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CONTENTS

Editorial	7
The Depression: A Long-Term View <i>Immanuel Wallerstein</i>	9
An Alternative Perspective for the Global South—Neoliberal Economic Policies in the United States: The Impact of Globalisation on a ‘Northern’ Country <i>Kim Scipes</i>	12
The Palestinian Paradox <i>Helena Cobban</i>	48
Crisis as Opportunity: New Directions for Regulating Finance <i>C.P. Chandrasekhar</i>	56
The Global Financial Crisis and the Developing World <i>Jayati Ghosh</i>	76
Impact of the Financial Crisis on the Rural Economy in India: Intensification of the Agrarian Distress? <i>Arindam Banerjee</i>	96
The Abortion Controversy in the United States: From Comstock to <i>Roe v. Wade</i> and After <i>A. M. Thomas</i>	115
Afghanistan, Taliban and the Southern Asian Geopolitics <i>Happymon Jacob</i>	132
Issues and Challenges in India’s Grand Strategy in the New Century <i>W. Lawrence S. Prabhakar</i>	151
Reinventing Public Sphere: Habermas’s ‘Sluice’ Model under Neoliberal ‘Siege’ <i>K.M.Seethi</i>	174
Identity and Authenticity: A Critical Exploration into the Political Theory of Charles Taylor <i>Chandran Komath</i>	192
A Sociologist Critically Examines Paul Krugman’s Economics <i>Kim Scipes</i>	217

Editorial

The current scenario of global food security is reported to be worsening as documented by various international agencies. The global economic crisis has surely deprived an additional one billion people of access to food. There has been a significant increase in hunger across the world, and it is estimated that one billion people are now undernourished. These are all documented in *The State of Food Insecurity in the World 2009* which came out in the background of the worsening economic crisis.

Almost all countries across the world have witnessed economic slowdown. No nation is free from this malady and, perceptibly, it is the poorest countries—and the poorest people—that must bear the brunt of the worst sufferings. The crisis is, no doubt, unprecedented, with so many critical factors coming together to make it vulnerable to people at the risk of food insecurity. The food crisis that erupted in 2006–08 had already pushed the prices of basic staples beyond the reach of millions of poor people. Global food commodity prices still remain high. Domestic prices too have been higher, 17 per cent higher in real terms than two years earlier. The price rise has obviously compelled many poor families to sacrifice health care, education or food. Earlier, the economic crises that affected Third World countries had a bearing on individual countries only, or several countries in a particular region. In such cases, these countries resorted to various instruments such as currency devaluation, borrowing or increased use of state assistance to cope with the effects of the crisis.

The Third World countries today—which are more financially and commercially knit together in the world capitalist economy than they were two decades ago—are far more vulnerable to setbacks in global markets. In fact, many countries have already experienced decline in their trade and financial inflows, and have witnessed their export earnings, foreign investment, development aid and remittances falling. This state of affairs will not only undermine the employment potentials, but also reduce the resources available for government programmes that are essential to promoting growth and supporting those in need.

A decade has passed since the heads of states assembled for the World Food Summit organised by the Food and Agriculture Organisation (FAO) and brought forth the famous Rome Declaration on Food Security in 1996. The Summit was an important turning point as the Declaration reaffirmed the people's right for access to safe, nutritious and adequate food and also

the fundamental right to be free from hunger. Yet another objective of the Summit was to ensure a significant improvement in food security by reducing the number of people without adequate food from 800 million to half by 2015. The Rome Declaration also offered the conceptual foundation of food security, which is defined as a situation when all people, at all times, have access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life. However, even after a decade, the scenario has not changed significantly and the number of undernourished people around the globe has continued to grow. India, Pakistan, Indonesia, North Korea, Mongolia, Tajikistan etc. are some of the countries where the scenario has been very disappointing.

There are arguments that if global food security is to be achieved and sustained, the twin-track approach supported by Food and Agricultural Organisation (FAO), World Food Programme (WFP), the International Fund for Agricultural Development (IFAD) and their development partners will be vital. This strategy seeks to address both the shorter-term acute hunger driven by food or economic shocks and the longer-term chronic hunger that is symptomatic of extreme poverty. What is suggested is that governments must create or improve safety nets and social-protection programmes in order to help the hungry or those most in need. It is also envisaged to stimulate the local economy by creating jobs and increasing agriculture and local value-added food production. To ensure that the question of hunger is addressed in the years to come, Third World countries must be assisted with the development, economic and policy tools required and thereby boosting their agriculture sectors in terms of both productivity and resilience in the face of crises. But how do we ensure that the mistakes committed during the first spell of the Green Revolution are not repeated? Let no miracle seeds destroy our sustainable agriculture and precious bio-eco systems.

It may be recalled that economic crises in the past had led to declines in public investment in agriculture. However, the experience shows that there is no alternative to reducing poverty and hunger than investing in agriculture, harmonised with the programmes that would ensure people's access to the food that is produced. Notwithstanding the persisting global economic crisis, support to agriculture should not be slashed; indeed, it must be stepped up. No doubt, a healthy agriculture sector, combined with a growing non-farm economy and effective safety nets and social-protection programmes, including food safety nets and nutrition-assistance programmes, is essential to eradicate poverty and food insecurity in a sustainable manner. But the challenge before a large number of countries in the Third World is how to make it possible and sustainable without revisiting the neoliberal policy-prescriptions.

The Depression: A Long-Term View

Immanuel Wallerstein

The depression has started. Journalists are still coyly enquiring of economists whether or not we may be entering a mere recession. Don't believe it for a minute. We are already at the beginning of a full-blown worldwide depression with extensive unemployment almost everywhere. It may take the form of a classic nominal deflation, with all its negative consequences for ordinary people. Or it might take the form, a bit less likely, of a runaway inflation, which is simply another way in which values deflate, and which is even worse for ordinary people.

Of course everyone is asking what has triggered this depression. Is it the derivatives, which Warren Buffett called "financial weapons of mass destruction"? Or is it the subprime mortgages? Or is it oil speculators? This is a blame game, and of no real importance. This is to concentrate on the dust, as Fernand Braudel called it, of short-term events. If we want to understand what is going on, we need to look at two other temporalities, which are far more revealing. One is that of medium-term cyclical swings. And one is that of the long-term structural trends.

The capitalist world-economy has had, for several hundred years at least, two major forms of cyclical swings. One is the so-called Kondratieff cycles that historically were 50-60 years in length. And the other is the hegemonic cycles which are much longer.

In terms of the hegemonic cycles, the United States was a rising contender for hegemony as of 1873, achieved full hegemonic dominance in 1945, and has been slowly declining since the 1970s. George W. Bush's follies have transformed a slow decline into a precipitate one. And as of now, we are past any semblance of U.S. hegemony. We have entered, as normally happens, a multipolar world. The United States remains a strong power, perhaps still the strongest, but it will continue to decline relative to other powers in the decades to come. There is not much that anyone can do to change this.

The Kondratieff cycles have a different timing. The world came out of the last Kondratieff B-phase in 1945, and then had the strongest A-phase upturn in the history of the modern world-system. It reached its height circa 1967-73,

and started on its downturn. This B-phase has gone on much longer than previous B-phases and we are still in it.

The characteristics of a Kondratieff B-phase are well known and match what the world-economy has been experiencing since the 1970s. Profit rates from productive activities go down, especially in those types of production that have been most profitable. Consequently, capitalists who wish to make really high levels of profit turn to the financial arena, engaging in what is basically speculation. Productive activities, in order not to become too unprofitable, tend to move from core zones to other parts of the world-system, trading lower transactions costs for lower personnel costs. This is why jobs have been disappearing from Detroit, Essen, and Nagoya and factories have been expanding in China, India, and Brazil.

As for the speculative bubbles, some people always make a lot of money in them. But speculative bubbles always burst, sooner or later. If one asks why this Kondratieff B-phase has lasted so long, it is because the powers that be — the U.S. Treasury and Federal Reserve Bank, the International Monetary Fund, and their collaborators in western Europe and Japan — have intervened in the market regularly and importantly — 1987 (stock market plunge), 1989 (savings-and-loan collapse), 1997 (East Asian financial fall), 1998 (Long Term Capital Management mismanagement), 2001-2002 (Enron) — to shore up the world-economy. They learned the lessons of previous Kondratieff B-phases, and the powers that be thought they could beat the system. But there are intrinsic limits to doing this. And we have now reached them, as Henry Paulson and Ben Bernanke are learning to their chagrin and probably amazement. This time, it will not be so easy, probably impossible, to avert the worst.

In the past, once a depression wreaked its havoc, the world-economy picked up again, on the basis of innovations that could be quasi-monopolised for a while. So, when people say that the stock market will rise again, this is what they are thinking will happen, this time as in the past, after all the damage has been done to the world's populations. And maybe it will, in a few years or so.

