billion. This brought Lloyds TSB to its knees as well and it too had to be rescued by the government. Royal Bank of Scotland (RBS) was partly nationalized, so that it became 83 per cent taxpayer-owned. Shares in European banks followed suit; Fortis, the huge Dutch–Belgian bank, lost almost half its value in just a few days and was taken into joint ownership by the two governments. In Germany, France, the Irish Republic and Iceland similar bailouts were taking place. And most of this happened in just a few days in September 2008. The situation was exacerbated by millions of ordinary depositors rushing to withdraw their funds from the banks. Lending between banks had more or less dried up because the inter-bank lending rates (known as LIBOR) were prohibitive.

By the time the crisis passed, the US Treasury had acquired stakes in several more major financial institutions, including Goldman Sachs, Morgan Stanley, J. P. Morgan Chase, and two mortgage underwriters, Freddie Mac and Fannie Mae. The function of these last two institutions was not to provide mortgages directly to house-buyers, but to act as an insurance by underwriting mortgages given by other banks. Much of the help was provided under the Bush administration's Troubled Asset Relief Program (TARP) and later by the Obama administration's Public–Private Investment Program. According to an official report in July 2009, TARP had saddled the taxpayers of the USA with a debt of $27.3 trillion. By that time the crisis had developed into a global recession. The whole bailout operation was extremely controversial. President Bush was accused of being un-American and of introducing socialism. To get the TARP approved by Congress it was necessary to attach several conditions: limits on executive pay, a cap on dividends and the right of the government to take stakes in the ailing banks.

(b) What were the causes of the great crash?

Paul Mason, economics editor of the BBC *Newsnight* programme, **sums** up the causes of the crisis neatly in his book *Meltdown* (2010):

> If you exalt the money-changers, exhort them to make more money and hail the ascendancy of speculative finance as a 'golden age', this is what you get. The responsibility for what happened must lie, as well as with any banker found to have broken the law, with regulators, politicians and the media who failed to hold them up to scrutiny.

He argues that the system known as neo-liberalism that had been in operation for the last quarter of a century was mainly responsible for the catastrophe. In the words of Sir Keith Joseph, a UK Conservative supporter of the free-market system, neo-liberalism involved 'the strict and unflinching control of money supply, substantial cuts in tax and public spending and bold incentives and encouragements to the wealth creators'.

Beginning in the last decade of the twentieth century, globalization played an important role, as national economies became interlinked as never before. In the 20 years after 1990 the world's labour force doubled and with the increase in migration, became global. China and the former Soviet bloc joined the world economy. The greater availability of labour brought a fall in real wages in the leading western economies, including the USA, Japan and Germany. Yet consumption grew, made possible by a massive increase in credit and the heyday of the credit-card era. The credit boom seemed sustainable at first but after 2000 the debts began to run out of control. At the same time capital flowed around as western financiers began to invest abroad more than ever before, and this caused a huge rise in global imbalances. For example, China's foreign currency reserves grew from $150 billion in 1999 to $2.85 trillion in 2010, but between 1989 and 2007 the US deficit increased from $99 billion to $800 billion. So long as the US housing boom continued, the situation was just about sustainable, but once house prices began to falter, chaos was unleashed as the amount of toxic debts soared. To look at the steps towards meltdown in more detail:

The deregulation of the US banking industry in 1999–2000

In November 1999 the US Congress passed an act designed to promote economic growth through competition and freedom. This cancelled the regulation, dating from the Depression of the 1930s, that prevented investment banks from handling the savings and deposits of the general public, and meant that they now had access to far larger funds. Banks were also allowed to act as insurance companies. A year later futures and all other derivatives were exempted from being classified as gambling and all attempts to regulate the derivatives market were declared illegal. Probably the most common type of derivatives are futures: a future is a contract in which you agree to buy something at a future date, but at a price decided on now. The hope is that in the meantime the price will go up, enabling you to sell it again at a profit. The actual contract between the two parties can itself be sold and resold several times before the agreed date. However, there is a risk involved: in the meantime the price might fall, but you still have to pay the agreed price. Another type of derivative develops when observers start betting among themselves on whether the original contract will be fulfilled. The option derivative is similar to a future except that you simply agree the option to buy, rather than actually buying the commodity itself.

