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The Battle among Reformers and the Populists in Rising Nations

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Executive
The United States has exceeded its debt limit and the limit has to be raised in the next couple of months to avoid defaulting on its debt. Indeed, some experts are saying that the debt limit has already been breached and the Treasury is resorting to extraordinary measures to keep the economy going. Further, the point needs to be understood that raising the debt limit means that the United States has the facility to fund what has already been spent and raising the debt limit does not mean that the country is engaging in more debt. In other words, what politicians across the spectrum have to keep in mind is that the debt limit is all about repaying what is already spent and hence, it is not an indicator of how much the United States has to borrow in future. That is a separate issue altogether and the reason for discussing this aspect in detail is that the Republicans have been consistently insisting that the US cannot go on borrowing without cuts in spending.

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I. INSISTENCE ON SPENDING CUTS TO COOPERATE ON RAISING THE DEBT CEILING

To continue the last point made above, the Republican Party is stuck on the demand that in order for Congress and the Senate to increase the debt ceiling, there must be a corresponding agreement to cut spending on social and welfare related services. This means that the Republicans are tying the deal to increase the debt limit on the Obama administration agreeing to spending cuts. Without going into too much detail about how these spending cuts would impact the economy, it needs to be mentioned that spending cuts in welfare and social related schemes would hurt the poor and the needy more than they would hurt the rich and the privileged.

Considering the fact that the poor and the needy have already been hurt and impacted by the ongoing recession, it would be fair to say that such spending cuts would deal a double whammy to them and would leave them without any state guaranteed social services. The point here is that spending cuts can also be in the realm of defences and other areas where the US is already a profligate spender and hence, spending cuts can be actualized in those areas.

A. Worst Case Scenarios and Best Case Scenarios

The worst case scenario would be one where the US defaults on its debt which would lead to a catastrophic effect on the global financial system since the US is the world’s largest economy and the pivot on which the global economy rests.

This means that all stakeholders have to realize that actualizing the agreement on the debt limit is in everybody’s interest and hence, they must sit down at the negotiating table and thrash out an agreement on raising the debt limit. The last time such an eventuality was contemplated which was in fall 2011; the US had to suffer a ratings downgrade because of the brinkmanship of the Republicans.

Therefore, the worst-case scenario cannot be contemplated at all and so, the best-case scenario would be one where the Republicans take the fight till the last moment and then agree on raising the debt limit. Even this best-case scenario is dangerous because delaying the agreement till the last minute would spook the markets and cause the interest rates to rise, which would have knock on effects on all sectors of the economy.

The point here is that the situation is such that both the worst-case scenario and the best-case scenario offer dangerous times for the US economy and this is the key point that is being made in this article. Finally, it is our recommendation that investors and professionals prepare themselves for all eventualities and take steps accordingly. The show of brinkmanship that is being played out in Washington makes for good theatre but bad economics.

II. THE BATTLE AMONG REFORMERS AND THE POPULISTS IN RISING NATIONS

A. The Conflict of Ideologies

In many developing countries that are undertaking large-scale reforms in their economies, there is a conflict between reformers and populists among the policymaking elite on the kind of policies that have to be pursued for the economic welfare of the citizens.

While the reformers want neoliberal and globalist policies to be implemented that would integrate these economies into the global economy and reap the benefits of foreign investment and greater share for the free markets, the populists want the countries to put welfare of the citizens first in the assumption that neoliberal policies work only for the privileged and the wealthy.

The key aspect here is the ideological divide over whether neoliberal policies favour the skilled and the educated apart from the elites and leave those who are less privileged behind. In other words, the conflict is between those who believe that free markets and neoliberal policies benefit everybody and those who believe that handing out freebies and subsidies is the only way to bring those who are left out in the neoliberal paradigm up to the level of those who are benefiting from the reforms.

B. The Case of India as an Example of the Conflict

This conflict and divide between the reformers and the populists can be seen best in the way India has taken hesitant steps on the road to liberalization and economic reforms. Ever since the country started liberalizing in the 1990s, there has been a tendency to take one-step forward and two steps backward, as the reformers have been stymied by the populists in their attempts to introduce neoliberal reforms and globalize the economy.

Often, this manifests itself in the manner of the reformers opening up a particular sector for foreign competition or undertaking reforms in the public sector enterprises only to be met with vociferous opposition to their attempts that result in stalled reforms and setbacks. A case in point is the recent passage of several populist schemes aimed ostensibly at the poor and the needy.