There is however something new that may interfere with this nice cyclical pattern that has sustained the capitalist system for some 500 years. The structural trends may interfere with the cyclical patterns. The basic structural features of capitalism as a world-system operate by certain rules that can be drawn on a chart as a moving upward equilibrium. The problem, as with all structural equilibria of all systems, is that over time the curves tend to move far from equilibrium and it becomes impossible to bring them back to equilibrium.

What has made the system move so far from equilibrium? In very brief, it is because over 500 years the three basic costs of capitalist production — personnel,

inputs, and taxation — have steadily risen as a percentage of possible sales price, such that today they make it impossible to obtain the large profits from quasi-monopolised production that have always been the basis of significant capital accumulation. It is not because capitalism is failing at what it does best. It is precisely because it has been doing it so well that it has finally undermined the basis of future accumulation.

What happens when we reach such a point is that the system bifurcates (in the language of complexity studies). The immediate consequence is high chaotic turbulence, which our world-system is experiencing at the moment and will continue to experience for perhaps another 20-50 years. As everyone pushes in whatever direction they think immediately best for each of them, a new order will emerge out of the chaos along one of two alternate and very different paths.

We can assert with confidence that the present system cannot survive. What we cannot predict is which new order will be chosen to replace it, because it will be the result of an infinity of individual pressures. But sooner or later, a new system will be installed. This will not be a capitalist system but it may be far worse (even more polarising and hierarchical) or much better (relatively democratic and relatively egalitarian) than such a system. The choice of a new system is the major worldwide political struggle of our times.

As for our immediate short-run and interim prospects, it is clear what is happening everywhere. We have been moving into a protectionist world (forget about so-called globalisation). We have been moving into a much larger direct role of government in production. Even the United States and Great Britain are partially nationalising the banks and the dying big industries. We are moving into populist government-led redistribution, which can take left-of-centre social-democratic forms or far right authoritarian forms. And we are moving into acute social conflict within states, as everyone competes over the smaller pie. In the short run, it is not, by and large, a pretty picture.

An Alternative Perspective for the Global South—Neoliberal Economic Policies in the United States: The Impact of Globalisation on a ‘Northern’ Country

Kim Scipes

Most contemporary discussions of globalisation, and especially of the impact of neoliberal economic policies, focus on the countries of the Global South (Bond 2005; Ellner and Hellinger 2003; Harris 2006; Klein 2007; MR 2007; and Scipes 1999, 2006b). Recent articles arguing that the globalisation project has receded and might be taking different approaches (Bello 2006; Thornton 2007) have also focused on the Global South. What has been somewhat discussed (Giroux 2004; Piven 2004; Aronowitz 2005) but not systematically addressed, however, is what has been the impact of globalisation and especially related neoliberal economic policies on working people in a *northern* country? ¹

This article specifically addresses this question by looking at the impact of neoliberal economic policies on working people in the United States. Following Frances Fox Piven, neoliberal economic policies refer to the set of policies carried out, in the name of individualism and unfettered markets, for “the deregulation of corporations, and particularly of financial institutions; the rollback of public services and benefit programs; curbing labour unions; ‘free trade’ policies that would pry open foreign markets; and wherever possible the replacement of public programs with private markets” (Piven 2007: 13). The case of the United States is particularly useful to examine because its elites have projected themselves as “first among equals” of the globalisation project (Bello 2006), and it is the place of the Global North where the neoliberal project has been pursued most resolutely and has advanced the farthest. In other words, the experiences of American workers illuminate the effects of the neoliberal project in the Global North to the greatest extent, and suggest what will happen to working people in other northern countries should they accept their respective governments’ adoption of such policies. However, care must be taken as to how this is understood. While sociologically-focused textbooks (Aguirre and Baker 2008; Hurst 2007) have joined together some of the most

recent thinking on social inequality—and have demonstrated that inequality not only exists but is increasing—this has been generally presented in a *national* context; in this case, within the United States. And if they recognise that globalisation is part of the reason for increasing inequality, it is generally included as one of a set of reasons.

This article argues that we simply cannot understand what is happening unless we put developments within a *global* context: the United States effects, and is affected by, global processes. Thus, while some of the impacts can be understood on a national level, we cannot ask related questions as to causes—or future consequences—by confining our examination to a national level: we absolutely must approach this from a global perspective (Nederveen Pieterse 2004 and 2008).

This also must be put in historical perspective as well, although the focus in this piece will be limited to the post-World War II situation. Inequality within what is now the United States today did not—obviously—arise overnight. Unquestionably, it began at least 400 years ago in Jamestown—with the terribly unequal and socially stratified society of England’s colonial Virginia *before* Africans were brought to North America (Fischer 1989), much less after their arrival in 1619, *before* the Pilgrims. Yet, to understand the roots of development of contemporary social inequality in the US, we must understand the rise of ‘Europe’ in relation to the rest of the world (Rodney 1972; Nederveen Pieterse 1989). In short, again, we have to understand that the development of the United States has been and will always be a global project and, without recognising that, we simply cannot begin to understand developments within the United States.

We also have to understand the multiple and changing forms of social stratification and resulting inequalities in the US. This article prioritises economic stratification, although is not limited to just the resulting inequalities. Nonetheless, it does not focus on racial, gender or any other type of social stratification. However, it is not written from the perspective that economic stratification is always *the* most important form of stratification, nor from the perspective that we can only understand other forms of stratification by understanding economic stratification: all that is being claimed herein is that economic stratification is one type of social stratification, arguably one of the most important types, yet, only one of several, and investigates the issue of economic stratification in the context of contemporary globalisation and the neoliberal economic policies that have developed to address this phenomenon as it affects the United States.

Once the global-historical perspective is understood and after quickly suggesting in the ‘prologue’ *why* the connection between neoliberal economic

policies and the effects on working people in the United States has not been made usually, this article focuses on several interrelated issues: (1) it reports the current economic situation for workers in the United States; (2) it provides a historical overview of US society since World War II; (3) it analyses the results of US Government economic policies; and (4) it ties these issues together. From that, it comes to a conclusion about the impact of neoliberal economic policies on working people in the United States.

Prologue: Origins of Neoliberal Economic Policies in the United States

As stated above, most of the attention directed toward understanding the impact of neoliberal economic policies on various countries has been confined to the countries of the Global South. However, these policies have been implemented in the United States as well. They arguably began in 1982, when the Chairman of the US Federal Reserve, Paul Volcker, launched a vicious attack on inflation—and caused the deepest US recession since the Great Depression of the late 1920s-1930s.

However, these neoliberal policies have been implemented in the US perhaps more subtly than in the Global South. This is said because, when trying to understand changes that continue to take place in the United States, these economic policies are hidden ‘under’ the various and sundry ‘cultural wars’ (around issues such as drugs, premarital sex, gun control, abortion, marriages for gays and lesbians) that have been taking place in this country and, thus, not made obvious: most Americans, and especially working people, are not aware of the changes detailed below.²

However, it is believed that the implementation of these neoliberal economic policies *and* the cultural wars to divert public attention are part of a larger, conscious political programme by the elites within this country that is intended to prevent re-emergence of the collective solidarity among the American people that we saw during the late 1960s and early 1970s (Piven 2004 and 2007)—of which the *internal* breakdown of discipline within the US military, in Vietnam and around the world, was arguably the most crucial (Moser 1996; Zeiger 2006)—that ultimately challenged, however inchoately, the very structure of the established social order, both internationally and in the United States itself. Thus, we see both Democratic and Republican Parties are in agreement to maintain and expand the US empire (in more neutral political science-ese, a ‘unipolar world’), but the differences that emerge within each party and between each party are generally confined to how this can best be accomplished. While this article focuses on the economic and social changes going on, it should be

kept in mind that these changes did not ‘just happen’: conscious political decisions have been made that produced social results (Piven 2004) that make the US experience—at the centre of a global social order based on an ‘advanced’ capitalist economy—qualitatively different from experiences in other more economically-developed countries. So, what has been the impact of these policies on workers in the US?

1) The Situation for US Workers and Growing Economic Inequality as of Mid-2007

Steven Greenhouse of *The New York Times* published a piece on 4 September 2006, writing about entry-level workers, young people who were just entering the job market. Greenhouse noted changes in the US economy; in fact, there have been substantial changes since early 2000, when the economy last created many jobs.

- > Median incomes for families with one parent age 25-34 fell 5.9 per cent between 2000-2005. It had jumped 12 per cent during the late 1990s (The median annual income for these families today is \$48,405.)
- > Between 2000-2005, entry-level wages for male college graduates fell by 7.3 per cent (to \$19.72/hr).
- > Entry-level wages for female college graduates fell by 3.5 per cent (to \$17.08).
- > Entry-level wages for male high school graduates fell by 3.3 per cent (to \$10.93)
- > Entry-level wages for female high school graduates fell by 4.9 per cent (to \$9.08)

Yet, the percentage drop in wages hides the growing gap between college and high school graduates. Today, on average, college grads earn 45 per cent more than high school graduates, where the gap had “only” been 23 per cent in 1979: the *gap* has doubled in 26 years (Greenhouse 2006b).