The deregulation, together with the spread of the latest computer technology, was certainly a 'bold incentive and encouragement' to the bankers who now had a free hand to indulge in all these types of speculation. It enabled the derivatives market to become global, and foreign-exchange dealing increased rapidly. In the two years leading up to the crash, there was a massive rush of money into derivatives and currency trading. The statistics are staggering: in 2007 the total value of the world's stock market companies was $63 trillion; but the total value of derivative investments stood at $596 trillion – eight times the size of the real economy. It was as though there were two parallel economies – the real economy and a kind of phantom or fantasy economy which only existed on paper. Admittedly, not all the derivative dealings were speculative, but enough of them were risky to cause concern among perceptive financiers. As early as 2002 Warren Bultett, probably the world's most successful investor, warned that derivatives were a time bomb, financial weapons of mass destruction, because in the last resort, neither banks nor governments knew how to control them. Paul Mason concludes that since the end of the 1990s, 'this new global finance system has injected gross instability into the world economy'. By October 2008, even Alan Greenspan, a former chairman of the Federal Reserve, who had always claimed that banks could be trusted to regulate themselves, was forced to admit that he had been wrong. By the time the crisis peaked, some 360 banks had received capital from the US government.

Sub-prime mortgages and the collapse of the US housing market

The long-running housing boom in the USA reached a peak towards the end of 2005. House prices had been rising steadily and had reached levels that could not be sustained. Too many houses had been built, demand gradually fell and so did prices. The unfortunate thing was that many houses, especially during the latter stages of the boom, had been sold using sub-prime mortgages. These are mortgages lent to borrowers who have a high risk of being unable to keep up the payments, and for that reason sub-prime borrowers have to pay a higher interest rate. As house prices were rising, mortgage providers were able to repossess houses whose buyers defaulted on their mortgage payments, and make a profit from selling them on. When house prices began to fall, many lenders foolishly continued to push sub-prime mortgages, and suffered heavy losses when the buyers defaulted. The more careful mortgage providers took out insurance to underwrite their loans, so insurance companies like AIG, Freddie Mac and Fannie Mae were faced with huge payouts. Niall Ferguson, in one of his 2012 Reith Lectures, suggested that Freddie and Fannie should take a large slice of the blame for the crisis, because they encouraged people who really couldn't afford to do so to take out mortgages.

Another of the practices that contributed to the meltdown was known as collateral debt obligation (CDOs). This was the packaging together of different debts and bonds for sale as assets; a package might include sub-prime mortgages, credit-card debts and any kind of debt, and anybody buying the package would hope to receive reasonable interest payments. In fact since the year 2000, buyers, which included investment banks, pension funds and building societies, had been receiving interest payments on average between 2 and 3 per cent higher than if the debts had not been bundled up. But then several things went wrong – houses prices fell by around 25 per cent, more people defaulted on the mortgage payments than had been expected, unemployment rose, and many people were unable to pay off their credit-card debts. One estimate put the likely losses to buyers at $3.1 trillion.

3 Leverage, short selling and short-termism

These were other tactics in which banks indulged in order to make money, and which eventually ended in disaster. Leverage is using borrowed money to increase your assets which can then be sold at a profit when the value increases. Lehman was guilty of this, having a very high leverage level of 44. This means that every $1 million owned by the bank had been stretched by borrowing so that they were able to buy assets valued at $44 million. In a time of inflation like the period 2003–6, these assets could be sold at a comfortable profit. But it was gamble, because only a small downward movement in the value of the assets would be enough to break the bank. As John Lanchester explains:

> Lehman made gigantic investments in the property market, not just in the now notorious sub-prime mortgages, but also to a huge extent in commercial property. In effect, Fuld [Richard Fuld, head of Lehman Brothers] allowed his colleagues to bet the bank on the US property market. We all know what happened next.

As US house prices collapsed and the number of mortgage defaulters soared, Lehman was left with debts of $613 billion. In the words of Warren Buffett: 'when the tide goes out it reveals those who are swimming naked'.

Short selling is a strange process in which the investor first borrows, for a fee, shares from a bank or other institution which is not planning to sell the shares itself. The investor then sells the shares in the hope that their price will fall. If and when this happens, he buys the shares back, returns them to the owner and keeps the difference. It is the company whose shares are being sold and bought that suffers, as illustrated by the plight of Morgan Stanley. As the crisis deepened investors began to move their money out. In three days 10 per cent of the cash on Morgan Stanley's books was withdrawn. The share price began to fall and this was the signal for short sellers to unload their Morgan Stanley shares, sending the share price plunging further.

