ECONOMIC REVIEW 2001

INTRODUCTION

This volume of Bargaining Indicators for 2002 comes in the context of the September 11 attacks on the World Trade Center in New York, the United States' war on Afghanistan, the collapse of the economy of Argentina and with it the biggest sovereign bankruptcy in history. All these historic events are unfolding within the first synchronised global recession since the 1970s, and have in turn deepened this recession. Within South Africa, this edition of Bargaining Indicators comes in the context of the first anti-government national strike by organised labour since the 1994 elections, and a deepening of the economic slowdown that we noted in the last edition of Bargaining Indicators.

In this review of economic developments during 2001 we shine the spotlight on the global recession and its dynamics, and we look in particular at the slide of the world's largest economy – that of the United States - into its first serious economic crisis since the end of the cold war, and we take a look at the significance of the attacks of September 11 and their aftermath on the dynamics of the global recession. We conclude our discussion of the global recession by discussing the responses of the Bush government and its allies, and at the meaning of these responses for neoliberal economic orthodoxy.

We continue our analysis by looking at developments within the South African economy. In particular, we look at the implications of the global recession on the South African economy, and at how the currency crisis that has unfolded since the last quarter of 2001 forms an important moment in the dynamics of the unfolding global recession. Within this context we look at the main economic indicators (GDP; GDE; fixed capital formation, operating surpluses, wages, employment, savings and so on).

Lastly, we look at the year ahead, and in particular at the implications of the global and domestic economic developments for the 2002 bargaining season.

1. CAPITALISM, NEO-LIBERAL GLOBALISATION AND CRISIS

In our last edition of Bargaining Indicators we wrote that the world economy was poised on the verge of a global recession. We noted that by the end of 2000, hopes of the continuation of the boom that had characterised the US economy for best part of the 1990s were beginning to fade. By the time we updated our economic review in July 2001, we wrote that the "global economic slowdown [was] now a fact". From earlier attempts to talk the looming recession out of existence, the economists and financial analysts of the ruling classes now tried to talk the recession into a mere cyclical downswing. At the time many argued that the cycle would be a V-shaped one, which meant that the economy would recover soon and move into another growth phase similar to the one they were accustomed to in the 1990s.

Then came the events of September 11 2001. The attacks launched on the key symbols of United States economic and military dominance on September 11 – the World Trade Center and the Pentagon – are (economically) significant on four levels. Firstly, although the events of '9-11' – as Wall Street analysts now refer to them – did not *cause* the global recession now unfolding, they were crucial in accelerating the development of the breadth of the recession, as well as its depth. Secondly, the events of 9-11 made it easier for the opinion-makers, both in government and in the private sector, to accept the global recession that had been a fact before the events of 9-11. Indeed, many economists within the American ruling class now talk openly about the fact that the recession preceded the events of 9-11. Thirdly, the events of 9-11 provided the political cover for the ruthless job cuts that unfolded before 9-11, but which have accelerated since. Fourthly, 9-11 provided the cover for the beginnings of a shift away from the neo-liberal orthodoxy that had guided policy makers in the United States and the world.

Before taking stock of these implications of 9-11, it is necessary to look at the dynamics of the neoliberal context within which this recession is unfolding.

Crisis, Neoliberalism, and Crisis

The ten-year old stock market boom out of which the United State is now emerging was the culmination of neoliberal market reforms that have been underway since the global recession of the early 1970s. This "new economy" was also seen as proof of the essential correctness of the neoliberal outlook. The US boom provided powerful ammunition for those intent on imposing the neoliberal paradigm on the rest of the world.

The neoliberal programme

Neoliberalism, as a serious economic programme for various governments, emerged out of the global economic crisis that broke out in the early 1970s. The 1970s crisis was a crisis of profitability for the various capitalist classes. Capitalists in many parts of the world experienced sharp declines in profits. It took about 10 years for the international capitalist class to realise that they needed a serious change in economic orientation if they were to restore their profitability levels. The crisis continued to deepen throughout the 1970s, as overproduction of commodities continued to lead to profit losses. In response, capitalists took larger amounts of capital away from productive investment. Instead, they made profits by selling currencies and shares in financial markets, and by earning interest from their large cash reserves in banks. This is called speculative investment.

This growing importance of money capital was evidenced by the growth of powerful new financial institutions - the so-called finance houses in the United States of America. By the early 1980s, these institutions had become more powerful than some of the largest banks in the world. The dominance of this class of financiers over the other sections of the capitalist class, and over society, took a major step when company and state debt (or credit) was increasingly securitised – especially from the 1970s onwards. The securitisation of debt (or credit) is a process whereby credit to companies or governments is made in a form in which it (debt or credit) can be bought or sold. The major forms of this securitisation are shares, corporate bonds and government bonds. When credit in this form became the main source of financing company or government operations the financiers secured their domination over other sections of the capitalist class, and over governments. The producer capitalists and governments could be instantly punished by the click of a computer mouse when the money traders decide to sell their shares or bonds.

But money does not produce wealth and growth, it is a consequence of wealth creation. This is because at any point in time the amount of money in circulation in a country must reflect the commodities in circulation. If there is more money than the commodities, then the value of money falls – what is called inflation. When financiers, therefore, "earn" more money from financial speculation, they are merely taking a portion of the wealth – now reflected in money – already in circulation. With higher interests rates and inflated stock prices, for example, a larger portion of this wealth is transferred to the financiers.

Money capitalists are therefore a parasitic class that feeds on those - both capitalists and other classes in society - involved in creating wealth. As a result, neoliberalism's central principle is the transfer of wealth from the producers - the working class, small business people, the poor in general and even other capitalists - to the financier strata. This transfer of wealth from the poor to the rich constitutes the basic programme of all neoliberal policies, including Gear[1].