A 2004 story in *Business Week* found that 24 per cent of all *working* Americans received wages below the poverty line.³ In January 2004, 23.5 million Americans received free food from food pantries. “The surge for food demand is fuelled by several forces—job losses, expired unemployment benefits, soaring health-care and housing costs, and the inability of many people to find jobs that match the income and benefits of the jobs they had.” And 43 million people were living in low-income families with children (Jones 2004). A 2006 story in *Business Week* found that US job growth between 2001-2006 was really based on one industry: health care. Over this five-year period, the health-care sector has added 1.7

million jobs, while the rest of the private sector has been stagnant. Michael Mandel, the economics editor of the magazine, writes:

... information technology, the great electronic promise of the 1990s, has turned into one of the greatest job-growth disappointments of all time. Despite the splashy success of companies such as Google and Yahoo!, businesses at the core of the information economy—software, semi-conductors, telecom, and the whole range of Web companies—have lost more than 1.1 million jobs in the past five years. These businesses employ fewer Americans today than they did in 1998, when the Internet frenzy kicked into high gear (Mandel 2006: 56).

In fact, “take away health-care hiring in the US, and quicker than you can say cardiac bypass, the US unemployment rate would be 1 to 2 percentage points higher” (Mandel 2006: 57).

There has been extensive job loss in manufacturing. Over 3.4 million manufacturing jobs have been lost since 1998, and 2.9 million of them have been lost since 2001. Additionally, over 40,000 manufacturing firms have closed since 1999, and 90 per cent have been medium and large shops. In labour-import intensive industries, 25 per cent of laid-off workers remain unemployed after six months, two-thirds of them who do find new jobs earn less than on their old job, and one-quarter of those who find new jobs “suffer wage losses of more than 30 per cent” (AFL-CIO 2006a: 2).

The AFL-CIO details the American job loss by manufacturing sector in the 2001-05 period:

- Computer and electronics: 543,000 workers or 29.2 per cent
- Semiconductor and electronic components: 260,100 or 36.7 per cent
- Electrical equipment and appliances: 152,500 or 26 per cent
- Vehicle parts: 153,400 or 18.6 per cent
- Machinery: 289,400 or 19.9 per cent
- Fabricated metal products: 235,200 or 13.3 per cent
- Primary metals: 144,800 or 23.5 per cent
- Transportation equipment: 246,300 or 12.1 per cent
- Furniture products: 58,500 or 13.4 per cent
- Textile mills: 158,500 or 43.1 per cent
- Apparel 220,000 or 46.6 per cent
- Leather products: 24,700 or 38.3 per cent
- Printing: 159,300 or 19.9 per cent
- Paper products: 122,600 or 20.4 per cent
- Plastics and rubber products: 141,400 or 15 per cent

- Chemicals: 94,900 or 9.7 per cent
- Aerospace: 46,900 or 9.1 per cent
- Textiles and apparel declined by 870,000 jobs 1994-2006, a decline of 65.4 per cent (AFL-CIO, 2006a: 2).

By the end of 2005, only 10.7 per cent of all US employment was in manufacturing—down from 21.6 per cent at its height in 1979—in raw numbers, manufacturing employment totaled 19.426 million in 1979, 17.263 million in 2000, and 14.232 million in 2005.⁴ The number of production workers in this country at the end of 2005 was 9.378 million.⁵ This was only slightly above the 9.306 million production workers in 1983, and was considerably below the 11.463 million as recently as 2000 (US Bureau of Labour Statistics 2006b). As one writer puts it, this is “the biggest long-term trend in the economy: the decline of manufacturing.” He notes that employment in the durable goods (e.g., cars and cable TV boxes) category of manufacturing has declined from 19 per cent of all employment in 1965 to 8 per cent in 2005 (Altman 2006). And at the end of 2006, only 11.7 per cent of all manufacturing workers were in unions (US Bureau of Labour Statistics 2007).

In addition, in 2004 and 2005, “the real hourly and weekly wages of US manufacturing workers have *fallen* 3 per cent and 2.2 per cent respectively” (AFL-CIO 2006a: 2). The minimum wage level went unchanged for nine years: until recently when there was a small increase—to \$5.85 an hour on 24 July 2007—US minimum wage had remained at \$5.15 an hour since 1 September 1997. During that time, the cost of living rose 26 per cent. After adjusting for inflation, this was the lowest level of the minimum wage since 1955. At the same time, the minimum wage was only 31 per cent of the average pay of non-supervisory workers in the private sector, which is the lowest share since World War II (Bernstein and Shapiro 2006).

In addition to the drop in wages at all levels, fewer new workers get health care benefits with their jobs:⁶ In 2005, 64 per cent of all college grads got health coverage in entry-level jobs, where 71 per cent had gotten it in 2000—a 7 per cent drop in just five years. Over a longer term, we can see what has happened to high school grads: in 1979, two-thirds of all high school graduates got health care coverage in entry-level jobs, while only one-third do today (Greenhouse 2006b). It must be kept in mind that only about 28 per cent of the US workforce are college graduates—most of the work force only has a high school degree, although a growing percentage of them have some college, but not college degrees.

As things have become so bad, many young adults have gotten discouraged

and given up. The unemployment rate is 4.4 per cent for ages 25-34, but 8.2 per cent for workers 20-24. (Greenhouse 2006b). Yet things are actually worse than that. In the US, unemployment rates are artificially low. If a person gets laid off and gets unemployment benefits—which fewer and fewer workers even get—they get a check for six months. If they have not gotten a job by the end of six months—and it is taking longer and longer to get a job—and they have given up searching for work, then not only do they lose their unemployment benefits, but they are no longer counted as unemployed: one doesn't even count in the statistics! According to the then-head of the US Federal Reserve System, Alan Greenspan, “the average duration of unemployment increased from twelve weeks in September 2000 to twenty weeks in March [2004]” (see Shapiro 2004: 4). In March 2004, 354,000 jobs workers had exhausted their unemployment benefits, and were unable to get any additional federal unemployment assistance: Shapiro (2004: 1) notes, “In no other month on record, with data available back to 1971, have there been so many ‘exhaustees’.”

Additionally, although it's rarely reported, unemployment rates vary by racial grouping. No matter what the unemployment rate is, it really only reflects the rate of whites who are unemployed because about 78 per cent of the workforce is white. However, since 1954, the unemployment rate of African-Americans has always been more than twice that of whites, and Latinos are about one and a half times that of whites. So, for example, if the overall rate is five per cent, then it's at least ten per cent for African-Americans and 7.5 per cent for Latinos.

However, most of the developments presented above—other than the racial affects of unemployment—have been relatively recent. What about longer term? Paul Krugman, a Nobel Prize-winning Princeton University economist who writes for *The New York Times*, pointed out these longer term effects: non-supervisory workers make less in real wages today (2006) than they made in 1973! So, after inflation is taken out, non-supervisory workers are making less today in real terms than that their contemporaries made 33 years ago (Krugman 2006b). Figures provided by Stephen Franklin—obtained from the US Bureau of Statistics, and presented in 1982 dollars—show that a production worker in January 1973 earned \$9.08 an hour—and \$8.19 an hour in December 2005 (Franklin 2006). Workers in 2005 also had less long-term job security, fewer benefits, less stable pensions (when they have them), and rising health care costs.⁷

In short, the economic situation for ‘average Americans’ is getting worse. A front-page story in the *Chicago Tribune* tells about a worker who six years ago was making \$29 an hour, working at a nuclear power plant. He got laid off,

and now makes \$12.24 an hour, working on the bottom tier of a two-tiered unionised factory owned by Caterpillar, the multinational earth moving equipment producer, which is less than half of his old wages. The article pointed out, “Glued to a bare bones budget, he saved for weeks to buy a five-pack of \$7 T-shirts” (Franklin 2006). As Foster and Magdoff point out:

Except for a small rise in the late 1990s, real wages have been sluggish for decades. The typical (median-income) family has sought to compensate for this by increasing the number of jobs and working hours per household. Nevertheless, the real (inflation-adjusted) income of the typical household fell for five years in a row through 2004 (Foster and Magdoff 2009: 28).

A report by *Workers Independent News* (WIN) stated that while a majority of metropolitan areas have regained the 2.6 million jobs lost during the first two years of the Bush Administration, “the new jobs on average pay \$9,000 less than the jobs replaced,” a 21 per cent decline from \$43,629 to \$34,378. However, WIN says that “99 out of the 361 metro areas will not recover jobs before 2007 and could be waiting until 2015 before they reach full recovery” (Russell 2006).

At the same time, Americans are going deeper and deeper into debt. At the end of 2000, total US household debt was \$7.008 trillion, with home mortgage debt being \$4.811 trillion and non-mortgage debt \$1.749 trillion; at the end of 2006, comparable numbers were a total of \$12.817 trillion; \$9.705 trillion (doubling since 2000); and \$2.431 trillion (US Federal Reserve 2007-rounding by author). Foster and Magdoff (2009: 29) show that this debt is not only increasing, but based on figures from the Federal Reserve, that debt as a percentage of disposable income has increased overall from 62 per cent in 1975 to 96.8 per cent in 2000, and to 127.2 per cent in 2005.

