The Most Recent Crisis of Capitalism: To What Extent Will it Impact the Globalization Process of Recent Decades

Hamid Hosseini
King's College

The paper tries to demonstrate that the globalization process of recent decades has been weakened during the recent global recession. This process of deglobalization, the paper demonstrates, can be seen in the decline of international trade, the rise of protectionism, and the decline and certain changes in the pattern and destination of FDI. Prior to demonstrating the above, the paper discusses the various dimensions and relative severity of this recent crisis, which began during the last few weeks of 2007. By providing various historical example of capitalist crisis in the United States or in England it argues that capitalism has frequently witnessed altering periods of prosperity and recession or depression, often marked by a crisis of finance.

INTRODUCTION

Beginning with the last few weeks of 2007, the United States economy, as well as the world capitalist system, began to witness a rather severe recession. In terms of severity, this crisis which began in the financial and housing sectors of the U.S. economy, has been viewed as the worst since the Great Depression of the 1930s. According to many economists, had it not been for the various government interventions across the major industrialized economies, this severe recession would have turned into another world-wide depression.

This severe recession has had various consequences, within individual countries and across the globe.

The paper begins to demonstrate that there is nothing unusual about recessions or even depressions, since capitalism has frequently witnessed altering periods of prosperity and recession or depression, often, as in the case of this most recent recession, marked by a crisis in finance.

Before discussing the global impact of this most recent recession, it is worth mentioning that capitalism, since its inception a few centuries ago, has had global tendencies, although it has become much more global since World War II. Aspects of this globalization has been seen in the decline of obstacles to international trade, the rise of foreign direct investment (FDI) and the multinational enterprise, the emergence of international organizations like the IMF, the World Bank, and the WTO (and before the 1990s the GATT), and the integration of various economies in the form of the EU and NAFTA.

The paper tries to demonstrate that the globalization process that began after WWII, and was intensified as a result of the collapse of the Soviet system and the transformation of former socialist economies of Eastern Europe and China, has been weakened during this recent global recession. In other words, the recent global recession has caused a form of deglobalization. The weakening of the globalization, as the paper will demonstrate, will in particular be seen in the decline of international trade, the rise of protectionism, and the decline and some changes in the pattern and destination of FDI.

Crisis and the History of Capitalism

Although the ongoing recession has been severe, it should not, however, be viewed as a permanent one, and one that would result in the end of capitalism. Economic crises of different types have always been real under capitalism. This is truly undeniable. For, it has been witnessed from the inception of capitalism. For example, during the 19^{th} century, when capitalism was still in its first phase, financial crisis followed by depressed economic conditions occurred in England (perhaps the first capitalist country) in 1815, 1825, 1836, 1847, 1866, 1873, 1882, 1890 and 1900. (Schumpeter, 1954). The United States' capitalist economy too had witnessed economic crises during the 19th century, or the early parts of the 20^{th} century. Wesley Michell, one of the first American economists interested in crisis and business cycles, indicated in 1923 that from 1812 to 1920 the US economy passed through a crisis some fifteen times, in: 1812, 1818, 1825, 1837, 1847, 1857, 1873, 1884, 1890, 1893, 1903, 1910, 1913, and 1920. According to Joseph Schumpeter, during the 19^{th} century, the world economy also experienced three great depressions – during the 1840s, the 1970s, and the 1890s. Schumpeter also discussed breakdown with similar regularity during the 18^{th} century, when perhaps what we now call capitalism began. Of course, beginning with the classical school (established by Adam Smith in the 1770s), economists who adhered to the Say's Law ignored or denied the possibility of crisis and business cycles under capitalism. As a result, it was left to unorthodox economists to discuss the possibility of crisis or business cycles under capitalism. For example, in 1820 unconventional British economist Thomas Malthus, in 1819 French socialist historian Jean Charles Sismondi, and a few decades later John Hobson discussed the possibility of a type of economic crisis called under consumption, not to mention Marx who discussed the possibility of crisis under capitalism which, in his opinion, would lead to its demise. Other than Marx and those who discussed the possibility of under consumption crisis, the periodic and cyclical nature of capitalism first began to be discussed in the 1860s by European statisticians rather than economists. Discussion of business cycles, and not necessarily economic crisis, began by writers like Clement Juglar, Tugan – Borenousky, Aftalion, and Spiethoff.