Neoliberalism is uneven

Although the neoliberal programme was an attempt to resolve capitalism's problems of overproduction and profitability, it was unable to restore the global economy onto another long-run boom similar to the one that ran from the end of the Second World War to the end of the 1960s. Indeed, since the recession of the 1970s the world economy has never been able to achieve the growth rates that were achieved during the post-war boom[2]. At *different times, different regions and industries* within world economy achieved high growth rates. Invariably, these were regions and industries in the advanced capitalist countries.

[1] For a further development of this argument see Oupa Lehulere, "Gear Blues on the morning after", South African Labour Bulletin, Vol ? no ?, August 1999.

[2] The growth rates achieved by China in the context of stagnation around it not only prove the lack of synchronization, but is also due to special features of China. We cannot go into these features in the context of this review.

The most important feature of the development of the world economy since the recession of the 1970s, and up to the end of the US boom of the 1990s, has been lack of synchronisation.

Transfer of wealth

This lack of synchronisation of the world economy, a lack of uniform growth (or recession for that matter), was however not a product of chance: the lack of synchronisation was the very engine of economic development over the last 25 years or so. The failure of the neoliberal model to lift the world economy onto a long-run growth path which can be seen in the low growth rates that have characterised the world economy over this period, meant that high growth rates achieved in certain regions, countries, industries or even enterprises, were achieved at the expense of, or because of stagnation, in other regions, countries, industries and enterprises.

Put in other words, within the context of the lack of significant increases in the mass of social wealth on a global scale (that is low growth) the growth of certain regions, countries, industries or enterprises is made possible by the *transfer of wealth* from other regions, countries, industries and enterprises. The neoliberal model is essentially a model that organises and facilitates this transfer of wealth from the weak (politically, economically and militarily) to the strong. Socially, the neoliberal model is about the transfer of wealth from the poor to the rich, from the working class to the capitalist class, and within the capitalist class from the producer capitalist to the financier.

There are various ways in which this transfer of wealth is organised and facilitated.

Wages and profits

Over the last 25 years of the neoliberal programme, wages of workers have grown much slower than profits. Of particular importance is the fact that the slowing down of the growth in wages has taken place within the context of the rise in the productivity of labour. The rise in productivity and the slowing down of wage growth has ensured that the unit cost of labour has also been on the decline. In the last review we noted that in South Africa labour productivity went from 0.2% per worker per year (on average) in the 1980s, to around 3.5% per worker per year in the 1990s. In our July update we saw that in 2000 we had to lowest increase in wages in 30 years.

In the US, as in South Africa, the increases in the profitability of enterprises have been fuelled by this increase in productivity, low wages and low unit labour costs. The transfer of wealth from workers to capitalist has been one of the key factors that have underpinned the boom in profits in the context of low long-run economic growth.

The long-run decline in wages and unit labour costs has also been facilitated by new forms of employment like casualisation and subcontracting.

The social wage and taxation

Over the last 25 years of the neoliberal programme there has been a steady decline in the social wage. The social wage refers to those elements of the working class's standard of living, which are collectively supplied by the state. These services are either subsidised or supplied free at the point of delivery. Examples of such services are education, health, transport, housing, water and sanitation, household fuel or power, and so on. The neoliberal programme, embraced by many governments, has administered cuts in the provision of these services over more than two decades. As a result of these cuts the working class has had to pay for these essential services from their diminishing income, and this has lowered the purchasing power of working class income.

The social wage is funded by taxation, in particular of corporate profits. The decline of the social wage has been fuelled by the lowering of taxes on profits. On the other hand, the neoliberal state has increased taxes on the working class through the introduction of regressive taxes like VAT.

Through these measures wealth has been transferred from the working class and the poor to the capitalist class and other elites.

Currency Devaluation

An important feature of neoliberalism – in particular through its programme known as Economic Structural Adjustment Programme (ESAP) – over the last two decades has been the imposition of currency devaluations on many countries in the south. The reason advanced for these devaluations has been that they stimulate exports and therefore economic growth. The reality, however, is that when a currency of a particular country is devalued, the wealth that was produced and continues to be produced by that country becomes available to the countries with strong currencies at much lower prices.

The promotion of 'export led growth', and the devaluations that are imposed (through market, and administrative, means) on countries in the south constitutes one of the most important means for the transfer of wealth from the south to the north. In the context of a recession, capitalists operating through the dominant currencies are able to shift wealth away from weaker-currency capitalists towards themselves.

Privatisation

Privatisation is another key feature of the neoliberal programme. In almost all instances, the state companies that are privatised are sold at cheap prices relative to what the new owners will benefit. The state companies, however, represent wealth accumulated by the population of the country over a long period of time. The sale of these enterprises at cheap prices therefore represents one form of the transfer of wealth from the working class and the poor, to the capitalists and the rich.

High interest rate regimes

Since the beginning of the 1980s high interest rates have been an important element of the international financial system. Indeed, the so-called debt crisis has been a result of the international interest rate regime. Countries that had borrowed during a period of low interest rates suddenly found it difficult to service their debt given the new high interest rates. Through high interest rates, wealth that is created in the production process – both in the dominant capitalist countries and in those on the periphery – is transferred to the class of financiers. The argument that these high interest rates reflect risk is a smokescreen to hide this transfers – and this can be seen in the fact the so-called risk notwithstanding, the large banks located in the United States have had high profitability for close to two decades.

Securitisation

The listing of large companies, including state enterprises in the runup to their privatisation, provides the capitalist class with the means to effect the transfer of wealth created in production from workers to the financier capitalist class in particular. The stock and other financial markets act as a disciplining force that compels managers to ensure that the distribution of the companies' incomes is consistently in favour of profits, and therefore the capitalist. 'Markets' punish any tendency towards increasing labour's share of income by devaluing that company's stock, which makes it open to take-over by more 'well-behaved' capitalists.