Short-termism is the common banking practice of lending money for long terms and borrowing it for short terms – you issue a long-term loan and fund it by short-term borrowing yourself. When lending between banks dried up in September 2008 following the rush of depositors to withdraw cash, many banks were unable to pay out. This was because they had lent too much out on long-term loans which they could not get back immediately, and had failed to keep to the rule that they must hold a large enough 'cushion' to fall back on.

Many banks tried to get round this regulation by setting up a son of 'shadow' banking system. paul Mason explains how the system worked:

> The essence of the shadow banking system is that it is designed to get round the need for any capital cushion at all. Almost everybody in the shadow system was 'borrowing short' by buying a piece of paper on the vast international money market, and then 'lending long' by selling a different piece of paper into that same money market. So it was basically just traditional banking: but they were doing it with no depositors, no shareholders and no capital cushion to fall back on. They were pure intermediaries. They did it by exploiting a loophole in the regulations to create two kinds of off-balance sheet companies known as 'conduits' and 'structured investment vehicles' (SIVs). ... The conduits were set up by banks in offshore tax havens. The bank would, theoretically, be liable for any losses, but it did not have to show this on its annual accounts.

Incredible as it may seem, all this was kept secret from investors, which didn't matter when all was running smoothly. But there was one huge flaw in the system: it could only work as long as bankers continued to buy and sell everything on offer. As soon as short-tenn credit was no longer available, bankers could not fund their long term loans, and inevitably some pieces of paper became unsaleable.

4 *Regulators and credit-rating agencies failed to do their job satisfactorily*

Since 2000, thanks to the actions of both the US and UK governments, regulation of the banking system had been exercised with what can only be described as a light touch. The politicians were apparently happy to continue this non-interventionist attitude since bankers had played an important part in achieving the consumer boom and full employment. They mistakenly believed that bankers could therefore be trusted not to do anything too risky. The credit-rating agencies were the second line of defence against high risk. The three main agencies are Standard and Poor's, Moody's and Fitch. Their job is to carry out a risk-assessment process on banks, companies and assets and award grades showing investors whether or not it would be sate to do business with them. The safest gets an AAA rating, while BB or less indicates a high-risk institution or commodity. Between 2001 and 2007 the amount of money paid to the three main credit rating agencies doubled, reaching a total of $6 billion. Yet an official report published in July 2007 was highly critical of the work of the rating agencies. They were accused of being unable to show convincing evidence that their methods of assessment were reliable, especially in the case of CDOs. They were unable to cope with the vast increase in the amount of new business that they were called on to do since 2000. Many critics saw the whole system as suspect: the fact that institutions and sellers of bonds actually paid for their own ratings invited 'collusion': if they gave the correct ratings, they risked upsetting the banking business and losing market share. As a result, no decisive action was taken until it was too late. For example, it was only a matter of hours before the British HBOS collapsed in September 2008 that Standard and Poor's downgraded it, and even then the comforting phrase, 'but the outlook is stable', was added.

(c) The aftermath of the crash

Although the capitalist financial system had been saved from total collapse, the consequences of the crisis were clearly going to be felt for a long time. As the money supply dried up, demand for goods fell, and across the world, manufacturing industry slumped. Many of the weakest companies went to the wall and unemployment rocketed. In the USA in the first few months of 2009 it was calculated that around half a million jobs a month were being lost. The great exporting nations like China, Japan, South Korea and Germany suffered huge falls in exports. Although central bank interest rates were almost zero in the USA and Britain, nobody was investing to try to stimulate the still declining economy. Attempts to deal with this problem included:

- Fiscal stimulus provided by governments and central banks. As early as November 2009 the Chinese government had decided to supply cash worth $580 billion over the next two years to fund various environmental projects. Banks were encouraged to lend vast sums of money, guaranteed by the state, to fund other projects. Millions of new jobs were created, and within a few months China's economic growth rate had recovered and surpassed its previous high point. The main problem was the uncertainty about how risky those massive bank loans were.

