Greenspan points to further economic weakness

By Nick Beams
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The economic slowdown in the United States, which has resulted in a sharp reduction in world economic growth over the past six months, seems certain to continue, according to testimony delivered by US Federal Reserve Board chairman Alan Greenspan to the US Congress.

Presenting the central bank’s semi-annual report on Wednesday, Greenspan said that by “aggressively easing” monetary policy—the interest rate cuts of 2.75 percentage points over the past six months—the Fed had moved to “support demand, and, we trust, help lay the groundwork for the economy to achieve maximum sustainable growth.”

“But the uncertainties surrounding the current economic situation are considerable, and, until we see more concrete evidence that the adjustments of inventories and capital spending are well along, the risks would seem to remain mostly tilted toward weakness in the economy.”

Greenspan noted that, while in the recent period incoming data on economic activity had turned from “persistently negative to more mixed,” the period of “sub-par economic performance” was not yet over and “we are not free of the risk that economic weakness [arising from weakened demand abroad as well as domestic developments] will be greater than currently anticipated, and require further policy response.”

In its report to Congress, the Fed downgraded its outlook for US economic growth this year to between 1.25 and 2 percent, from the range of 2 to 2.5 percent it estimated in February. But while predicting a pick-up in 2002, it added a note of caution: “Even though an appreciable recovery in the growth of economic activity by early next year seems the most likely outcome, there is as yet no hard evidence that this improvement is in train, and the situation remains very uncertain.”

Figures on the level of industrial activity compiled by the Fed and released earlier this week point to the serious nature of the downturn. The US entered its ninth consecutive month of falling industrial output in June, the longest slide in almost 20 years.

Total production in factories, mines and utilities dropped by 0.7 percent in June, while total capacity utilisation fell to 77.0 percent, down from 77.6 percent in May. In the April-June quarter industrial output fell at an annual rate of 5.6 percent following a 6.8 percent rate of decline for the first quarter.

Greenspan noted that with a rise in overall capacity in high-tech manufacturing industry of almost 50 percent last year, well in excess of the already rapid increases over the previous three years, a glut in these industries was inevitable at some point. But the “adjustment” was faster than most business anticipated and was compounded by other factors, including the rise in energy costs.

“Moreover, weakness emerged more recently among our trading partners in Europe, Asia, and Latin America. The interaction of slowdowns in a number of countries simultaneously has magnified the softening each of the individual economies would have experienced on its own.”

Greenspan pointed to the fall in inventories as one of the causes for the slowdown and held out the prospect that “at some point” the liquidation of inventories would come to an end leading to a boost in production and incomes.

“Of course, the timing and force with which that process of recovery plays out will depend on the behaviour of final demand. In that regard, the demand for capital equipment, particularly in the near term, could pose a continuing problem.

“Despite evidence that expected long-term rates of return on the newer technologies remain high, growth of investment in equipment and software has turned decidedly negative. Sharp increases in the uncertainties about the short-term outlook have significantly foreshortened the time frame over which businesses are requiring new capital projects to pay off.” This had led to a “major scaling back of new capital spending initiatives” although presumably one that was not long lasting.

However in addition to this process, “a deterioration in sales, profitability, and cash flow has exacerbated the weakness in capital spending. Pressures on profit margins have been unrelenting. Although earnings weakness has been most pronounced for high-tech firms, where the previous pace of expansion left oversupply in its wake, weakness is evident virtually across the board, including most recently in earnings of foreign affiliates of American firms.”

Greenspan also pointed to the risks to consumer spending over the next few quarters arising from reduced household wealth and reduced confidence because of the weaker jobs market.

As if rehearsing his lines for future hearings, when the economic situation may well be even more serious, the Fed chairman pointed to what he saw as the limitations on the conduct of monetary policy.

“A central bank,” he said, “can contain inflation over time under most conditions. But do we have the capability to eliminate booms and busts in economic activity? Can fiscal and monetary policy acting at their optimum eliminate the business cycle, as some of the more optimistic followers of J.M. Keynes seemed to believe several decades ago?”

Not according to Greenspan because “there is no tool to change human nature” and too often “people are prone to recurring bouts of optimism and pessimism that manifest themselves from time to time in the buildup or cessation of speculative excesses.”

In other words, there is no rational explanation for the violent cyclical turns in the capitalist economy, because, in the final analysis, they are rooted in the structures of the human psyche.

Other observers, however, are starting to voice their fears that the present US downturn may have its origins in the very processes which have transformed the global economy in the past decade.

The latest assessment of the investment firm Morgan Stanley is that the world economy has entered recession, defined as world gross domestic product growth of less than 2.5 percent. According to the firm’s chief economist Stephen Roach, while the global recession stems “in large part” from the “IT shock” in America, this is not just the latest in a long string of unexpected shocks.

“[T]he global recession of 2001 is very much a by-product of the previous downturn of 1998. Indeed I would argue that the two downturns could be viewed more as a continuum of one long and drawn out global business cycle—one that could well go down in history as the world’s first recession of this modern-day era of globalisation. And if the world doesn’t get its act together, this type of downturn could well be symptomatic of what now lies ahead—a more unstable and recession-prone global economy.”

In 1998, Roach notes, the Fed responded to what Greenspan called an “unprecedented seizing up of world financial markets” by cutting interest rates and pumping liquidity into the international financial system. This led to a rapid acceleration in global growth, reaching to 4.8 percent in 2000, the fastest such gain since 1976.

But this process of “global healing sowed the seeds of its own demise” by creating the conditions for the high-tech boom in the US economy in 1999-2000. “A Fed-induced, Nasdaq-led liquidity bubble gave rise to the great IT overhang that has since wreaked such havoc on the US and the broader global economy.”

In other words, according to this analysis, the very measures which were aimed at trying to prevent a major crisis at one point, created the conditions for major problems at another. This is a sure indication that the financial turbulence of 1997-98 and now the slowdown in the US and world economy do not arise from human nature but are the expression of deep-seated contradictions within the global capitalist economy.