



## Is the world ready for another recession?

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Having failed to foresee the Great Recession that ravaged the world economy during the last six years plus, which witnessed 23 million people out of work all over the world, the highly paid researchers at the two Bretton Woods institutions have been atoning for their acts of commission or omission.

They are churning out heaps of research papers getting us ready for another world economic crisis, whether lurking around the corner or not.

It is very similar to the situations where our own weather forecasters feel guilty, when they failed to predict the 2005 tsunami which destroyed lives and properties in South and Southeast Asia. They do not want to take any more risks. They know now very well that it is better to “forecast and prepare for the worst” even it turns out to be a storm in a tea-cup!

### **The 2005 warning**

However, one has to admit at least one person knew something was going to happen, when the financial bubbles were rising and spreading. It was 2005 at a function honouring the retiring US Federal Reserve chairman Alan Greenspan, once heralded as a financial wizard and now criticized as the man who encouraged the bubbles and failed “to take away the punch bowl when the party was getting wild.” The then Chicago-based academic, Raghuram Rajan now the Governor, Reserve Bank of India, chose the “wrong occasion” to present a paper on: “Has Financial Development Made the World Riskier?”.

Incidentally, students of monetary economics are aware that the phrase “take away the punch bowl” was from a speech by William McChesney Martin, Jr., who was Fed chairman, the longest-serving (1951-1970) under five presidents. He was referring to a timely central bank action “to reduce the stimulus that it has been giving the economy.”

Rajan in his paper described how financial sector managers were encouraged by lax monetary policy of the Fed to “take risks that generate severe adverse consequences.” He issued the warning on a looming disaster.

The then US Treasury Secretary Lawrence Summers described the warnings of “slightly lead-eyed premise of [Mr. Rajan's] paper to be misguided.” He also called Rajan a “luddite” (a 19<sup>th</sup> century term referring to an opponent of technological change).

In January 2012, when the crisis broke out, Rajan’s warning was seen in retrospect by *Wall Street Journal* as prescient: “The financial crisis has savaged the reputation of Mr. Greenspan and others now seen as having turned a blind eye toward excessive risk-taking.”

### **The latest signal**

We are now sure that critics would not call the two Bretton Woods institutions as “luddites!”

The latest signal of an impending crisis came on Tuesday this week. A 272-page research publication authored by Ayhan Kose of the World Bank's Development Prospects Group, and Marco Terrones, of the International Monetary Fund’s Research Department warns the world “of possibility of another global recession lingering.”

The publication, *Collapse and Revival: Understanding Global Recessions and Recoveries* acknowledges the 2009 recession, which stemmed from excess and risky lending in USA resulting in worldwide recession as the “most severe of the four global recessions of the past half century.

A recession is technically defined as a contraction in real output per capita (that is output adjusted for inflations) for two consecutive quarters. The contraction is also accompanied by a decline in various measures, such as industrial production, unemployment, trade and capital flows, and energy consumption.

Kose and Terrones say there have been four world recessions since 1960, starting in 1975, 1982, 1991 and 2009. In the latest 2009 case, the decline was the deepest and widest of all. Along with industrialized countries, many emerging and developing countries contracted too. In all 65% of world economies suffered.

The reason is clear: the globalization process is at its maximum today.

### **Why fresh concerns?**

Early October, IMF cut its July world growth forecast of 3.3% for 2016 to 3.1% . Slowdown in China and the resultant falls in commodity prices made the outlook gloomier than before.

Kose and Terrones are of the opinion that governments are not doing their job. Past recoveries were due to greater public investment initiatives. But in the current Great Recession episode, in addition to cuts in government spending, there has been a lack of coordination between fiscal and monetary policy. When monetary policy has been aiming at encouraging borrowing by private sector, governments were not supportive.

Recalling the words of monetarist and Nobel Laureate, Milton Friedman, who compared recoveries to a guitar string arguing that the harder the string is pulled, the faster it returns.

In the current crisis, Kose and Terrones note: “The guitar string seems to have been pulled down so hard that it snapped.”

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