Three polls from mid-2006 found “deep pessimism among American workers, with most saying that wages were not keeping pace with inflation, and that workers were worse off in many ways than a generation ago” (Greenhouse 2006). And, one might notice, nothing has been said about increasing gas prices, lower home values, etc. The economic situation for most working people is not looking pretty.

In fact, bankruptcy filings totalled 2.043 million in 2005, up 31.6 per cent from 2004 (AP 2006), before gas prices went through the ceiling and housing prices began falling in mid-2006. Yet in 1998, writers for the *Chicago Tribune* had written, “... the number of personal bankruptcy filings skyrocketed 19.5 per cent last year, to an all-time high of 1,335,053, compared with 1,117,470 in 1996” (Schmeltzer and Gruber 1998). And at the same time, there were 37 million Americans in poverty in 2005, one out of every eight. Again, the rates vary by

racial grouping: while 12.6 per cent of all Americans were in poverty, the poverty rate for whites was 8.3 per cent; for African Americans, 24.9 per cent were in poverty, as were 21.8 per cent of all Latinos (what is rarely acknowledged, however, is that 65 per cent of all people in poverty in the US are white.) And 17.6 per cent of all children were in poverty (US Census Bureau 2005).

What about the ‘other half’? This time, Paul Krugman gives details from a report by Ian Dew-Becker and Robert Gordon, titled “Where Did the Productivity Growth Go?.” Krugman writes:

Between 1973 and 2001, the wage and salary income of Americans at the 90th percentile of the income distribution rose only 34 per cent, or about 1 per cent per year. But income at the 99th percentile rose 87 per cent; income at the 99.9th percentile rose 181 per cent; and income at the 99.99th percentile rose 497 per cent. No, that’s not a misprint. Just to give you a sense of who we’re talking about: the nonpartisan Tax Policy Center estimates that this year, the 99th percentile will correspond to an income of \$402,306, and the 99.9th percentile to an income of \$1,672,726. The Center doesn’t give a number for the 99.99th percentile, but it’s probably well over \$6 million a year (Krugman 2006).

But how can we understand what is going on? We need to have a historical approach to understand the significance of the changes reported above.

(2) The US Social Order Since World War II

When considering the US situation, it makes most sense to look at ‘recent’ US developments, those since World War II. Just after the War, in 1947, the US population was about six per cent of the world’s total. Nonetheless, this six per cent produced about 48 per cent of all goods and services in the world!⁸ With Europe and Japan devastated, the US was the only industrialised economy that had not been laid waste. Everybody needed what the US produced—and this country produced the goods, and sent them around the world.

At the same time, the US economy was not only the most productive, but the rise of the industrial union movement in the 1930s and 1940s—the CIO (Congress of Industrial Organisations)—meant that workers had some power to demand a share of the wealth produced. In 1946, just after the war, the US had the largest strike wave in its history: 116,000,000 production days were lost in early 1946, as industry-wide strikes in auto, steel, meat packing, and the electrical industry took place across the United States and Canada, along with smaller strikes in individual firms. Not only that, but there were general strikes

that year in Oakland, California and Stamford, Connecticut. Workers had been held back during the war, but they demonstrated their power immediately thereafter (Lipsitz 1994; Murolo and Chitty 2001). Industry knew that if it wanted the production it could sell, it had to include unionised workers in on the deal. It was this combination—devastated economic markets around the world and great demand for goods and services, the world’s most developed industrial economy, and a militant union movement—that combined to create what is now known as the “great American middle class.”⁹

To understand the economic impact of these factors, changes in income distribution in US society must be examined. The best way to illuminate this is to assemble family data on income or wealth¹⁰—income data is more available, so that will be used; arrange it from the smallest amount to the largest; and then to divide the population into fifths, or quintiles. In other words, arrange every family’s annual income from the lowest to the highest, and divide the total number of family incomes into quintiles or by 20 per cents (i.e., fifths). Then compare changes in the top incomes for each quintile. By doing so, one can then observe changes in income distribution over specified time periods.

The years between 1947 and 1973 are considered the ‘golden years’ of the US society.¹¹ The values are presented in 2005 dollars, so that means that inflation has been taken out: these are *real dollar values*, and that means these are valid comparisons.

Figure 1: US Family Income, in US dollars, Growth and Distribution, by quintile, 1947-1973 compared to 1973-2001, in 2005 Dollars

	Lowest 20%	Second 20%	Third 20%	Fourth 20%	95th Per centile¹²
1947	\$11,758	\$18,973	\$25,728	\$36,506	\$59,916
1973	\$23,144	\$38,188	\$53,282	\$73,275	\$114,234
Difference (26 years)	\$11,386 (97%)	\$19,145 (100%)	\$27,554 (107%)	\$36,769 (101%)	\$54,318 (91%)
1973	\$23,144	\$38,188	\$53,282	\$73,275	\$114,234
2001	\$26,467	\$45,355	\$68,925	\$103,828	\$180,973
Difference (28 years)	\$3,323 (14%)	\$7,167 (19%)	\$15,643 (29%)	\$30,553 (42%)	\$66,739 (58%)

Source: US Commerce Department, Bureau of the Census (hereafter, US Census Bureau) at www.census.gov/hhes/www/income/histinc/f01ar.html. All dollar values converted to 2005 dollars by US Census Bureau, removing inflation and comparing real values. Differences and percentages calculated by author. Percentages shown in both rows labelled “Difference” show the dollar difference as a percentage of the first year of the comparison.

Data for the first period, 1947-1973—the data above the grey line—shows there was *considerable real economic growth for each quintile*. Over the 26-year period, there was approximately 100 per cent real economic growth for the incomes at the top of each quintile, which meant incomes doubled after inflation was removed; thus, there was significant economic growth in the society.

And importantly, *this real economic growth was distributed fairly evenly*. The data in the fourth line (in parentheses) is the percentage relationship between the difference between 1947-1973 real income when compared to the 1947 real income, with 100 per cent representing a doubling of real income: i.e., the *difference* for the bottom quintile between 1947 and 1973 was an increase of \$11,386, which is 97 per cent more than \$11,758 that the top of the quintile had in 1947. As can be seen, other quintiles also saw increases of roughly comparable amounts: in ascending order, 100 per cent, 107 per cent, 101 per cent, and 91 per cent. In other words, the rate of growth by quintile was very similar across all five quintiles of the population. When looking at the figures for 1973-2001, something vastly different can be observed. This is the section *below* the grey line. What can be seen? First, *economic growth has slowed considerably*: the highest rate of growth for any quintile was that of 58 per cent for those who topped the fifth quintile, and this was far below the “lagger” of 91 per cent of the earlier period.

Second, *of what growth there was, it was distributed extremely unequally*. And the growth rates for those in lower quintiles were generally lower than for those above them: for the bottom quintile, their real income grew only 14 per cent over the 1973-2001 period; for the second quintile, 19 per cent; for the third, 29 per cent; for the fourth, 42 per cent; and for the 80-95 per cent, 58 per cent: loosely speaking, the rich are getting richer, and the poor poorer.

Why the change? I think two things in particular. First, as industrialised countries recovered from World War II, corporations based in these countries could again compete with those from the US—first in their own home countries, and then through importing into the US, and then ultimately when they invested in the United States. Think of Toyota: they began importing into the US in the early 1970s, and with their investments here in the early ‘80s and forward, they now are the largest domestic US auto producer. The second cause for the change has been the deterioration of the American labour movement: from 35.3 per cent of the non-agricultural workforce in unions in 1954, to only 12.0 per cent of all American workers in unions in 2006—and only 7.4 per cent of all private industry workers are unionised, which is less than in 1930!

This decline in unionisation has a number of reasons. Part of this deterioration has been the result of government policies—everything from the

crushing of the air traffic controllers when they went on strike by the Reagan Administration in 1981, to reform of labour law, to reactionary appointments to the National Labour Relations Board, which oversees administration of labour law. Certainly a key government policy, signed by Democratic President Bill Clinton, has been the North American Free Trade Act (NAFTA). One analyst came straight to the point:

Since ... [NAFTA] was signed in 1993, the rise in the US trade deficit with Canada and Mexico through 2002 has caused the displacement of production that supported 879,280 US jobs. Most of these lost jobs were high-wage positions in manufacturing industries. The loss of these jobs is just the most visible tip of NAFTA's impact on the US economy. In fact, NAFTA has also contributed to rising income inequality, suppressed real wages for production workers, weakened workers' collective bargaining powers and ability to organize unions, and reduced fringe benefits (Scott 2003: 1).