The drift towards the securitisation of the most important capitalist corporations, and of the forms of government borrowing, provide the ground for the large-scale transfer of wealth from the poor to the rich that has characterised the last two and a half decades.

These new forms of the transfer of wealth from the poor to the rich have been used together with older methods like transfer pricing, the enforcement of unequal terms of trade and so on.

It is this paradigm of transfer of wealth, as opposed to the creation of new wealth, that explains both the boom the US has enjoyed over the last decade, as well the recession now currently underway.

2. THE UNITED STATES' RECESSION

The current recession now unfolding in the United States needs to be understood against the background of the specific nature of the boom that is now coming to an end.

The boom of the 1990s in the US was essentially a stock market boom. In the context of the post 9-11 period, Bruce Nussbaum captured the essence of the 1990s US economy when he wrote that "it was the currency we paid our entrepreneurs with, the way we financed our retirement, the means to corporate mergers, the measure of individual success, the game to win, the essence of our culture – stocks". According to Michael Mandel, during the 1990s the value of stocks, venture capital, and debt financing all grew faster than GDP. The soaring stocks paid high dividends to those who owned them, and this in turn fuelled the consumption spending that kept the US economy buoyant. But the rate at which the stocks were rising was outstripping production and earnings. Companies, like the so-called dot.com companies, had high stocks even though they had not registered any profit. On the other hand, in order to be in the "game to win", middle and upper-class America borrowed deeply until the US savings' rate went into negative territory.

If stock prices were rising faster than GDP, and if American citizens did not have the incomes to finance the stock market boom, where was the money coming from? The answer to this is that the US boom in stocks was financed by capital from abroad, capital that was fleeing from areas of low growth and economic crisis. In other words, the source of the stock market and consumption boom in the US of the 1990s was the weakness of the other centers of the world economy – in particular Europe, Asia and Japan.

The Thai bhat's crash in 1997, and the global stock market crash that followed it were symptoms of a deeper malaise in the world economy. The problem was that the world economy was experiencing overproduction in its key industrial sectors. In other words, the production of commodities was outstripping the ability to buy them, and this resulted in a crisis of profitability. Already by the end of 1996, the glut in the chemicals sector had pushed down prices by 36%, and in the microchip sector the glut depressed prices by up to 82%. In the automobile industry, the world economy's powerhouse, capacity utilization was at a 73% low, and it was estimated that by the end of the decade of the 90s the industry will overproduce by about 22 million cars.

The glut in commodities also produces a glut in capital. It was this glut that fuelled the stock market boom in the US, and the orgy of speculation in the world's financial market. Cheap money in the US also fuelled a consumption boom, and it was this consumption boom that made the US what some have called the 'world's consumer of last resort'. These twin engines of capital inflows into the US, and a consumption boom, have produced the US's extraordinarily large current account deficit, and at the same times the means of financing it. According to Julia Lichtblau, a financial reporter at Business Week, the US current account deficit rose to $445 billion in 2000, and financed by capital inflows, which hit $478 billion in the same year.

The US boom of the 1990s was therefore more of a consumption and stockmarket-led boom, and less of a production-led boom. More importantly, the US economic boom was an island in the sea of slow growth and recession, and the larger the amounts of capital that fled to this island the rougher the seas of recession became. This fact is the single most important one in understanding the breadth and depth of the recession in the US.

The breadth of the US recession

The recession in the US has spread to all the important sectors of the economy. From technology to autos, to retailing, to manufacturing and energy, the outlook is bleak. So desperate is the situation that the big auto companies in the US offered zero interest rates on the purchase of new cars in order to attract customers. This, however, will only serve to postpone the steep drop in sales that has began.

The depth of the recession

The depth of the recession is of major concern to the leaders of the capitalist world. As a result, many analysts and economists have been talking the recession out of existence. Indeed, within these circles there is a consensus that the US economy will rebound by mid 2002, although some have cautioned that it will be "recovery with a small 'r'." All of this is of course wishful thinking. We can only understand the depth of the recession from its internal dynamics as well as its broader context.

We have seen that the US boom was based on the glut in capital, which in its turn was a product of a world largely in recession. In order for a recovery to take place soon, new and profitable areas of investment have to be found soon. Most of the industries being engulfed by the recession have a long way to go before they clear the over-capacity that is now generalized. On the other hand, the glut in capital that had fuelled the US boom has meant that there have as yet been few bankruptcies and outright closure of firms as a result of the recession. The closure and rapid takeover of firms by others normally clears the 'decks', allows for inventories to be destroyed, and therefore for new space for production to be created.

The depth of the unfolding recession can be gleaned from the forecasts in corporate earnings. For example, David Wyss, an economist at Standard and Poor's, estimates that the S&P 500-stock index will show the sharpest drop since the Second World War.

Another important factor that indicates a deep recession is that with the rest of the world being in recession, there is no prospect for new areas of investment abroad to rescue the US out of recession. In the present context, the US recession and the global recession will reinforce each other.

The tendency for the recession in the US and in the rest of the world to be mutually reinforcing is also due to the fact that <u>within</u> the main nodes of the world economy outside the US, the recession is also synchronised. Within the Euro zone, all the economies are moving in the same negative direction, and Asia, and Japan in particular, continues to be trapped in recession.

Although the events of 9-11 did not cause the recession, by forcing opinion makers in the US to admit to the seriousness of the recession, and by exposing the fragility of the stock market boom, it will cause the consumption boom that has fuelled growth to ground to a halt. The steep drop in airline travel, the declines in retail (Pricewaterhouse Cooper estimates that retail will post its lowest gains in a decade), and the drop in technology purchases as capital expenditure is cut, all point to an end to the consumption boom.

