Coronavirus and Capitalism's Vulnerability*

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Even while the slow growth that followed the Great Recession endures, the world economy is staring at another recession. The OECD Secretariat has reduced its forecast of global GDP growth by half a percentage point to 2.4 per cent, which is the lowest since the global financial crisis. The immediate trigger is the coronavirus epidemic that is disrupting global economic activity. But there is a larger message being sent out by the virus onslaught. The damage that it has inflicted on the global economy and the near certainty that the damage would only intensify, has revealed the new vulnerabilities accumulated during the neoliberal era that afflict the world economy.

At the time of writing China, which is the epicentre of the epidemic, has reported close to 90,000 cases of infection and nearly 3,000 deaths. The only good news is that there are signs that the number of new cases in that country are declining. But that is being countered by evidence of global spread. Infections by the virus have been reported from 63 countries and the number of cases and deaths are rising rapidly in new focal points like Iran, Italy and South Korea.

The damage wrought by the virus has been severe from the start not only because of its virulent nature, but also the fact that the epidemic originated in Wuhan city in Hubei province of China. Three features have characterised the transformation of the world economy in the years since the 1980s. First, large parts of manufacturing production have exploited the liberalisation of trade and investment rules to move out of the erstwhile centres of industrial capitalism in the West and Japan, to relocate to new sites that deliver cost advantages, especially in the form of a reserve of cheap labour. Second, while this has resulted in production chains that straddle the globe, there are only a few countries that have disproportionately benefited from the process of relocation. China is a leader among them, sucking in raw materials and intermediates and producing intermediates and final goods for export not just to the West, but also to the newly industrialising and less developed countries. Third, this special position of China has meant that its economy has grown rapidly spawning a set of middle income, rich and super-rich individuals whose consumption expenditure has grown enormously. That makes China not only the leading factory of the world and but an increasingly important market for goods produced both in China and abroad.

This multifaceted transformation of the world economy creates new vulnerabilities. Any development that adversely affects Chinese consumption demand and/or Chinese production reverberates in the form of demand and supply shocks onto the rest of the world. This was clear even in 2003, when the adverse effects of the SARS epidemic on the Chinese economy were transmitted to the world economy. But much has changed since then, not least being the fact that while in 2003 China accounted for just 4 per cent of global GDP, that figure stands at 16 per cent today.

The immediate impact of the epidemic was, of course, on the Chinese economy. As the contagion forced factories to close and the government to lock down cities, production fell abruptly, as did employment. Moreover, travel for work or on holiday (especially given the mass movement of migrant workers during the lunar New Year celebrations) froze. According to the Financial Times, figures from the Civil Aviation Administration of China indicate that the number of passengers carried by Chinese airlines from the end of the lunar New Year break on January 27 to February 12 was down 70 per cent compared with the corresponding period of the previous year. As a result around 70 per cent aircraft were grounded, affecting employment and earnings in the industry. Similar effects across sectors is expected to reduce growth in the once buoyant Chinese economy to less that 5 per cent in 2020.

As growth and demand in China falters, the implications of the vulnerability stemming from the asymmetric globalisation of world production is becoming clear. In 2019, China accounted for three fourths of the increase in world oil demand. The International Energy Agency has concluded that "the consequences of Covid-19 [the coronavirus] for global oil demand will be significant," and reduced its estimate of global demand for oil in 2020 to 825,000 barrels a day from an earlier 1.2 million barrels a day. Falling demand and expectations of a further decline have brought down the price of Brent, the benchmark crude, from $69 a barrel at the beginning of the year to close to $50. That is going to hit oil exporting countries adversely, especially those like Russia where government revenues are overwhelming dependent on receipts from oil sales. One effect triggers another in a globalised world.