So far as English academic economists were concerned, the possibility of business cycle was only admitted during the first two decades of the 20^{th} century (Hutchison, 1978). The subsequent decades brought forth a flood of statistical and historical materials and theoretical technique that changed the subject into a recognized branch of economics. Among the first explanations of business cycle in English and by conventional economists occurred in the hands of Pigou, Hawtrey and even J.M. Keynes, to be followed by Wesley Mitchell, Irving Fisher, Joseph Schumpeter, Friedrick Hayek and others.

Of course, business cycle theories did not stop in the first half of the 20^{th} century, since New Classical economists led by Robert Lucas(1977) continued the analysis of business cycles. Robert Lucas, in a series of papers during the 1970s, tried to place business cycles into an economy in equilibrium. The works by Robert Lucas on business cycles led to what became known as real business cycle theory, to be distinct from business cycles that stem from financial and monetary factors. Although the phrase real business cycle as coined by John Long and Charles Plasser in their 1983 Journal of Political Economy paper, the theory was actually introduced by Finn Kydlord and Edward Prescott in their 1982 Econometrica paper.

The Impact of Recent Global Recession on International Trade and Protectionism – a Reversing of Globalization Protectionism – a Reversing of Globalization?

The financial crisis that started at the end of 2007 was intensified in the fall of 2008 leading the worst global recession since Great Depression of the 1930s. One of the consequences of this recession was the tremendous decline in international trade. As suggested by Mark Wynne and Erasmus Karsting (2009), the decline in trade and the protectionist instincts that resulted from it have raised the concerns that "today's crisis may lead to deglobalization – a reversal of the globalization that has characterized the past three decades." (Economic Letter, Dallas FED., Nov. 2009). This decline, one can argue, has had at least two different causes – the drying up of trade finance, and the intensification of protectionist measures.

Global trade plummeted in the last months of 2008. In fact, world trade volumes dropped some 14% from December 2008 to February 2009. The WTO (2009) estimated that the volume of global trade for the year 2009 will exhibit its biggest contraction since WWII, generating significant concern. In fact, the

WTO estimated a 9% decline in global export volumes in 2009. According to the October 2009 edition of the IMF's World Economic Outlook, international trade as measured by total exports of goods and services will decline 11.9% for the year 2009. While for the advanced economies the decline of export was to be 13.6%, the decline for the emerging and developing economies was to be only 7.2% decline. These decliners are rather unprecedented. For example, during the recession of 2001, global trade increased by 0.3 per cent. That, of course, was because of the continued export growth in the emerging economies. According to Wynne and Karsting (2009), using the study done by economic historians Barry Eichengreen and Kevin O'Rourke, declines in international trade during this recent recession have exceeded the losses during the 1930s. These economic historians, by indexing to the peaks in global industrial production in both of those two episodes, maintain that global trade fell 32 percent during the first year of this recent recession, while it only fell 12 percent during the first year of the Great Depression. Again, leading to some form of deglobalization.

As stated before, one possible explanation of this decline has been the drying up trade finance. Given that financial sectors of most economies have been in crisis, it can be argued that a collapse in trade credit is in large part the cause of the breakdown of international trade. As argued by McKinnon (2009), international trade is more vulnerable to the credit crisis and associated counter- party risk than is purely domestic transacting. A similar argument is made by Bhagwatti (2009), when he writes that "an important new contributing factor on the downside is that we have not just a Main Street crisis but also a Wall Street crisis, and the drying up of financial credit has further harmed trade." It is for this reason that, as a response to this problem in 2008, the G20 established special programs and facilities to provide billions of dollars in trade financing.