  In the USA, newly elected Democrat president Barack Obama's fiscal stimulus of $787 billion went into operation in February 2009. It was a controversial move because the Republican party was totally against it: even in a crisis as serious as this, they believed that the state should not be expected to provide help. A right-wing Republican group calling themselves the Tea Party Movement launched an anti-stimulus protest campaign encouraging Republican state governors not to accept stimulus money. Although the US economy did begin to grow again towards the end of 2009 and continued slowly through 2010, there were still 15 million unemployed at the end of the year.

  In the EU the effects of the crisis varied among its 27 member states. They experienced different degrees of recession, though the average growth reduction at the end of 2009 was 4.7 per cent. The three Baltic states fared the worst, suffering full-scale slump: Estonia's GDP fell by 14 per cent, Lithuania's by 15 per cent and Latvia's by 18 per cent. France did best, losing only 3 per cent of GDP. Most states borrowed heavily in order to launch fiscal-stimulus packages. For example, in 2009 France's borrowing was equivalent to 8 per cent of GDP and Britain's was 11 per cent. These amounts were quite small compared with America's and China's, but in the case of France they were successful: as early as August 2009 the French economy was growing again. The problem was that they were all left with massive national debts. Those countries which had signed up to the Maastricht Agreement of 1991 (see Section 10.4(h)) had broken the rules that borrowing must not exceed 3 per cent of GDP and total debt must be limited to 60 per cent of GDP.
- Quantitative easing (QE). This was the practice, first thought of by John Maynard Keynes back in the 1930s, of increasing the amounts of cash in circulation by 'printing money'. In fact nowadays banks do not actually print new notes: the central banks simply invent or create more money which is added into their reserves, and then used to buy up government debts. The UK was the first to use QE in March 2009 when a modest £150 billion was 'created', and this to some extent helped to put demand back into the system. According to Paul Mason, 'Britain's "pure" QE strategy saw it inject around 12 per cent of GDP into the economy. The Bank of England estimates this should, over a period of three to four years, filter through into a 12 per cent increase in the money supply and thus in demand.' The USA adopted QE soon after Britain. However, the European Central Bank rejected QE on the grounds that it would threaten the stability of the euro. It was argued that simply making more of the existing money available to eurozone banks and buying AAA-rated bonds would be sufficient to stimulate demand. But demand was not sufficiently stimulated and consequently the value of the euro was weakened. By the end of 2009 the eurozone was in big trouble as the cost of all the fiscal stimulus and bank bailouts had to be faced. Some economists were already predicting that the zone was on the verge of break-up. In fact some economists and politicians *hoped* it would break up, so this seemed an unmissable opportunity!

(d) The eurozone in crisis

The financial crisis in Greece sparked things off. In October 2009 the newly elected social-democrat government discovered that the country's budget deficit – which stood at 6 per cent according to the previous government – was in reality 12.7 per cent. Over half its actual debt, with a little assistance from Goldman Sachs, had been moved into the shadow-banking system, 'off' balance sheet'. It later emerged that there were serious flaws in the Greek system that had allowed massive tax evasion and other corrupt practices, such as pensions still being paid to families of the deceased. The immediate problem was that Greece had financed its national debt with short-term loans, a quarter of which were due for repayment in 2010. How were they going to find the necessary €50 billion? The first step was to introduce strict austerity policies – cuts in pensions, wages and social services and a campaign to eliminate tax evasion. Eventually in May 2010 the eurozone banks and the IMF agreed a loan of €110 billion to Greece, provided they fulfilled the austerity programme. This was extremely unpopular with the Greeks, and resulted in strikes and two general elections over the next two years. By the autumn of 2011 there seemed a real danger that Greece would default on its debts. Worried about the disastrous effects this might have on other members of the eurozone, leaders agreed to write off half of Greece's debts to private creditors.