Lastly, it is not yet clear how the foreign investors who fuelled the US economy in the 1990s are going to react in the medium term. If there is large-scale repatriation of capital, we could be talking about a recession on the scale of the 1930s. On the other hand, it is important to note that even if the capital does stay in the US, the other ingredient that made the 1990s boom, viz., consumption spending, is slipping very fast. Under these conditions it is clear that the US is in for a broad and deep recession.

Blood-letting on the employment front

Another factor that is likely to ensure that the consumption boom comes to an end is the rising number of unemployed in the US. By the end of 2000 job losses had began to accelerate, and as we noted in the mid-year review 2001, the US economy lost jobs at a rising rate throughout 2001. The increasing unemployment took a new turn after 9-11. The airlines, in the direct line of fire so to speak, announced large-scale retrenchments. Boeing announced a layoff of 30 000 workers, and American and United airlines each announced layoffs of 20 000 workers.

The airline industry, where retrenchment announcements attracted the most media attention due to the events of 9-11, was a symptom of a broader process. According to the Bureau of Labor Statistics (BLS), an agency of the US government, retrenchments in the third quarter of 2001 were sharply higher than the corresponding third quarter of 2000. In the first three quarters of 2001 over 1.1million workers were retrenched, which was more than the workers retrenched in the whole of 2000. According to the BLS, the third quarter of 2001 was the first time since the series began that employers cited 'slack work' as a reason for the retrenchments most frequently. Even in the minds of employers, the recession is increasingly emerging as the most important reason for retrenchments.

The BLS figures also reveal the breath and depth of the recession. Industries from manufacturing, agriculture, retail and services were affected. Manufacturing accounted for 36% of the retrenchments, and within this category the sub-sectors most affected were electronic and electrical equipment (in particular semi-conductors), industrial machinery and equipment, and transportation equipment. Services accounted for 21% of retrenchments, and public utilities and transportation accounted for 17%. Agriculture accounted for 12% of the layoffs. It is significant that most of the retrenchments are occurring in the electronic sectors within manufacturing, as these sectors were crucial in the consumption boom of the 1990s. Even more important, is the effect of the recession on the sectors producing machinery and industrial equipment. The significance of this sector goes far beyond the sector itself, and gives us an indication of future retrenchments, as well as the decline in the labour absorption capacity of the economy as a whole.

Over and above the impact on the workers themselves, the retrenchments will further dampen consumer spending, and drive the US much deeper into recession. This becomes clear when one considers that retrenchments are just one way of cutting wages and thus labour costs in recession. Others are delaying the filing of vacancies – even when they are needed, reducing perks, freezing salaries, freezing promotions, and encouraging workers to take unpaid leave. All these will put pressure on consumer spending.

Responses to the recession

In the Bargaining Indicators Review Update 2001 we noted that as a response to the slide into recession, the Federal Reserve Bank – the US's central bank – cut interest rates by more than 2.75% within three quarters. Over a nine-month period, the Federal Reserve has cut rates by 3.5%. The interest rate cuts are an attempt to keep consumer spending buoyant, and the private sector has taken the cue from the Federal Reserve, as can be seen from the zero percentage auto sales initiative.

The events of 9-11 have introduced a new dimension to the attempts to shore up the economy. The events have given the policy makers in Washington the excuse they needed to pump money into the economy and thus stimulate consumption. Within this new policy turn, funds aiding the victims of the September attacks are, in the medium term, the less significant amounts. Of more importance, a sharp increase in military spending is envisaged in both the immediate and the long term. In fiscal 2002 the US government plans to boost military spending by $18.4 billion, and by $190 billion over the next 10 years. This, of course, is nothing but spending aimed at stimulating a flagging economy. The new regime of state spending can be seen in the fact that in October 2001 Lockheed Martin, the defense contractor, won a government contract upwards of $200 billion to build military aircraft.

The US government has a long history of bailing out large corporations facing tough economic conditions. The decision to bail out the airline industry by an estimated $17.5 billion continues this tradition, and more bailouts have not been ruled out. Tax cuts of up to $50 billion are also on the cards. These come on the backs of tax cuts of $40 billion for the 2001 fiscal year.

The significance of the responses of the US policy makers to the recession is that they have abandoned any pretence at sticking to neoliberal orthodoxy. Across the board the policy makers, with the support of capital, have returned to the old methods of Keynes: stimulating investments, boosting consumer demand and increasing spending. The advice offered by the US led International Monetary Fund to Asian economies and other third world economies mired in recession has, on the other hand, been the exact opposite to that adopted by the US policy makers. This of course is hypocritical, but to stop at such observations is to miss the point.

The critical point is that the adoption of Keynesian type stimuli on a world scale, at the present moment, will only deepen the recession – and might even drive the global economy into a full-scale depression. This is because the implementation of full scale

Keynesian demand management policy by the other nodes of the world economy – Japan and Europe in particular – would lead to a reversal of capital flows into the US, which in turn would drive the US even sharper into recession and depression. A US economy descending into depression will drag the entire capitalist world into a 1930s style depression, given the dependence of the leading capitalist groups of Europe and Japan on the continuing leadership of the United States in the world economy. Many of the leading companies from these centers, for example Toyota and Honda from Japan, and Siemens and Deutsche Bank from Germany, all rely on the US market for a significant slice of their profits.

We now have a log-jam which can only lead towards the deepening of the recession: on the one hand the US economy cannot break out of the recession on its own – it needs a growing world economy. On the other hand a growing world economy will reverse capital flows out of the US, which would drive the US into deeper recession. The contradictions are driving towards an explosive finale.