While one does not dispute the fact that these schemes are needed to lift the poor out of poverty, the fact remains that India already doles out subsidies in a manner that exceeds the subsidies of many other countries. The key aspect here is that despite all these subsidies and sops, the underprivileged have not benefited which raises serious questions about the way in which these subsidies and welfare schemes and the populist policies are implemented.

C. Global Ideological Clash and the Present Situation

The other aspect about the conflict between the reformers and the populists is the manner in which the prevailing global situation affects the fortunes of these two opposing camps. For instance, when the world was divided into the Socialist camp led by the erstwhile USSR or the Soviet Union and the US led capitalist camp, many developing countries allied themselves with either of the two superpowers and followed socialism or capitalism.

However, the fall of the Soviet Union pushed many socialist countries towards capitalism and for the decades of the 1990s and the 2000s, it seemed that capitalism had won the ideological battle. Of course, this was short-lived as the global economic crisis of 2008 proved that capitalism was also vulnerable to excesses and that the growth of the previous two decades was an illusion.

Therefore, the situation in many developing countries at the moment is a state of confusion over reforms and populism and it is our view that it would take some time before equilibrium is established between the competing camps of reformers and populists. It would be safe to say that the present out of balance world is likely to persist being in a state of crisis for some time to come as the developing countries look towards the US and the Europe for the kind of economic ideology that has to be followed.

III. RESTITUTION THE ANIMAL MOODS IN THE WORLD-WIDE ECONOMY TO REVITALIZE DEVELOPMENT

A. The Metaphor of the Animal Spirits to Describe the Markets

For those of us who observe the financial markets gyrate wildly from highs and lows to periodic booms and busts, the analogy of a beast that has periodic bouts of aggression and depression is the most apt metaphor to describe these swings and mood shifts in the markets.

No wonder that many economists liken the financial markets and the economy to that of animal spirits, which drive growth through a process of aggressive wealth creation and at the same time, when they are not tamed properly, lead to busts and market crashes. The key aspect here is that the economy needs to be stimulated in the same manner that as humans, we have to be aggressive in our careers and at the same time, know when to stop and quit.

In other words, kick starting an economy after it crashes is like an individual who rediscovers his animal side after languishing in the doldrums for a while and starts to rebuild and rejuvenate him or herself. This metaphor of an economy that is powered by animal spirits is the title of a popular book by famous economists, which is indicative of the hold that this metaphor has on popular imagination.

B. Oscillating Between Excess and Moderation

The point here is that economies and societies are comprised of individuals and hence, markets represent the popular mood of the individuals who make up the same system. As any student of economics would tell you, an economy grows and crashes in the same manner that individuals have highs and downs throughout their lives.

This is where the metaphor of rejuvenating growth by rekindling our animal spirits is so apt to describe the manias, panics, and the crashes. In other words, when we are facing a downturn in the economy or in our professional or personal lives, the best way to bootstrap and lift ourselves and the economy up is through reconnecting with our animal nature and hitting the ground running so that we finish ahead of the others.

Of course, the animal spirits metaphor is also used to describe how individuals in societies and economies once they lose their Mojo can flounder, languish, and hence, need a dose of adrenaline to rouse themselves and motivate themselves to perform well and succeed.

C. How Markets correct themselves and why we need Animal Spirits Now

However, just like rekindling animal spirits would lead to highs in our careers and by extension the economy can do well when individuals pour all their energies, there needs to be some moderation as well as otherwise excesses can lead to crashes and busts. This is precisely what happened in the decades of 1990s and the 2000s when the excess of speculation and financialization led to the global economic shock of 2008.

Therefore, many economists who use the animal spirits metaphor also say that the beast needs to be tamed from time to time and this is the power of the free markets that correct themselves when the balance is exceeded. In other words, a well-functioning economy based on markets would find the equilibrium between excessive manias and booms and would correct itself when faced with too much of the good thing.

This is the central theme that many economists point to when they talk about the economy being rejuvenated through the rekindling of animal spirits. Further, they also point to the fact that of all markets, the stock market in particular resembles animal spirits in action as the wild swings that we witnessed in recent years are certainly like an animal that is out of control at times but nonetheless provides the much needed energy and momentum for the creative destruction processes of capitalism.

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