Another reason for the decline of international trade during this recent global recession has been the rise of protection in various countries. For, in spite of the repeated pledges by world leaders to avoid trade barriers, protection has been on the march during the last two years, which, according to Mark Landler (2009), has provoked "nasty trade disputes and undermining efforts to plot a coordinated response to the worst global economic downturn since World War II." Retrieved from http://newyorktimes.com, March 22, 2009. It is no wonder that during this recession, Russia has raised tariffs on used cars, China has tightened import standards on food (such as banning Irish pork), India has banned Chinese toys, Argentina has tightened licensing requirements on auto parts, textiles and leather goods, and various countries, including the United States and Australia, have subsidized embattled automakers or car dealers. (Ibid.). The economists at the World Bank have been concerned that even without protectionism the recent global downturn is likely to result in the largest annual decline in international trade of the last eighty years. They believe protectionism is capable of aggravating this decline even further. According to Richard Newfarmer, the World Bank's special representative to the WTO, the present level of protectionism is capable of causing trade wars that could have devastating economic consequences. In early 2009, the World Bank President, Robert Zoellick warned that 2009 could be a very dangerous year, as leaders would face rising calls for protection from economically insecure population. To him, the World Trade Organization has the obligation to monitor the protectionist actions of various countries. It is in this type of climate that economist Kenneth Rogoff has been worried about the United States backing away from free trade". In fact, to him, the next two years could be a disaster for free trade. Or, in a WTO(2009) report last year, Director-General Pascal Lamy complained about the rise of protectionism among both industrialized and developing nations during this recent recession. To him, "The danger today is of an incremental build-up of restrictions that could slowly strangle international trade and undercut the effectiveness of policies to boost aggregate demand and restore sustained growth globally." During these few years, a growing number of countries have raised tariffs, imposed import restrictions, or have reinstated subsidies. As argued by Annys Shin (Washington Post, March 2009), these countries have been quick to defend home industries by filing complaints with the WTO over dumping.

The Recent Economic Crisis and Its Impact on FDI Flows in the World.

As stated before, the world economy became more global in recent decades, one of its consequences being the emergence and rise of foreign direct investment (FDI). Although the flows of FDI had declined to some extent in the first couple of years of the new millennium, it grew tremendously during 2003-2007. This was fuelled by steady world economic growth, ongoing liberalization in investment regimes, and the implementation of large-scale internalization strategies by a growing number of multinational (or transnational) corporations. This growth in 2003-2007 led to an unprecedented flow of foreign direct investment. According to an UNCTAD(World Investment Report (2009), the FDI flows reached a historic record of $1,979 billion in 2007.

According to UNCATAD (2009) sources, global FDI inflows, which had reached its highest in 2007, fell to $1,697 billion in 2008. This was a decline of 14%. This decline of FDI inflows continued in 2009. In fact, according to the UNCTAD (2009) sources, the preliminary data collected for 96 countries suggests that those FDI inflows for the first quarter of 2009 fell as much as 44% as compared to the same period in 2008. These declines can be viewed as the result two major factors that have affected not only FDI flows but also domestic investment activities. On the one hand, as it seems, the capability of firms to invest has been reduced as a result of the decline in access to financial resources, which has been caused by a decline in corporate profits and lower availability and higher costs of finance globally. On the other hand, the decline can be attributed to the negative impact of the economic slowdown on the propensity to invest, especially in the more advanced countries. As a result of these, MNCs have and will try to curtail both their costs and investment activities-whether domestic or global.

It is interesting that the impact of this recent global slowdown has been different in different economic groupings of the world (according to the UN, these consisting of developed countries, developing countries, and the transition economies of South-East Europe and the Commonwealth of Independent States (CIS). This, of course, demonstrates a change in the pattern of globalization. It is interesting that in the more advanced economies, where the crisis in the financial sector first began, FDI inflows declined in 2008. However, for the same period FDI inflows in the developing and transition economies continued to rise. Of course, according to the World Investment Report 2009 (issued by UNCTAD), these differences ended in late 2008 and early 2009 (for which the data is available).