3. THE SOUTH AFRICAN ECONOMY: THE ACCUMULATION OF POVERTY

In our last Economic Review we noted that the growth that had been registered by the South African economy in the third quarter of 2000 – annualised at 3% increase over the corresponding period in 1999 – was built on shaky foundations. At the time, the growth of the South African economy was taking place in the context of an unfolding recession internationally. In the Economic Review Update, in July 2001, we wrote that by the first quarter of 2001, South Africa was being drawn into the downward spiral into recession. We accounted for the delay in the synchronisation of the South African economy with the US recession to the slowness with which the US recession reacted on the Euro zone, which is South Africa's most important trading partner.

On the Road to Recession

By the end of 2001 South Africa was fully synchronised with the global recession. After the decline in real gross domestic product from 3% to 2% in the first quarter of 2001, the decline continued into the third quarter and came in at 1%.

Overall, South Africa's GDP grew at 1.5% for first three quarters of 2001, compared to a year on year economic growth rate of 3.5% for 2000. As in the US, the decline in growth reflected declines across a broad spectrum of economic sectors.

Agriculture leads again...

In Economic Review 2001 we noted that agriculture led the growth in 2000, with a third quarter contribution of 24% growth. Agriculture also led the decline in growth in 2001, and production in the sector fell for three consecutive quarters in 2001. Outside of the platinum sector, mining production registered declines in the third quarter of 2001, and reflected the effects of the global recession.

Decline in production was also registered in the manufacturing sector, with the most affected sectors being transport equipment, food, beverages and tobacco, chemicals and base metal product. In particular, notwithstanding South Africa's export competitive currency, external demand for manufactured goods declined considerably. As the global recession continues to deepen, this sector will continue to register steeper and steeper declines.

Declines in real value added were registered in the commercial sector, whereas sectors like services, storage and communications and financial services continued to register modest gains.

Conspicuous Consumption
Although the economiy slowed in the third quarter of 2001, gross domestic expenditure (GDE)[3] grew by a strong 8.5% in the third quarter (year-on-year) of 2001. This growth was against the background of a decline of 2.5% in the second quarter of 2001.

The growth in GDE comes against the background of falling growth and falling exports, and has thus contributed to creating a deficit on the current account of the balance of payments. The changes in Final Consumption by Households reflected the shift in the distribution of income in favour of the rich and against the working class and the poor. The 2.5% growth in final consumption by households was dominated by expenditure on durable and semi-durable goods. In particular, expenditure on new cars was prominent, whereas in the semi-durable category expenditure was focused on recreational and entertainment goods. In contrast, expenditure on non-durables declined from 2.5% to 2% from the second to the third quarter of 2001.

Expenditure by general government on the rise...
Real expenditure by general government rose from 1.5% in the second quarter to 2.5% in the third quarter of 2001. In 2000 real expenditure by general government went up by a meager 0.5%, compared to an increase of 1% for the first three quarters of 2001. This expenditure increase comes in the context of the decline in GDP, and thus shows counter-cyclical behaviour on the part of government. The rise in government expenditure, however, took place in the context of a decline in real spending on workers wages.

Gross fixed capital formation on the rise...
Gross fixed capital formation, which measures capital spending in the economy, rose by an annualised 3% in the third quarter of 2001. This followed increases of 4% in the first

[3] **Gross Domestic Expenditure** is made up of four categories: Final Consumption by Households; Final Consumption Expenditure by general government; Gross fixed capital formation; and Change in Inventories.

two quarters. This compares favourably against a rise of 0.5% during the corresponding period last year. Within the private sector, the increase in capital formation was driven by expenditure on the platinum mines, and as with the trend last year, on setting up the cell-phone infrastructure.

On the other hand, gross fixed capital formation by public corporations slowed down from 4% growth in the second quarter to 1.5% in the third quarter on an annualised basis. From the figures released by the Reserve Bank it is not clear what the significance of these figures is for gross capital formation as a percentage of GDP. At the time of the Review 2001, gross capital formation as a percentage of GDP was at a low of 14.4%, which was far from what was needed to sustain job creation and economic growth.

Factor incomes: workers loose out...

Operating surpluses, which had grown strongly in the year ending September 2000 at 17%, reflected recession conditions in the year ending September 2001 and increased slower at 9%. On the other hand, the growth in aggregate compensation to employees accelerated from 7.5% in the year ending September 2000 to 8% in the year ending September 2001. In the year ending September 2001 the share of wages in national income, at 53%, was lowest since the Second World War (with the exception of 1980).

The shift against labour in the distribution of income is also reflected in the wage settlements for the year ending June 2001. In the first quarter the increase in wages in the public sector slowed down from 16.3% in the first quarter (annualised) to 4.4% in the second quarter (annualized). In the private sector wages also grew slower at 7.3% in the first half of 2001, well below the first half of 2000, which came in at 9.1%.

Labour productivity also slowed down due to the onset of the recession, but the decline in compensation for employees ensured that unit labour costs continue to fall.

Gross savings show no improvement...

The consumption boom in the third quarter of 2001 coincided with declines in the real disposable income of households. In the year ending September 2001 the real disposable incomes of household declined to 2.5%, from 3.5% for 2000 as a whole. The boom in household expenditure, from among the middle and upper classes in society, was financed by credit. This led to a rise in the indebtedness of households. The debt-to-income ratio of households went from 54.5% in the second quarter of 2001 to 56% in the third quarter, on an annualised basis. This privatisation of deficit financing, a tendency for the well-off to finance consumption through credit was reflected in the figures for credit extension to the domestic economy. Total domestic credit extension accelerated from 2.3% in the second quarter of 2001 to 7.4% in the third quarter. The increase in the same period for the private sector was 2.7% in the first quarter to 14.2% in the third quarter.

The upshot of this was that gross savings as a percentage of GDP deteriorated from 16.5% in the first quarter of 2001 to 15% by the third quarter of 2001. As with the 2000 period, the main culprits in these falling savings were corporations. The private sector's savings as a percentage of GDP fell from 12% in the first quarter of 2001 to 10.5% in the third quarter. The drop in savings from the corporate sector was caused by falling operating surpluses, and significantly, by the payment of relatively high dividends. As a percentage of GDP, savings by households remained stable at 3% in the third quarter.