But the effects of shrinking demand extend far beyond a crucial intermediate like oil. Chinese tourists, who move in droves to destinations worldwide during periods like the lunar New Year break, are cancelling plans because they cannot leave their own homes or because they are banned from entry into many countries struggling to limit the spread of the epidemic across their borders. In the event, the airline industry, travel business and firms marketing luxury brands that Chinese shoppers splurge on are facing a sudden shrinkage of demand. Industry estimates suggest that Chinese buyers not only accounted for two-fifths of the Euro 280 billion spent on luxury goods in 2019, but also picked up as much as 80 per cent of the increment in sales.

The shock, however, is not delivered only from the demand side. Given China's central role in a range of global value chains, as a supplier of both intermediate inputs and of final products, the virus-induced production halts in the country are having repercussions across the globe. The ever-vibrant smart phone industry, in which brands varying from US major Apple's IPhone to China's own Xiaomi rely on production in Chinese factories, including some in Wuhan, has suddenly seen supplies shrink, forcing Apple to consider postponing the launch of the next upgrade of its product. In other instances, the problem is not the availability of final products but of components and parts sourced from China. Fiat Chrysler has announced that it is likely to cut production because of dwindling inventories of imported components and parts, and pharmaceutical production in India is falling and prices rising because bulk drug intermediates imported from China are now not available.

As is inevitable, this setback to global production because of demand and supply shocks triggered by the coronavirus epidemic in China is soon fed by developments in the rest of the world. As economies experience the effects of these shocks, with production, employment and earnings fallings, they too contribute to the shocks, turning into propagators of the initial force from China. Moreover, the coronavirus epidemic is no more just a Chinese phenomenon, proving to be intense in Iran, Italy and South Korea, and signalling that new epicentres are likely to emerge. Since this would have similar consequences as in China with ripple effects on other economies (even if not as strong as those from China), these countries would not remain mere propagators but turns drivers themselves. All this suggests that the prospect of a recession is significant, and there is little room for complacency.

Nowhere was such complacency more visible than among investors in financial markets drunk on the cheap liquidity that central banks have poured into their economies. Using the cheap money that neoliberal monetary policy delivers, they have been speculating on stocks in a manner that suggests they believed the party cannot end. The long post-crisis boom in equity markets persisted even as the coronavirus choked a growing number of victims worldwide. As late as February 20, analysts at even the ever-optimistic Goldman Sachs were warning that investors were underestimating the effects of the virus on earnings and arguing that the prospect of a "correction", or a 10 per cent or more fall in market indices, was "high". It was only when market favourites like Apple projected earnings to fall short of earlier forecasts, or even to decline, that investors began to react, with the leading indices indeed registering a correction over the week ending February 28.

Give the high levels that equity prices have touched, this may only be the beginning. The external effects that a sharp fall in market prices can have on the real economy had been demonstrated by the 2008 financial crisis. A similar turn of events is a real possibility, especially if the economic crisis triggered by the coronavirus intensifies. This is not the only element of financial fragility characterising the system today. Over the decade when cheap money flooded financial markets because of the overreliance on unconventional monetary policies (involving quantitative easing and low interest rates), the corporate sector has borrowed hugely. In the case of many of them, the hit they would be taking because of the corona crisis may make the interest and amortisation burden too heavy to bear, leading to defaults that would pull financial firms and banks down as well. That would be one more route through which the crisis can intensify. Neoliberal and financial policies have added to the fragility that neoliberal trade and investment policies and the asymmetric globalisation they propelled have generated.

The prospect of a recession, including a deep one, is daunting also because governments seem to have eroded their ability to intervene to counteract such a crisis. The embrace of neoliberalism has meant that there are few buyers for a proactive fiscal policy, which in a period of crisis must be financed by borrowing, within the dominant policy establishment. On the other hand, overreliance on monetary policies has not merely brought interest rates to rock bottom, but also fed speculative frenzy in asset markets, rather than raising demand and real economy growth. As a result, there is little head room left for the use of even the largely ineffective monetary lever to combat a recession. The coronavirus, besides the devastation it has wreaked on human health and life, has not just revealed the fragility of a neoliberal economic order. It also puts to test the ability of neoliberal governments to pull the world economy out of the abyss into which it may well descend.

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