In 2008, FDI inflow to more advanced economies declined as much as 29%. According to the above-mentioned report, this was mostly due to cross-border M & A (merger and acquisition) sales that fell as much as 39% in value after a five-year boom which had ended in 2007. In Europe, cross-border M & A deals declined as much as 56%, while in Japan the decline was 43%. The recent crisis has especially had worldwide negative impacts on mega deals – those with a transaction value of more than $1 billion.

During the first half of 2008, the less advanced economies of the world were not as much affected by the recent crisis, as compared to the more advanced economies. This, according to UNCTAD Secretary-General Supachai Panitchpakdi, had to do with the fact that the financial systems of the LDCs were less interlinked with the hard-hit banking system of the United States and Western Europe. During that period, those economies grew perhaps as a result of the rise in the commodity prices. During that period, their FDI continued to grow. However, this growth had a slower pace than previous years – 17% overall, 27% in Africa, but 13% in Latin America. However, in the second half of 2008 and into 2009, FDI inflows into the LDCs also began to decline. Inflows to South, East, and South-East Asia witnessed a 17% expansion, reaching on high of $298 billion in 2008. This was followed by a significant decline in the first quarter of 2009. The same was more or less the same for the transition economies of South-East Europe and the CIS. For these countries, inflows rose by 26% to $114 billion in 2008 (a record high), but then fell by 47% in the first quarter of 2009.

As a result of the recent recession, the overall rankings of the largest home and host countries for FDI flows too have changed. In 2008, the United States maintained its position as both the largest recipient and source of foreign direct investment. However, for 2008, many transition and developing economies witnessed an increase in both the inflow as well as the outflow of foreign direct investment. According to the above sources, these groups of countries saw an increase of 43%, in their FDI inflows and one of 19% in 2008. During the same year several European countries saw the sliding of their rankings-both in FDI inflows and outflows. Example is the UK which lost its position as the second largest recipient and source of foreign direct investment.

According to world investment report, in 2008 the FDI flows for what it calls structurally weak countries increased. The report includes in this group three types of countries-the least developed economies, landlock developing countries, and small island developing countries. The increase of FDI flows to those three types of countries by 29%, 54% and 32% respectively. However, due to their structured weaknesses, including their dependency of the export of commodities whose demand are declining, these countries are vulnerable for the attraction of FDI. As a result, these countries should promote FDI for those industries-such as food and beverages-which are less likely to suffer from cyclical global fluctuations.

As a result of the globalization process of recent decades, there exit several dozens of thousands multinational companies that play a major and growing role in the world economy. For example, exports by branches and subsidiaries of these companies are estimated to account for about 1/3 of total world exports of goods and services. These multinationals employed employing some 77 million people 2008. In spite of this significant role, however, they were not insulated from this recent global recession. These companies witnessed a decline: in their ability to engage in FDI, in the value of their total production, in their sales, and in their employment of different types of workers in their various international affiliates.

Concluding Remarks: Are We at the End of Globalization?

Capitalism, which began as a global economic system a few centuries ago, became even more global after the end of World War II. This globalization became possible as a result of the following: technological advances in the means of transportation, the desire of major world economic powers to cooperate rather than adhere to violence to residue conflicts among themselves-as witnessed by numerous wars among European powers in early centuries of capitalism and two world wars in the 20th century, the lowering of trade restriction and more advocacy of free trade among major economic powers, the establishment of first GATT and WTO later to encourage more free trade, the creation of more international organizations such as the IMF and the World Bank to facilitate more global economic activities, the emergence of FDI as a vehicle for national-based companies while being transformed to multinational enterprises, and the rise of regional economic organizations-like the EU and NAFTA-to ease trade of goods and resources and investment activity among various economies possible. Of course, the fall of the Soviet Union and transformation of various socialist economies to capitalism after 1989 made globalization more of a reality. In fact, as a result of global economic impulses that occurred in more recent decades, various writers were predicting a more flat world-as we have seen in the writings of New York Times columnist Thomas Friedman, or a world in which the nation- state becomes insignificant because international organization would become more powerful and significant.