Meanwhile some other eurozone countries had also got themselves too heavily in debt. In November 2011 the Republic of Ireland had to be helped with a bailout of €85 billion. Portugal, which had suffered crippling competition from Germany and China, was on the verge of bankruptcy. In July 2011 Moody's had downgraded Portugal's debt to 'junk' status, and in October it too received an IMF bailout. Portugal had the lowest GDP per capita in western Europe and in March 2012 the unemployment rate was around 15 per cent. By August 2011 Spain and Italy had drifted into the danger zone. Paul Mason explains what happened next (in *Why It's Kicking Off Everywhere: The New Global Revolutions* (2012)):

> The European Central Bank was forced to break its own rules and start buying up the debt of these two massive, unbailable economies. The dilemma throughout the euro crisis has been clear: whether to impose losses from south European bad debts onto north European taxpayers, or onto the bankers who had actually lent the money to these bankrupt countries in the first place. The outcome was always a function of the level of class struggle. By hitting the streets, Greek people were able to force Europe to impose losses on the bankers: where opposition remained within traditional boundaries – the one-day strike, the passive demo – it was the workers, youth and pensioners who took the pain. Meanwhile Europe itself was plunged into institutional crisis. Monetary union without fiscal union had failed.

27.8 THE WORLD ECONOMIES IN 2012

At the turn of the millennium 'globalization' had been the buzzword. It seemed to promise huge benefits for the world – increased connectivity between countries, faster growth, greater transfer of knowledge and wealth, and perhaps even a fairer distribution of wealth. Economists talked about the 'BRIC' countries, meaning Brazil, Russia, India and China. These were the world's fastest growing and largest emerging market economies, and between them they contained almost half the world's population. Many economists were predicting that it was only a matter of time before China became the largest economy in the world, Probably some time between 2030 and 2050. Goldman Sachs believed that by 2043 all the BRIC countries would be in the world's top 10 economies, and that by 2050 they would be the top four, with China in first place. The USA was expected to have been relegated to fifth place.

There were differing views about actual details of how this scenario would play out. In 2008 the BRIC countries held a summit conference. Many analysts got the impression that they had ulterior motives of turning their growing economic strength into some kind of political power. They could carve out the future economic order between themselves. China would continue to dominate world markets in manufactured goods, India would specialize in providing services, while Russia and Brazil would be the leading suppliers of raw materials. By working together in this way the BRIC states can present an effective challenge to the entrenched interests and systems of the West. However, the fact that these four countries have very little in common could mean that any economic and political co-operation would only be temporary, or rather artificial. Once China becomes the world's largest economy, it might not need the other three. In that case it could be China and the USA that work together to lead the global economy.

It was not immediately obvious how the 2008 meltdown would affect the BRIC nations. Many economists believed it would be possible for them to 'decouple' themselves from the West and continue growing. This turned out not to be the case and many commentators began to doubt whether globalization had been a 'good thing' after all. It seemed as if it had made the world economy less stable, more volatile, and more vulnerable to the danger of a crisis in one country infecting the rest of the world. A brief survey of the world's leading states shows that, unfortunately, very few were able to avoid the contagion. As a report from Credit Suisse said: 'We may not be at the brink of a new global recession, but we are even less likely to be at the threshold of a global boom.'

(a) China

As we saw earlier, the financial crisis of 2008 caused an immediate drop in China's exports. China launched a great spending spree in 2008 and 2009 to improve the country's infrastructure and launch a number of environmental projects. This seemed to work at first and China's growth rate soon recovered. However, this policy was continued through 2010 and 2011 when the total investment was an unprecedented 49 per cent of China's GDP. There were several problems with this state of affairs. Most observers believed that there was a limit to the number of roads, airports and high-rise flats that China could keep on building, and they feared that there had been an unsustainable building bubble that was about to burst, just as similar bubbles burst earlier in the USA, Spain and Portugal. The concentration on domestic consumption and reduced demand from overseas meant that exports, and therefore revenue from exports, were continuing to decline, and the growth rate was slowing. The Chinese themselves were extremely nervous about their own vulnerability in view of the continuing crisis in the eurozone. So much so that in June 2012, along with India, they contributed tens of billions of dollars to the IMF's emergency fund for tackling the EU's ongoing problems.

(b) Brazil

Like China, Brazil initially responded well to the 2008 economic crisis, launching a massive property-building project. This created thousands of new jobs and unemployment fell to its lowest level for many years. Domestic demand continued at a high level. The economy continued to grow, receiving a huge boost with the discovery of more oil and gas reserves off the coast. By 2012 Brazil had become the world's ninth largest oil producer, and was hoping eventually to become the fifth largest. It had overtaken Britain and was noW ratcd to be the sixth largest economy in the world. Other good news was that poverty was dccreasjng - over the last few years, the incomes of the poorest 50 per cent of the popU!·ion have increased by almost 70 per cent. Brazil will host the 2014 soccer World Cup and the 201b Summer Olympics will take place in Rio de Janeiro.