These attacks by elected officials have been joined by the effects due to the restructuring of the economy. There has been a shift from manufacturing to services. However, within manufacturing, which has long been a union stronghold, there has been significant job loss: between July 2000 and January 2004, the US lost three million manufacturing jobs, or 17.5 per cent, and 5.2 million since the historical peak in 1979, so that "Employment in manufacturing [in January 2004] was its lowest since July 1950" (CBO 2004). This is due to both outsourcing labour-intensive production overseas and, more importantly, technological displacement as new technology has enabled greater production at higher quality with fewer workers in capital-intensive production (Fisher 2004). Others have blamed burgeoning trade deficits for the rise: "... an increasing share of domestic demand for manufacturing output is satisfied by foreign rather than domestic producers" (Bivens 2005).¹³ Others have even attributed it to changes in consumer preferences (Schweitzer and Zaman 2006). Whatever the reason, of the 50 states, only five (Nevada, North Dakota, Oregon, Utah, and Wyoming) did not see any job loss in manufacturing between 1993-2003, yet 37 lost between 5.6 and 35.9 per cent of their manufacturing jobs during this period (Public Policy Institute 2004).

However, part of the credit for deterioration of the labour movement must be given to the labour movement itself: the leadership has been simply unable to confront these changes and, at the same time, they have consistently worked against any independent action by rank-and-file members.¹⁴ However, it must be asked: are the changes in the economy presented herein merely statistical manipulations, or is this indicating something real?

This point can be illustrated another way: by using CAGR, the Compound Annual Growth Rate. This is a single number that is computed, based on compounded amounts, across a range of years, to come up with an average number to represent the rate of increase or decrease each year across the entire period. This looks pretty complex, but it is based on the same idea as compound interest used in our savings accounts: you put in \$10 today and (this is obviously not a real example) because you get ten per cent interest, so you have \$11 the next year. Well, the following year, interest is not computed off the original \$10, but is computed on the \$11. So, by the third year, from your \$10, you now have \$12.10. And this is what is meant by the Compound Annual Growth Rate: this is average compound growth by year across a designated period.

Based on the numbers presented above in Figure 1, the author calculated the Compound Annual Growth Rate by quintiles (Figure 2). The annual growth rate has been calculated for the first period, 1947-1973, the years known as the 'golden years' of US society. What has happened since then? Compare results from the 1947-73 period to the annual growth rate across the second period, 1973-2001, again calculated by the author.

Figure 2: Annual percentage of family income growth, by quintile, 1947-1973 compared to 1973-2001

Population by quintiles	1947-1973	1973-2001
95th Percentile	2.51%	1.66%
Fourth quintile	2.72%	1.25%
Third quintile	2.84%	.92%
Second quintile	2.73%	.62%
Lowest quintile	2.64%	.48%

Source: Calculated by author from the data provided by the US Census Bureau at www.census.gov/hhes/www/income/histinc/f01ar.html.

What we can see here is that while everyone's income was growing at about the same rate in the first period—between 2.51 and 2.84 per cent annually—by the second period, not only had growth slowed down across the board, but it grew by very different rates: what we see here, again, is that the rich are getting richer, and the poor poorer. If these figures are correct, a change over time in the percentage of income received by each quintile should be observable. Ideally, if the society were egalitarian, each 20 per cent of the population would get 20 per cent of the income in any one year. In reality, it differs. To understand Figure 3, below, one must not only look at the percentage of income held by a quintile across the chart, comparing selected year by selected year, but one

needs to look to see whether a quintile's share of income is moving toward or away from the ideal 20 per cent.

Figure 3: Percentage of family income distribution by quintile, 1947, 1973, 2001.

Population by quintiles	1947	1973	2001
Top fifth (lower limit of top 5per cent, or 95th Percentile) — \$184,500 ¹⁵	43.0%	41.1%	47.7%
Second fifth—\$103,100	23.1%	24.0%	22.9%
Third fifth—\$68,304	17.0%	17.5%	15.4%
Fourth fifth—\$45,021	11.9%	11.9%	9.7%
Bottom fifth—\$25,616	5.0%	5.5%	4.2%

(Source: U.S. Census Bureau at www.census.gov/hhes/www/income/histinc/f02ar.html.)

Unfortunately, much of the data available publicly ended in 2001. However, in the summer of 2007, after years of not releasing data any later than 2001, the Census Bureau released income data up to 2005. It allows us to examine what has taken place regarding family income inequality during the first four years of the Bush Administration.

Figure 4: US Family Income, in US dollars, Growth and Distribution, by quintile, 2001-2005, 2005 Dollars

	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Lowest level of top 5%
2001	\$26,467	\$45,855	\$68,925	\$103,828	\$180,973
2005	\$25,616	\$45,021	\$68,304	\$103,100	\$184,500
Difference (4 years)	-\$851 (-3.2%)	-\$834 (-1.8%)	-\$621 (-.01%)	-\$728 (-.007%)	\$3,527 (1.94%)

Source: US Census Bureau at www.census.gov/hhes/www/income/histinc/f01ar.html. (Over time, the Census Bureau refigures these amounts, so they have subsequently converted amounts to 2006 dollar values. These values are from their 2005 dollar values, and were calculated by the Census Bureau.) Differences and percentages calculated by author.

Thus, what we have seen under the first four years of the Bush Administration is that for at most Americans, their economic situation has worsened: not only has over all economic growth for any quintile slowed to a minuscule 1.94 per cent at the most, but that the bottom 80 per cent actually lost income; losing money (an absolute loss), rather than growing a little but falling

further behind the top quintile (a relative loss). Further, the decrease across the bottom four quintiles has been suffered disproportionately by those in the lowest 40 per cent of the society. This can perhaps be seen more clearly by examining CAGR rates by period.

We can now add the results of the 2001-2005 period share of income by quintile to our earlier chart:

Figure 5: Percentage of income growth per year by percentile, 1947-2005

Population by quintiles	1947-1973	1973-2001	2001-2005
Top 95 percentile	2.51%	1.66%	.48%
Fourth fifth	2.72%	1.25%	-.18%
Third fifth	2.84%	.92%	-.23%
Second fifth	2.73%	.62%	-.46%
Bottom fifth	2.64%	.48%	-.81%

Source: Calculated by author from data gathered from the US Department of the Census www.census.gov/hhes/www/income/histinc/f01ar.html.

As can be seen, the percentage of family income at each of the four bottom quintiles is less in 2005 than in 1947; the only place there has been improvement over this 58-year period is at the 95th percentile (and above).

Figure 6: Percentage of family income distribution by quintile, 1947, 1973, 2001, and 2005.

Population by quintiles	1947	1973	2001	2005
Top fifth (lower limit of top 5 per cent, or 95th Percentile) — \$184,500	43.0%	41.1%	47.7%	48.1%
Second fifth—\$103,100	23.1%	24.0%	22.9%	22.9%
Third fifth—\$68,304	17.0%	17.5%	15.4%	15.3%
Fourth fifth—\$45,021	11.9%	11.9%	9.7%	9.6%
Bottom fifth—\$25,616	5.0%	5.5%	4.2%	4.0%

Source: U.S. Census Bureau at www.census.gov/hhes/www/income/histinc/f02ar.html.

What has been presented so far, regarding changes in income distribution, has been at the group level; in this case, quintile by quintile. It is time now to see how this has affected the society overall. Sociologists and economists use a number called the Gini index to measure inequality. Family income data have

been used so far, and we will continue using it. A Gini index is fairly simple to use. It measures inequality in a society. A Gini index is generally reported in a range between 0.000 and 1.000, and is written in thousandths, just like a winning percentage mark: three digits after the decimal. And *the higher the Gini score, the greater the inequality*.

Looking at the Gini index, we can see two periods since 1947, when the US Government began computing the Gini index for the country. From 1947-1968, with yearly change greater or smaller, the trend is downward, indicating reduced inequality: from .376 in 1947 to .378 in 1950, but then downward to .348 in 1968. So, again, over the first period, the trend is downward. What has happened since then? From the low point in 1968 of .348, the trend has been upward. In 1982, the Gini index hit .380, which was higher than any single year between 1947-1968, and the US has never gone below .380 since then. By 1992, it hit .403, and we've never gone back below: .400. In 2001, the US hit .435. But the score for 2005 has only recently been published: .440.¹⁶ So, the trend is getting worse, and with the policies established under George W. Bush, I see them only continuing to increase in the forthcoming period [And by the way, this increasing trend has continued under both the Republicans and the Democrats, but since the Republicans have controlled the presidency for 18 of the last 26 years (since 1981), they get most of the credit—but let's not forget that the Democrats have controlled Congress across many of those years, so they, too, have been an equal opportunity destroyer!]

However, one more question must be asked: how does this income inequality in the US, compared to other countries around the world? Is the level of income inequality comparable to other “developed” societies, or is it comparable to “developing” countries? We must turn to the US Central Intelligence Agency (CIA) for our data. The CIA computes Gini scores for family income on most of the countries around the world, and the last time checked in 2007 (August 1), they had data on 122 countries on their web page and these numbers had last been updated on 19 July 2007 (US Central Intelligence Agency 2007). With each country listed, there is a Gini score provided.¹⁷ Now, the CIA does not compute Gini scores yearly, but they give the last year it was computed, so these are not exactly equivalent but they are suggestive enough to use. However, when they do assemble these Gini scores in one place, they list them alphabetically, which is not of much comparative use (US Central Intelligence Agency 2007).