As argued in previous sections, the financial crisis that began at the end of 2007 pushed the economy into a severe downtown that some have called the Great Recession. As a result of this severe recession, for example, world trade collapsed at a pace unseen since the since the Great Depression of the 1930s. And, in spite of pledges by world leaders to avoid erecting trade barriers, as argued before, protectionism also seems to be on the March provoking nasty trade disputes that undermine efforts to provide a coordinated response to the global recession.

The global recession has also had a dampening effect on foreign direct investment. As a result, FDI flows declined a great deal from its pick of $1,900 in 2007 to much lower in the years 2008 and 2009. As a result of the worst global recession, on since the 1930s, FDI appears set to continue falling at least in the short run. At least in the short run, multinational enterprises are unable or hesitant to continue their FDI expenditure at former levels, leading to a double digit decline of profits for those multinational companies. It is no wonder that, according to Pricewaterhouse Coopers' the Annual CEO Survey Report(released in January as PWC, 2009), there was a drastic fall in the confidence of the responses of the business executives who participated. According to this report, only 34% of the CEOs were optimistic about their growth prospects for the next few years. This, according to the report, is the lowest since 2003 when this annual survey first started.

Would the above suggest a process that would lead to a continuous process of deglobalization, reversing a process that began with the emergence of capitalism but was intensified in more recent decades? Recent developments in the form of declines in international trade and FDI activity, and the rise of protectionist arguments on the part of some, obviously demonstrate a decline in the globalization and integration of world economies of recent decades. These developments certainly show that the world is really not flat, the nation-states, that emerged and were strengthened with the rise and further developments of capitalism, are not on the verge of distinction, and that international organizations are not replacing nation-states and are not taking over their responsibilities. However, at the same time, these developments should not imply that we are now witnessing an end to globalization. So long as countries are uneven in their endowment of various types of resources, and technologies, they are different in their abilities and potentials to produce different types of goods and resources, and so long as demands for certain goods in individual countries exceed their ability to produce those goods, at least at reasonable prices, economic dependence among nations will remain, thus, globalization will persist. But, depending upon growth and decline and fluctuation in various economies in the world, the degree of globalization among various economies too would fluctuate. As domestic economies have seen ups and downs and fluctuating cycles, perhaps we should also expect ups and downs and cyclical fluctuations in the degree of globalization and interdependence and integration among different economies.

REFERENCES

Jagdish, B. (2009). Comments in “Collapse in world trade: a Symposium of Views”. *The International Economy*, Spring.

Hobson, J. & Mummery, F. (1889). *The Physiology of Industry*. London, Murray.

Hutchinson, T.W. (1978). *On Revolution and Progress*. New York, NY: Cambridge University Press.

International Monetary Fund Economic Outlook. October 2009.

Lander, M. (2009). *Trade Barriers Rise as Slump Tigklens Grip New York*, NY: Times (March) on line.

Lucas, R. (1977). “Understanding Business Cycles.” *Carnegie Rochester Conference Series on Public Policy*, (pp. 5, 7, 29).

McKinnon, R. (2009). China’s Dollar Link Can Be a Depression Stopper, *Wall Street Journal*. Feb.13th on line.

Mitchell, W. (1923). *Business Cycles*. Berkely, University of California Press.

Schumpeter, J. (1954) *History of Economic Analysis*. New York: NY, Oxford Univ. Press.

UNCTAD World Investment Report, 2009. Published by United Nations in New York & Geneva.

World Trade Organization Economic Report, 2009. Published by WTO, W.

Wynne, M. & Karsting, E. (2009) *Economic Letter*. Dallas FED, 2009.