In this scenario of falling savings, it is savings by general government which provide a counter-tendency. Due to the tight fiscal policies of the ANC government, government was able to reduce spending and register savings equivalent to 1% of GDP by the third quarter of 2001.

Inflation

Although the Rand has depreciated over 2001, inflation has continued to be moderated, with the CPIX (inflation without housing mortgages) falling from an annualised rate of 8.2% at the end of August 2000 to 5.8% at September 2001 annualised. Falling unit labour costs ensure that wages did not contribute to inflation, and the rate of increase in the prices of imported goods slowed down sharply from 16.2% in April 2000 to 7.6% in August 2001. On a quarter to quarter basis, however, CPIX rose from 4.5% in the second quarter of 2001 to 5.8% in the third quarter of 2001.

The main contributing category to this increase in CPIX is food prices, which went up by 18.4% in the year to September 2001. The prices of domestically produced manufactured goods also went up and contributed to the quarter- to-quarter increase in CPIX. In particular, it was non-durables like leather goods, footwear, fishing and non-food agricultural products that showed an increase.

Domestic interest rates down... and then up?

Throughout the first three quarters of 2001 interest rates and yields on government stock (that is interest paid on government debt) continued to fall. From the point of view of the Reserve Bank, this reflected the subdued inflationary pressures, but the pressure to lower interest rates was also influenced by the gathering recession. The government's tight fiscal policies, and the shift in its borrowing sources from domestic to foreign denominated bonds also tempered the pressure on local capital markets.

By the beginning of 2002, however, the Reserve Bank began nudging interest rates in the opposite direction, and engineered a 1% increase in its lending rate to financial institutions, who then passed on the increase to consumers.

Unemployment continues to rise...though slowly

According to the South African Reserve Bank unemployment in the non-agricultural sector rose by 1.5% in the first half of 2001, compared to a rise of 2% in the same period in 2000. Compared to the extent of the decline in employment over the last five years, the drop in the first half of 2001 was the slowest. The slowing down in employment was evident, according to the Bank, in both the private and the public sectors.

South Africa and the World Economy

In the public eye, the relationship of the South African economy to the rest of the world continued to be dominated by news about the depreciation of the Rand. Following the depreciation of 18.6% towards the end of 2000, the Rand registered a depreciation of 13.5% from the end of the second quarter of 2001 to the end of the third quarter. The Reserve Bank notes that this was the largest quarter-on-quarter depreciation since the global market crisis on 1998. Below we return to a discussion of the meaning and significance of the depreciation of the Rand, especially in the context of the unfolding recession.

Still waiting for the export boom...
In the Economic Review 2001 we noted that the depreciation of the rand notwithstanding, South Africa's exports have failed to live up to the promise of robust growth in the wake of depreciation. In the year ending September 2001 there was a steep decline in the value of exports and the volume of merchandise exports also fell sharply. The volume of exports in the third quarter went down by 11% on a quarter-on-quarter basis. Resource products, in particular platinum, played an important role in the decline. This largely reflected the recession condition in South Africa's main trading partners – Europe and to an extent the US.

The surge in the value of gold exports within the context of declining production volumes was largely due to the depreciation of the rand, but it failed to reverse the drift towards a deficit on the current account.

Imports also decline...
The unfolding recession within South Africa, and the depreciation of the rand, had a dampening effect on imports. It is significant that the decline was evident across both merchandise and capital goods imports. With respect to capital goods, the fact that the sub-sectors that showed the steepest decline were transport equipment and machinery, and electrical equipment is indicative of the slowdown in the South African economy, and will reinforce the recession now currently underway. The surge in imports that we reported on in the Economic Review 2001 thus came to an end, and from the second to third quarter of 2001 the volume of imports declined by 5%. On the other hand, the rand value of imports rose because of the depreciation of the rand.

Although both exports and imports declined during this period, the extent of the decline in exports *drove the balance of payments on the current account into deficit* by the third quarter of 2001.

Foreign Direct Investment fails to impress...
Foreign direct investment into the South Africa went up a meager R3 billion in the third quarter of 2001. The increase in FDI registered in the second quarter, to the value of R52.9 billion, was due to the once-off factor of the restructuring of De Beers' relationship to Anglo-American corporation.

And portfolio invest continues its volatile nature...
The economy experienced a net outflow of portfolio investment of R3.4 billion in the third quarter of 2001. This came on the back of a strong movement of portfolio investment into South Africa in the first three quarters of 2000, a movement that was the key to the surplus on the financial account registered then.

Taking into account other investments including loans and unrecorded transactions, the economy registered a *surplus on the financial account of the balance of payments* to the value of R5.8 billion in the third quarter of 2001. If however we take out of these figures the 'unrecorded transactions, the financial account would be in deficit to the amount of R0.8 billion.

Foreign debt declines...
South Africa's foreign and dollar-denominated debt declined from $36.9 billion to $34 from December 2000 to end June 2001. The decline was largely due to the payment of private sector debt, and to the net selling of rand-denominated bonds by foreigners in the same period.

And foreign reserves remain flat...
South Africa's net international reserves remain largely unchanged, as the surplus on the financial account was offset by the deficit on the current account.

On the other hand, the liberalization of South Africa's financial foreign exchange regime – in effect the creeping privatisation of the management of the nation's foreign exchange – can be seen by the fact that of the roughly R120 billion in forex reserves, the Reserve Bank held around R70 billion. From 1996 the difference between total foreign exchange reserves and the reserves held by the Reserve Bank has continued to widen. Moreover, it is not yet clear whether the dollar holding by South African exporters are worked into these figures: if they are not, then the divergence between reserves held by the Reserve Bank and total reserves could be wider.