However, the World Bank categorises countries, which means they can be compared within category and across categories. The World Bank, which does not provide Gini scores, puts 208 countries into one of four categories based on

Gross National Income per capita—that's total value of goods and services sold in the market in a year, divided by population size. This is a useful statistic, because it allows us to compare societies with economies of vastly different size: per capita income removes the size differences between countries. The World Bank locates each country into one of four categories: lower income, lower middle income, upper middle income, and high income (World Bank 2007a). Basically, those in the lower three categories are 'developing' or what we used to call 'third world' countries, while the high income countries are all of the so-called developed countries.

The countries listed by the CIA with their respective Gini scores were placed into the specific World Bank categories in which the World Bank had previously located them (World Bank 2007b). Once grouped in their categories, median Gini scores were computed for each group. When trying to get one number to represent a group of numbers, median is considered more accurate than an average, so the median was used, which means half of the scores are higher, half are lower—in other words, the data is at the 50th percentile for each category. The Gini score for countries, by Gross National Income per capita, categorised by the World Bank:

Figure 7: Median Gini Scores by World Bank income categories

Income category	Median Gini score	Gini score, US (2004)
Low income countries (less than \$875/person/year)	.406	.450
Lower-middle income countries (between \$876-3,465/ person/year)	.414	.450
Upper-middle income countries (between \$3,466-10,725/person/year)	.370	.450
Upper-income countries (over \$10,726/person/year)	.316	.450

(Countries selected by US Central Intelligence Agency were placed in categories developed by the World Bank) and compared to 2004 US Gini score as calculated by US Central Intelligence Agency (CIA).

As can be seen, with the (CIA-calculated) Gini score of .450, *the US family income is more unequal than the medians for each category*, and is more unequal than some of the poorest countries on earth, such as Bangladesh (.318—calculated in 2000), Cambodia (.400, 2004 est.), Laos (.370-1997), Mozambique (.396, 1996-97), Uganda (.430-1999) and Vietnam (.361, 1998). This same finding

also holds true using the more conservative Census Bureau-calculated Gini score of .440.

Thus, the US has not only become more unequal over the 35 years, as has been demonstrated above, but has attained a level of inequality that is much more comparable to those of developing countries in general and, in fact, is more unequal today than some of the poorest countries on earth. There is nothing suggesting that this increasing inequality will lessen anytime soon. And since this increasing income inequality has taken place under the leadership of both major political parties, there is nothing on the horizon that suggests either will resolutely address this issue in the foreseeable future regardless of campaign promises made. However, to move beyond discussion of whether President Obama is likely to address these and related issues, some consideration of governmental economic policies is required. Thus, he will be constrained by decisions made by previous administrations, as well as by the ideological blinders worn by those he has chosen to serve at the top levels of his administration.

3) Governmental Economic Policies

There are two key points that are especially important for our consideration: the US Budget and the US National Debt. They are similar, but different—and consideration of each of them enhances understanding.

A) US Budget. Every year, the US Government passes a budget, whereby governmental officials estimate beforehand how much money needs to be taken into cover all expenses. If the government actually takes in more money than it spends, the budget is said to have a surplus; if it takes in less than it spends, the budget is said to be in deficit.

Since 1970, when Richard Nixon was President, the US budget has been in deficit *every year* except for the last four years under Clinton (1998-2001), where there was a surplus. But this surplus began declining under Clinton—it was \$236.2 billion in 2000, and only \$128.2 billion in 2001, Clinton's last budget. Under Bush, the US has gone drastically into deficit: -\$157.8 billion in 2002; -\$377.6 billion in 2003; -\$412.7 billion in 2004; -\$318.3 billion in 2005; and “only” -\$248.2 billion in 2006 (Economic Report of the President 2007: Table B-78). Now, that is just yearly surpluses and deficits. They get combined with all the other surpluses and deficits since the US became a country in 1789 to create a cumulative amount, what is called the National Debt.

B) US National Debt. Between 1789 and 1980—from Presidents Washington through Carter—the accumulated US National Debt was \$909 billion or, to put it another way, \$.909 trillion. During Ronald Reagan's presidency (1981-89), the National Debt tripled, from \$.9 trillion to \$2.868

trillion. It has continued to rise. As of the end of 2006, 17 years later and after a four-year period of surpluses where the debt was somewhat reduced, National Debt (or Gross Federal Debt) was \$8.451 trillion (Economic Report of the President 2007: Table B-78). To put it into context: the US economy, the most productive in the world, had a Gross Domestic Product (GDP) of \$13.061 trillion in 2006, but the National Debt was \$8.451 trillion—64.7 per cent of GDP—and growing (Economic Report of the President 2007: Table B-1). In April 2006, one investor reported that “the US Treasury has a hair under \$8.4 trillion in outstanding debt. How much is that? He put it into this context: “... if you deposited one million dollars into a bank account every day, starting 2006 years ago, that you would not even have ONE trillion dollars in that account” (Van Eeden 2006).

Let’s return to the budget deficit: like a family budget, when one spends more than one brings in, they can do basically one of three things: (a) they can cut spending; (b) they can increase taxes (or obviously a combination of the two); or (c) they can take what I call the ‘Wimpy’ approach. For those who might not know this, Wimpy was a cartoon character, a partner of “Popeye the Sailor,” a Saturday morning cartoon that was played for over 30 years in the United States. Wimpy had a great love for hamburgers. And his approach to life was summed up in his rap: “I’ll gladly give you two hamburgers on Tuesday, for a hamburger today.”

What is argued is that the US Government has been taking what I call the Wimpy approach to its budgetary problems: it does not reduce spending, it does not raise taxes to pay for the increased expenditures—in fact, President Bush cut taxes for the wealthiest Americans¹⁸—but instead it sold US Government securities, often known as Treasuries, to rich investors, private corporations or, increasingly, to other countries to cover the budget deficit. In a set number of years, the US Government agrees to pay off each bond—and the difference between what the purchaser bought them for and the increased amount the US Government pays to redeem them is the cost of financing the Treasuries, a certain percentage of the total value. By buying US Treasuries, other countries have helped keep US interest rates low, helping to keep the US economy in as good of shape as it has been (thus, keeping the US market flourishing for them), while allowing the US Government not to have to confront its annual deficits. At the end of 2006, the total value of outstanding Treasuries—to all investors, not just other countries—was \$8.507 trillion (Economic Report of the President 2007: Table B-87). It turns out that at in December 2004, foreigners owned approximately 61 per cent of all outstanding US Treasuries. Of that, seven per cent was held by China; these were valued at \$223 billion (Gundzik 2005).

The percentage of foreign and international investors' purchases of the total US public debt since 1996 has never been less than 17.7 per cent, and it has reached a high of 25.08 per cent in September 2006. In September 2006, foreigners purchased \$2.134 trillion of Treasuries; these were 25.08 per cent of all purchases, and 52.4 per cent of all privately-owned purchases (Economic Report of the President, 2007: Table B-89).¹⁹ Altogether, "the world now holds financial claims amounting to \$3.5 trillion against the United States, or 26 per cent of our GDP" (Humpage and Shenk 2007: 4).

Since the US Government continues to run deficits, because the Bush Administration has refused to address this problem, the United States has become dependent on other countries buying Treasuries. Like a junky on heroin, the US *must* get other investors (increasingly countries) to finance its budgetary deficits. To keep the money flowing in, the US must keep interest rates high—basically, interest rates are the price that must be paid to borrow money. Over the past year or so, the Federal Reserve has not raised interest rates, but prior to that, for 15 straight quarterly meetings, they did. And, as known, the higher the interest rate, the mostly costly it is to borrow money domestically, which means increasingly likelihood of recession—if not worse. In other words, dependence on foreigners to finance the substantial US budget deficits means that the US must be prepared to raise interests rates which, at some point, will choke off domestic borrowing and consumption, throwing the US economy into recession.²⁰

Yet this threat is not just to the United States—according to the International Monetary Fund (IMF), it is a threat to the global economy. A story about a then-recently issued report by the IMF begins, "With its rising budget deficit and ballooning trade imbalance, the United States is running up a foreign debt of such record-breaking proportions that it threatens the financial stability of the global economy...." The report suggested that net financial obligations of the US to the rest of the world could equal 40 per cent of its total economy if nothing was done about it in a few years, "an unprecedented level of external debt for a larger industrial country" according to the report. What was perhaps even more shocking than what the report said was which institution said it: "The IMF has often been accused of being an adjunct of the United States, its largest shareholder" (Becker and Andrews 2004).

Other analysts go further. After discussing the increasingly risky nature of global investing, and noting that "The investor managers of private equity funds and major banks have displaced national banks and international bodies such as the IMF," Gabriel Kolko (2007) quotes Stephen Roach, Morgan Stanley's chief economist, on 24 April 2007: "a major financial crisis seemed imminent and that the global institutions that could forestall it, including the IMF, the

World Bank and other mechanisms of the international financial architecture, were utterly inadequate.” Kolko recognises that things may not collapse immediately, and that analysts could be wrong, but still concludes, “the transformation of the global financial system will sooner or later lead to dire results” (Kolko 2007: 5).