However, thc latest reports suggest that all is not well in Brazil. House prices in Rio have ,rUllcd since 2008, causing mortgage borrowing to rocket and raising the prospect of yet another crash if and when the housing bubble should burst. Since some of Brazil's pain exports included raw material, and oil to China, the slow-down in Chinese exports of manufactured goods and the general decline in global demand did LV ΛTwTfo Brazil's export trade, especially taking into account the 30 per cent fall in oil prices ,Λrm ll " ~rnfidence waned, d * the a*«s we• pss atic slowdown in grow

(c) India

India's economy had been expanding rapidly and words like 'dynamic' and 'rampaging Asian tiger' had been used to describe it. However, as the financial crisis hit the USA and Europe, demand for Indian goods plummeted and was still falling in 2012. In fact, Indian exports fell by a further 3 per cent in the year from May 2011 to May 2012. As the economy slowed down, investors began to desert India, preferring something safer, like the US dollar. This sent the value of the rupee plunging until in June 2012 it reached a record low against the dollar. In theory this should help Indian exports, which would be cheaper; but on the other hand it made India's imports more expensive, and this pushed up the cost of living, making even essentials difficult to afford. In addition India had further problems: much of its infrastructure was in a dilapidated state, and businesses complained of being hampered by corruption, bribery and unnecessary bureaucracy. The country's current account deficit stood at $49 billion in June 2011 and was estimated to be $72 billion at the end of 2012, which would be over four per cent of India's GDP. According to Morgan Stanley, a sustainable deficit ought to be no more than two per cent of GDP. Standard and Poor's and Fitch both reduced their ratings of the Indian economy to 'negative', though Moody's continued to rate it as 'stable'. Clearly India had failed to 'decouple' itself from the problems of the eurozone. Desperate for the eurozone crisis to be resolved, in June 2012 India joined China in making a substantial contribution to the IMF's emergency fund.

M) Russia

UP until 2008 the Russian economy enjoyed ten years of spectacular growth thanks mainly to high oil prices. GDP increased tenfold, and by 2008 revenues from oil and gas were Worth around $200 billion, about one-third of total revenue. The fact that the economy was so dependent on the price of oil meant that there could be no 'decoupling' from the rest of the world's economic problems. The rapid fall in oil prices and in demand for oil had a dΛastrous effect on Russia: in 2008 the price per barrel plunged from $140 to $40, caus'ng a drastic fall in revenue. The foreign credits that Russian banks and businesses had rclied on quickly dried up, leaving many firms unable lo pay cheir debts. The government LWas forced to help them by providing $200 billion to increase liquidity in the Russian banking sector. The Russian Central Bank also spent a third of its $600 billion Internati onal currency reserve fund to slow down the devaluation of the rouble. Fortunately, by the middle of 2009 the slump had bottomed out and the economy began to grow agatm In ?''. « well as becoming the world's leading oil producer, surpassing Saudi Arabia, Russia also became the second largest producer of natural gas and the thud largest exporter of steel and aluminium. The high price of oil in 2011 helped the recovery and enabled Russia to reduce the large budget deficit that had accrued during the lean period in 2008 and early 2009.

However, recognizing the danger of being too dependent on oil, the government successfully encouraged the expansion of other areas. In 2012 Russia was the world's second largest producer of armaments, including military aircraft, after the USA, and the IT industry had a year of record growth. Companies making nuclear power plants were expanding, and several plants were exported to China and India. In 2012 statistics showed that Russia was the third richest country in the world in terms of cash reserves; inflation had been reduced and unemployment had fallen. Nor was the expansion confined to Moscow and St Petersburg; other cities, including Nizhny Novgorod, Samara and Volgograd (formerly Stalingrad), were playing an important role in the diversification of industry. Of the four BRIC nations Russia was clearly the strongest economically.

(e) The USA

Unemployment, which had stood at 15 per cent at the end of 2010, continued to fall, but only slowly. Fitch ratings agency estimated that President Obama's fiscal stimulus packages boosted US GDP by 4 per cent over the following two years. However, according to a *Guardian* report (27 June 2012), 'the US economy is still limping along with very slow growth and a high rate of unemployment. Although the economy has been expanding for three years, the level of GDP is still only 1 per cent higher than it was nearly five years ago. Recent data shows falling real personal incomes, declining employment gains, and lower retail sales.' Another problem was that, although mortgage interest rates were low, house prices have continued to fall and in 2012 were 10 per cent lower in real terms than they were two years ago.