The so-called rand crisis
We have seen that currency devaluation is one of the mechanism through which wealth is transferred from the periphery to the center, from the poor to the rich. In the context of the neoliberal model, currency devaluation plays an important role because the devaluation makes it possible for capitalists at the center to take over or buy the assets from the capitalist in the periphery for next to nothing. The rand crisis that broke out in the third quarter of 2001, and that continued into the beginning of 2002 is a product of a

number of interrelated factors: South Africa's place in the world economy, the unfolding recession within South Africa, and the specific foreign exchange regime ushered in by Gear.

South Africa and its economy occupy a subordinate place within the world economy. Although it is the most industrialised economy on the continent, within the international division of labour South Africa's place is that of a producer of raw materials. Moreover, relative to the centers of capitalist production, South Africa is a low productivity economy. The operation of markets in general redistributes values in favour of high-productivity economies. For example, in the case of South Africa raw materials that are exported are re-imported in the form of finished industrial machinery and other products – a process that transfers wealth to the centers of capitalist production. As a result, since South Africa's embrace of neoliberal "open economy" dogma, this flow of wealth accelerates, and is reflected in the long-run tendency of the currency to depreciate against the currencies of high-productivity economies. The so-called currency crisis of the last quarter of 2001 must for this reason be seen as one in a number of such 'crises': a more visible moment in the evolution of a long-run tendency.

The long-run tendency for South Africa's currency to depreciate, especially against the US dollar, is accelerated and accentuated in the context of economic slow-down. The reason for this is that in high productivity economies like the US, because of their technological advantage, retrenchments that occur in the early stages of a recession tend to first raise productivity (as the technological advantage is exploited intensively) and only fall later as the spread of the recession leads to factory closures across a broad spectrum. On the contrary, in low-productivity economies early retrenchments at the beginning of recession register as immediate declines in productivity, since their productivity is tied to the intense exploitation of labour, as opposed to the intense exploitation of technology. The result is that currencies of low-productivity economies depreciate at a faster rate against the currencies of high-productivity economies, thereby accentuating the tendency for values to be distributed from the former to the latter. Because of Europe's own productivity problems, the rand has not depreciated as rapidly against European currencies as it is has against the dollar.

A third reason for the depreciation of the rand against the dollar is South Africa's own foreign exchange regime. The Gear foreign exchange regime allows exporters to hold the dollars they have earned in their export transactions for a period of up to six months, about 180 days. In a recession context, with domestic markets shrinking, these exporters have a natural incentive to keep their dollars for as long as possible – even beyond the 180 days permitted by law as the Minister of Finance has had occasion to complain. This of course dampens the demand for rands, with the result that its value (price) falls.

Over and above all this there is of course the actions of speculator – but these remain subordinate to the fundamental forces that determine the movement of currencies.

The South African state: the end of Gear?

The year 2001 saw the first national strike against the ANC in power. Significantly, the strike was organised and led by the ANC's alliance partner, Cosatu. The issues around which the strike took place are also of significance: they were about the direction of the country's economic policy, about the assumptions and the suitability of the dominant neoliberal orthodoxy, and about its particular manifestation in the policy of privatisation pursued by the ANC in power.

In the last Economic Review 2001 we noted how the government was determined to stay the course of neoliberalism, and how instead of the promised jobs, investment and growth we had retrenchments, capital flight and an economy that began slowing down even before it began to run. We noted a number of factors – sponsored and driven by Gear – that had combined to drive down the living standards of the working class. We looked at the worsening distribution of income, and how the rich were becoming richer while the poor were becoming poorer.

The government has continued to stay the course, and "fiscal and monetary discipline" continues to be the guide for policy makers and government bureaucrats. A year later, all the factors driving the living standards of the working class down continue to push in the same direction – towards the increasing impoverishment of the working class. These are:

- A sluggish economy. Today, the sluggishness has turned into a recession, and it is not impossible to expect not just a slow-growing economy, but an economy that is contracting.

- Job losses. This too will be deepened by the recession, and the Reserve Bank's comment that job losses are bottoming out is not supported by other data about the drift into recession.

- Wages are rising slowly, and more people are now dependent on these diminishing wages. The weakness of consumer spending in those goods and services traditionally covered by wages is an ominous warning: the working class is becoming less and less able to feed and clothe itself. At stake is no longer just a question of low wages, but a question of large sections of the working class sinking into hunger and poverty.

- A diminishing social wage is putting more pressure on wages. Even as the government announces 'increases' in social spending, the deep cuts administered on social services over the last few years mean that it will take years before the working class recovers to the levels of social provision before the cuts. With a recession looming, and with a likely drop in revenues, even this meager promise might be broken.

- The uneven distribution of income, and wealth inequality, is on the increase. As we have seen, 2001 saw the sharpest fall in labour's share of national wealth since the Second world war. Even the Reserve Bank had to admit in its Quarterly Bulletin: "By contrast, and probably reflecting the increasing disparities in the distribution of income among different classes, growth in real spending on non-durable goods and services slowed down..." We are beginning to talk not just about shifts in the distribution of income, and not just about diminishing shares of income, but about absolute declines in the incomes of the working class.

- The indebtedness of South Africans continues to rise. Listings on the credit bureaus for members of the working class have become a normal occurrence. On the other hand, middle class South Africa is also slipping deeper and deeper into debt. Years of neoliberal sermons on savings seems to be delivering the opposite message, as can be seen in the US, Argentina, and even South Africa.