What might happen if investors decided to take their money out of US Treasuries and, say, invest in Euro-based bonds? The US would be in *big* trouble, would be forced to raise its interest rates even higher than it wants—leading to possibly a severe recession—and if investors really shifted their money, the US could be observably bankrupt; the curtain hiding the “little man” would be opened, and he would be observable to all.

Why would investors rather shift their investment money into Euro-bonds instead of US Treasuries? Well, obviously, one measure is the perceived strength of the US economy. To get a good idea of how solid a country’s economy is, one looks at things such as budget deficits, but perhaps even more importantly balance of trade: how well is this economy doing in comparison with other countries?

The US international balance of trade is *in the red and is worsening*: \$717 billion in 2005. In 1991, it was \$31 billion. Since 1998, the US trade balance has set a new record for being in the hole every year, except during 2001, *and then breaking the all time high the very next year!* \$165 B in 1998; \$263 B in 1999; \$378 B in 2000; only \$362 B in 2001; \$421 B in 2002; \$494 B in 2003; \$617 B in 2004; and \$717 B in 2005 (Economic Report of the President 2007: Table B-103). According to the Census Department, the balance of trade in 2006 was -\$759 billion (US Census Bureau 2007).

And the US current account balance, the broadest measure of a country’s international financial situation—which includes investment inside and outside the US in addition to balance of trade—is even worse: it was -\$805 B in 2005, or 6.4 per cent of national income. “The bottom line is that a current account deficit of this unparalleled magnitude is unsustainable and there is no hope of it being painlessly resolved through higher exports alone,” according to one analyst (quoted in Swann 2006). Scott notes that the current account deficit in 2006 was -\$857 billion (Scott 2007 8, fn. 1). “In effect, the United States is living beyond its means and selling off national assets to pay its bills” (Scott 2007b: 1).²¹

In addition, during mid-2007, there was a bursting of a domestic “housing bubble,” which has threatened domestic economic well-being but that ultimately threatens the well-being of global financial markets. There had been a tremendous run-up in US housing values since 1995—with an increase of more than 70 per cent after adjusting for the rate of inflation—and this had created

“more than \$8 trillion in housing wealth compared with a scenario in which house prices had continued to rise at the same rate of inflation,” which they had done for over 100 years, between 1890 and 1995 (Baker 2007: 8).

This led to a massive oversupply of housing, accompanied with falling house prices: according to Dean Baker, “the peak inventory of unsold new homes of 573,000 in July 2006 was more than 50 per cent higher than the previous peak of 377,000 in May of 1989” (Baker 2007: 12-13). This caused massive problems in the sub-prime housing market—estimates are that almost \$2 trillion in sub-prime loans were made during 2005-06, and that about \$325 billion of these loans will default, with more than 1 million people losing their homes (Liedtke 2007)—but these problems are not confined to the sub-prime loan category: because sub-prime and “Alt-A” mortgages (the category immediately above sub-prime) financed 40 per cent of the housing market in 2006, “it is almost inevitable that the problems will spill over into the rest of the market” (Baker 2007: 15). And *Business Week* agrees: “Subprime woes have moved far beyond the mortgage industry.” It notes that at least five hedge funds have gone out of business, corporate loans and junk bonds have been hurt, and the leveraged buyout market has been hurt (Goldstein and Henry 2007).

David Leonhardt (2007) agrees with the continuing threat to the financial industry. Discussing “adjustable rate mortgages”—where interest rates start out low, but reset to higher rates, resulting in higher mortgage payments to the borrower—he points out that about \$50 billion of mortgages will reset during October 2007, and that this amount of resetting will remain over \$30 billion monthly through September 2008. “In all,” he writes, “the interest rates on about \$1 trillion worth of mortgages or 12 per cent of the nation’s total, will reset for the first time this year or next.”

Why all of this is so important is because bankers have gotten incredibly “creative” in creating new mortgages, which they sell to home buyers. Then they bundle these obligations and sell to other financial institutions and which, in turn, create new securities (called derivatives) based on these questionable new mortgages. Yes, it is basically a legal ponzi scheme, but it requires the continuous selling and buying of these derivatives to keep working: in early August 2007, however, liquidity—especially “financial instruments backed by home mortgages”—dried up, as no one wanted to buy these instruments (Krugman 2007). The US Federal Reserve and the European Central Bank felt it necessary to pump over \$100 billion into the financial markets in mid-August 2007 to keep the international economy solvent (Norris 2007).

So, economically, this country is in terrible shape—with no solution in sight. On top of this—as if all of this is not bad enough—the Bush Administration

was asking for another \$481.4 billion for the Pentagon's base budget, which it noted was "a 62 per cent increase over 2001." Further, the Administration sought an additional \$93.4 billion in supplemental funds for 2007 and another \$141.7 billion for 2008 to help fund the "Global War on Terror" and US operations in Iraq and Afghanistan (US Government 2007). According to Stockholm International Peace Research Institute (SIPRI), in 2006, the US defence spending was equivalent to 46 per cent of all military spending in the world, meaning that almost more money was provided for the US military in one year than was spent by the militaries of all the other countries in the world *combined* (SIPRI 2007). And SIPRI's accounting doesn't include the \$500 billion spent so far, approximately, on wars in Afghanistan and Iraq.

In short, not only have things gotten worse for American working people since 1973—and especially after 1982, with the imposition of neoliberal economic policies by institutions of the US Government—but ongoing Federal budget deficits, the escalating National Debt, the need to attract foreign money into US Treasuries, the financial market "meltdown" as well as the massive amounts of money being channelled to continue the empire, all suggest that not only will intensifying social problems not be addressed, but will get worse for the foreseeable future.

4) Synopsis

This analysis provides an extensive look at the impact of neoliberal economic policies enacted in the United States on American working people. These neoliberal economic policies have been enacted as a conscious strategy by US corporate leaders and their governmental allies in both major political parties as a way to address intensifying globalisation while seeking to maintain US dominance over the global political economy.

While it will be a while before anyone can determine success or failure overall of this elite strategy but, because of its global-historical perspective, sufficient evidence is already available to evaluate the affects of these policies on American working people. For the non-elites of this country, these policies have had a deleterious impact and they are getting worse. Employment data in manufacturing, worsening since 1979 but especially since 2000 (Aronowitz 2005), has been horrific—and since this has been the traditional path for non-college educated workers to be able to support themselves and their families, and provide for their children, this data suggests social catastrophe for many—see Rubin (1995), Barnes (2005), and Bageant (2007), and accounts in Finnegan (1998) and Lipper (2004) that support this—because comparable jobs available to these workers are not being created. Thus, the problem is not just that people

are losing previously stable, good-paying jobs—as bad as that is—but that there is nothing being created to replace these lost jobs, and there is not even a social safety net in many cases that can generally cushion the blow (Wilson 1996; Appelbaum, Bernhardt, and Murnane 2003).

Yet the impact of these social changes has not been limited to only blue-collar workers, although the impact has been arguably greatest upon them. The overall economic growth of the society has been so limited since 1973, and the results increasingly being unequally distributed since then, that the entire society is becoming more and more unequal: each of the four bottom quintiles—the bottom 80 per cent of families—has seen a decrease in the amount of family income available to each quintile between 2001-05. This not only increases inequality and resulting resentments—including criminal behaviours—but it also produces deleterious effects on individual and social health (Kawachi, Kennedy and Wilkinson 1999; Eitzen and Eitzen Smith 2003). And, as shown above, this level of inequality is much more comparable internationally to ‘developing’ countries rather than ‘developed’ ones.

When this material is joined with material on the US budget, and especially the US National Debt, it is clear that these “problems” are not the product of individual failure, but of a social order that is increasingly unsustainable. While we have no idea of what it will take before the US economy will implode, all indications are that US elites are speeding up a run-away train of debt combined with job-destroying technology and off-shoring production, creating a worsening balance of trade with the rest of the world and a worsening current account, with an unstable housing market and intensifying militarism and an increasingly antagonistic foreign policy: it is like they are building a bridge over an abyss, with a train increasingly speeding up as it travels toward the bridge, and crucial indicators suggest that the bridge cannot be completed in time.

Whether the American public will notice and demand a radical change in time is not certain—it will not be enough to simply slow the train down, but it must turn down an alternative track (Albert 2003; Woodin and Lucas 2004; Starr 2005)—but it is almost certain that foreign investors will. Should they not be able to get the interest rates here available elsewhere in the ‘developed’ parts of the world, investors will shift their investments, causing more damage to working people in the United States. And when this economic-focused analysis is joined with an environmental one—George Monbiot (2007) reports that the best science available argues that industrialised countries have to reduce their carbon dioxide emissions by 90 per cent by the year 2030 if we are to have a chance to stop global warming—then it is clear that US society is facing a period of serious social instability.