At the end of June 2012 the Organization for Economic Co-operation and Development (OECD), the Paris-based group of independent economists from 34 countries, produced its biannual report on the US economy. This confirmed that the US recovery remained fragile and pointed out that two of the main problems were record long-term unemployment and the widening gap between the poor and the wealthy. About 5.3 million Americans, 40 per cent of unemployed people, have been out of work for six months or more. Poverty in the US is worse than in Europe, and of the 34 OECD member states, only Chile, Mexico and Turkey rank higher in terms of income inequality. The report also suggested measures to remedy the situation:

- Equalize tax rates by ending tax breaks for the very wealthy – in other words, make the rich pay more. Earlier in 2012 the government proposed a measure to make sure that everyone making more than a million dollars a year pays at least 30 per cent in tax. Predictably, this was strongly opposed by the Republicans.
- Provide more investment for education and innovation, and more training programmes to get the long-term unemployed back to work.
- Increase gas prices to help reduce the use of fossil fuels.
- The government should reduce spending, but only gradually, rather than make drastic cuts; these might discourage business investment and slow growth even further.

How the situation would develop depended very much on the results of the presidential and congressional elections held in November 2012. Tax cuts for the wealthy introduced during the Bush administration were due to end on 31 December 2012. Another hangover from the Bush era was that automatic spending cuts would be applied at the end of 2012. The cuts involved, dubbed 'the fiscal cliff', would amount to $1.2 triHion.

(e) The European Union

In the summer of 2012 the future looked uncertain. In June there were tense elections in Greece when the party that was prepared to continue the austerity policy won a narrow victory over the socialist party that resented having austerity forced on the country by outsiders, and was determined to abandon the euro. And so the euro survived again. There was also resentment in some of the more economically successful north European states, especially in Germany, at having to bail out what many saw as the 'feckless, reckless and lazy' south. The most likely outcome seemed to be that the taxpayers of northern Europe would bail out the south and would, in effect, take control of overall eurozone economic policy, so that the eurozone would become much closer to being a fiscal union, and therefore, to some extent, a political union as well. Of course the governments of southern Europe resisted losing overall control of their economic policies; but without a bailout of some sort – the eurozone seemed likely to disintegrate.

On the other hand, many economists and financiers believed that the euro must be saved. In September 2012 Mario Draghi, the president of the European Central Bank (ECB), announced: 'We say that the euro is irreversible. So, unfounded fears of reversibility are just that – unfounded fears.' It was felt that the collapse of the euro would throw the entire global economy into chaos. Certainly Germany wanted the euro saved, because the cheap euro benefited German exports, whereas a strong Deutschmark would do considerable damage to their exports. Hopes for the survival of the euro revived in September 2012 when Mario Draghi unveiled a rescue plan that involved the ECB buying up the bonds of Spain and Italy, the two eurozone countries after Greece most heavily in debt. Those governments could then request a bailout from the ECB which would be granted, provided they agreed to implement strict austerity measures. The announcement of the plan received a glowing reception across most of Europe; stock markets soared on both sides of the Atlantic, and so did confidence in the euro's survival. This was sufficient to bring down borrowing costs for Spain and Italy, and their future seemed brighter. Even the Germans agreed to go along with the scheme. At first the German Bundesbank condemned the whole idea as 'tantamount to financing governments by printing banknotes'. But eventually, after pressure from Chancellor Merkel and Mario Draghi himself, followed a few days later by the approval of the German constitutional court, the Bundesbank, albeit rather grudgingly, agreed to back the plan. The European Stability Mechanism (ESM), as it was now known, was poised to go into operation with the creation of a rescue fund of E5(M) billion.

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QUESTIONS

1 What is meant by the term 'North–South divide'? What attempts have been made since 1980 to close the gap between North and South, and how successful have they been?
2 Assess the reasons why global warming is seen as such a serious problem for the world's future. To what extent do you think it is the twenty-first century's major problem?
3 Explain why there was a 'crisis of capitalism' in the decade leading up to 2012.

There is a document question about pollution and global warming on the website.