In the aftermath of the anti-privatisation strikes, and following public fights between Cosatu and the ANC, the two parties have agree to develop a new growth strategy that will satisfy both the working class and the needs of international financial institutions, according to a press release after their discussions. In our discussion on the US economy we saw that the neoliberal project as a project of the financier sections of capital is grounded on the distribution of wealth away from the working class, and toward capital in general, and the financier class in particular. What prospects are there, particularly in the context of a recession, to reconcile the interest of the working class and those of international financial capital?

4. THE GEAR MODEL IN THE CONTEXT OF RECESSION

Although neoliberalism as a programme is an attempt to resolve the crisis of profitability, it has been unable to lift the world capitalist economy out of a situation of stop-start growth to a consistent and generalised growth level. In a stagnating or slow-growing environment, neoliberalism has focused its energies on facilitating the transfer of a diminishing amount of wealth from the working class and the poor, to the capitalist class and the rich. In various ways throughout the course of 2001, Gear as a neoliberal programme has engineered this transfer of wealth. True to its character as a neoliberal programme, Gear fails to lift the South African economy onto a growth patht that is broad-based and sustainable. Instead it creates mechanisms that shift wealth from the dominated classes towards the dominant classes.

In a number of important ways, the development of the South African economy over the last few years, and in 2001 in particular, shares the features of the US model that is now sliding into recession.

A consumption boom

Like the US economy, the South African economy has been fuelled by a consumption boom that was not underpinned by growth in productive activity. In 2001 growth in gross domestic expenditure took place against the background of a drop in output.

High profits, high dividend payouts and poor savings

Like its US counterpart, over the last few years the South African economy has been characterized by very active stock markets. Not only has the stock market been as volatile as in the US, but also the value of shares traded has shown a steep upward tendency over the last few years. South Africa also has a large – that is relative to the size of its economy – and active market in derivatives, indicating a relatively high level of securitisation and a deep culture of speculation.

This high level of trade in equities and other securities has been accompanied by a tendency towards high dividend payments. This has encouraged the culture of consumption among the upper classes, and has led to a dismal savings rate. This consumption culture can also be seen in the weakness of capital formation, to the extent that organizations like Cosatu can speak of an investment strike on the part of capital.

Wages and profits

Like its US counterpart, the South African economy has seen sharp changes in the distribution of income. The share of labour in national income has been on the decline for a number of years, as is the case in the US. As author of the Gear policy, the government has acted as a wage setter, and we have seen declines in wages even in the context of an increase in government expenditure. South Africa mirrors, and surpasses the levels of inequality that are found in the US. Such steep inequalities in wealth are a trademark of neoliberalism.

Privatisation of deficit financing

Neoliberals have spent a lot of energy fighting against deficit financing by the state. According to the orthodox position, the state must under no circumstance finance itself through borrowing. On the other hand, in the US, and now in South Africa as well, the funding of consumption booms – not even production – is funded through credit. The figures on credit extension, and the growing indebtedness of South Africans is leading the South African economy into a situation similar to that of the US, where consumption is financed by credit.

The danger of a deep recession

An artificial consumption boom financed by credit, a weak capital base and lack of savings, and a dependence on portfolio capital flows to finance the tendency towards deficits on the current account on the balance of payments (triggered in part by the consumption patterns of the upper classes), all combine to open the South African economy to the possibility of a deep recession.

Unlike in the case of the US, South African has neither the markets, nor the political and military might (that is why US treasury bonds will remain attractive for some time) that keeps attracting capital to the US even when the prospects are dim. This means that the flows of portfolio investment could dry up quickly, and that would kill the consumption boom by forcing interest rates up, and this would drive South Africa into a very deep recession.

An additional factor that heightens the possibility of a deep recession is the tendency of South African capital, especially since Gear, to invest offshore as opposed to investing at home. Given the liberalised foreign exchange regime many local elites look to the US and the European stock markets as their haven.

Gear, far from creating the conditions for South Africa to withstand global economic crisis, has in fact made South Africa even more vulnerable and more prone to deep recession. Once it takes hold, the unfolding recession will take a long time to shake off, and it will be one of the deepest in the history of this country. The only way for South Africa to temper the depth and breath of the recession is to act like the US, that is to double speak: speak neoliberalism and act Keynesian. But South Africa's place in the world economy is different from that of the US, and the economy, through the currency, is bound to be punished by the "markets" if Keynesian stimuli were to be adopted.

5. BARGAINING 2002: THE CHALLENGES FOR THE UNIONS

In the Economic Review 2001 we noted that a number of factors were going to influence and have a bearing on bargaining in 2001. We clustered these factors into three broad categories: factors that will directly impact on bargaining; factors that will influence the balance of power between labour and capital, and lastly factors beyond the shopfloor that define the broader context of bargaining.

All the factors we discussed in the Economic Review 2001 remain relevant, even though some might need modification.

For this year's bargaining round we need to highlight what is probably a more fundamental challenge: are we seeing the end of Gear, or are we seeing the reinventing of Gear, with labour's consent and participation, under another name?

For over two decades of the neoliberal project, the bargaining agenda of trade unions has been on the retreat. The evidence can be seen in the long-run decline in wages, in the decline of the social wage, in retrenchments, in the introduction of 'flexible' labour legislation, and so on. The forces that have driven this defeat of the unions' bargaining agenda are not to be found on the shopfloor, neither are they to be found in tripartite bodies: these forces operate under the cover of darkness, that darkness we call the "free market". The fundamental challenge for labour is to use the crisis of the capitalist system, the collapse of Argentina, and many other similar events that have cast doubt over the invincibility of the present neoliberal order.

The challenge for unions is to realise that one cannot carry water home with a bucket full of holes. The bucket that is wages is full of holes: even as we fill it up, privatisation, cuts in social spending, the restructuring of tax regimes, and many other factors ensure that by the time we get home, the bucket is empty.

The challenge is not to abandon shop-floor issues in favour of the broader issue, but rather to bring the larger issues into the bargaining agenda.

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