5) Conclusion

This article has argued that the situation for working people in the United States, propelled by the general governmental adoption of neoliberal economic policies, is getting worse—and there is no end in sight. The current situation and historical change have been presented and discussed. Further, an examination and analysis of directly relevant US economic policies have been presented, and there has been nothing in this analysis that suggests a radical, but necessary, change by US elected officials is in sight. In other words, working people in this country are in bad shape generally—and it is worse for workers of colour than for white workers—and there is nothing within the established social order that suggests needed changes will be effected.

The neoliberal economic policies enacted by US corporate and government leaders have been a social disaster for increasing numbers of families in the United States. Globalisation for profit—or what could be better claimed to be “globalisation from above”—and its resulting neoliberal economic policies have long-been recognised as being a disaster for most countries in the Global South. This study argues that this top-down globalisation and the accompanying neoliberal economic policies have been a disaster for working people in northern countries as well, and most particularly in the United States. The political implications from these findings remain to be seen. Surely, one argument is not only that another world is possible, but that it is essential.

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Notes

- 1 By “northern” country, I use this term to refer collectively to the industrialised countries of the United States, Canada, Western Europe, Australia and New Zealand, and Japan. Although this paper was initially written during 2007 to address the larger issue of the effects of neoliberal economic policies on the United States, it also serves as a “snapshot” of economic conditions in this country just before the escalating economic crisis that has been considered as beginning in 2007. Accordingly, with only a few minor exceptions, I have not updated the data beyond 2006, even when available, so as to not “confuse” the analysis: unless specifically noted, the findings herein, are a result of the political-economic policies adopted by governmental and business leaders *prior* to the financial crisis, and thus cannot be attributed to the crisis.
- 2 Joe Bageant (2007) provides an in-depth look at individual, non-unionised white workers in and around Winchester, Virginia, and the impact of changes on these people and their families. While he shows they are very aware of how things are generally worsening for themselves and others in the region, Bageant also shows that they have little to no accurate understanding of what is causing these problems.

This author's experiences—growing up (at time in poverty) and serving as an enlistee in the US Marine Corps (1969-73), following with over 30 years experience as an activist in working class communities of all colors, working in and around the US labor movement, and living in a number of areas around the United States—and his academic training confirm this. See also, for example, William Finnegan (1998), Eitzen and Eitzen Smith 2003), Lipper (2004) and Barnes (2005).

- 3 For an interesting and vivid account of the struggles of low-waged workers—albeit written by an upper middle class professional journalist who took a series of low-waged jobs on an assignment—see Ehrenreich (2001).
- 4 Author's calculation of data from the "Economic Report of the President, 2007" (last updated 12 February 2007) shows 10.7 per cent of the total workforce employed in manufacturing (Economic Report of the President 2007, Table B-46).
- 5 These were not all in the manufacturing sector, although most were. Exact data has not been found.
- 6 In the US, because there is no national health service, health insurance is generally only provided through employment. Approximately 47 million Americans, 16.1 per cent of the population, had no health insurance in 2005. The number uninsured rose by 1.3 million between 2004-05, and almost 7 million between 2000 and 2005. "The per centage of people (workers and dependents) with employment-based health insurance has dropped by 70 per cent in 1987 to 59.5 per cent in 2005. This is the lowest level of employment-based health insurance coverage in more than a decade... (National Coalition on Health Care 2007: 1).
- 7 An Issue Brief" from the Democratic Party members serving on the Committee on Ways and Means in the US House of Representatives, dated October 21, 2003, pointed out that "the US economy has lost 2.7 million jobs since March 2001." They made the point that "This has been the longest period of declining employment since the Great Depression," and presented a chart (#2) that showed "The Change in Private Employment, Two Years After the Recession Began." The chart shows the decline of 2.8 per cent in private employment during the recession beginning in 2001—the closest figures from a comparable period was after the beginning of the 1973 recession, when private employment declined 1.7 per cent (US Ways and Means Committee Democrats 2003).
- 8 If this figure had reached 50 per cent, it would have meant that the US would have produced goods and services equal in value to those produced by all the other countries in the world *combined!* Still, 48 per cent is pretty impressive.
- 9 To better understand the US social situation, following Metzgar (2000), I delineate between the "professional" middle class—generally college educated and often employed as professionals such as doctors and lawyers, etc., as well as in management—and the "working" middle class, traditionally skilled workers and members of industrial unions in industries such as coal, steel, auto, meat packing, etc. While the post World War II economic expansion increased both parts of the middle class, it was the working part of the middle class that expanded so greatly, making a "middle class" lifestyle—including owning a boat and/or cottage on the lake, or a cabin in the woods, along with the ability to provide a college education

for their children—a reality for so many unionized industrial workers and their families. Metzgar (2000) is particular good for illuminating these processes especially during the 1950s-early '60s, including their contradictions, among working families.

- 10 Social scientists distinguish between “income” and “wealth.” Income is that what you receive in a year, from wages, salaries, and/or transfer payments (“welfare,” unemployment, alimony), etc. Wealth is what one owns, and can be passed down inter-generationally, such as a house to children. Income, while unequal as shown herein, in much less unequal than wealth, which is very skewed. “In the United States, the top 1 per cent of wealth holders in 2001 together owned more than twice as much as the bottom 80 per cent of the population. If this were measured simply in terms of financial wealth, i.e., excluding equity in owner-occupied housing, the top 1 per cent owned more than four times the bottom 80 per cent” (Foster and Magdoff 2009: 130). In other words, by focusing herein on family incomes, I am taking a more conservative approach than had I focused on wealth.
- 11 The elites in this country, and the mainstream media they control, see the 1947-73 period as being the norm for US society, and just see the economic changes since then as being cyclic—they assume, if they give it any thought at all, that US society will return to these days—sometime. As I argued 25 years ago (Scipes 1984), the economic changes are “structural” and conditions will generally get worse for a growing number of US workers. Developments presented in this paper suggest that so far, the analysis by myself and those who have taken a critical approach to the status quo have been the more correct of the two.
- 12 For some strange reason, the US Government does not want people to know the situation for the top five per cent of the population; accordingly, they only give data up to the 95th per centile. So while I refer to this as the top “quintile,” in reality it only covers from the 80-95th per centiles.
- 13 Bivens does not consider the origins of such foreign production: it is foreign-owned, or is it US-owned, but located overseas? As trade is becoming more capital intensive, even from “cheap labor” sites such as China, it looks to be more and more US-owned. If this speculation is correct, it would mean that US manufacturers are locating overseas—away from US workers and their unions—yet exporting back to the US to take advantage of the prices found within US markets. Thus, they get foreign wage costs with US consumption patterns and prices—a nice way to increase profits, yet with worsening consequences for American workers.

Note that in its 8 June 2006 Section 301 Petition Against the Chinese Government, the AFL-CIO includes the following: “Foreign direct investment (FDI) to China increased from \$46.8 billion in 2000 to \$60.3 billion in 2005—or \$100 billion including Hong Kong. Seventy per cent of China’s FDI is in manufacturing, with heavy concentrations in export-oriented companies and advanced technology centres. Contract (future) FDI projections are more than double the actual level today, with *US-based firms leading the way* (emphasis added) (AFL-CIO, 2006a: 4). The AFL-CIO also quotes the vice chairman of the US-China Economic and Security Review Commission, who stated, we are witnessing “the actual transfer

of US national manufacturing capacity [to China] and the export back of the goods” (AFL-CIO 2006a: 1).

According to statistics provided by the US-China Business Council (2006), the amount of FDI in China in \$US billions contracted by US firms between 1995-2004 was as follows: 1995: \$7.47; 1996: \$6.92; 1997: \$4.94; 1998: \$6.48; 1999: \$6.02; 2000: \$8.00; 2001: \$7.51; 2002: \$8.20; 2003: \$10.16; and 2004: \$12.17. The total came to \$77.87 billion. The amount of contracted FDI by US firms as a percentage of total FDI in China by year ranged over the 1995-2004 time-period from a low of 7.93 per cent to a high of 14.59 per cent.

In other words, trade with China *has* costs jobs in the United States—for an excellent analysis see Scott, 2007a—as the AFL-CIO and the Economic Policy Institute have claimed repeatedly. However, both organisations blame the Chinese government for unfairly trading with the US. I argue that my 2006 reasoning is more compelling (Scipes 2006a): it is the decisions by US-based multinational corporations and their governmental supporters to transfer production to China—both getting way from US unions and obtaining much lower wage rates—that is responsible for these massive job losses, not the Chinese government.

14. It is impossible to cover the literature on conditions within the US labour movement and efforts to change it with a couple of citations: the range is extensive, and much of it is of high quality. For the most extensive listing of references that I know of, organised by subject, is Kim Scipes’ “Contemporary Labor Issues” bibliography, which is on-line at <http://faculty.pnc.edu/kscipes/LaborBib.htm>. This, incidentally, is updated fairly regularly, and when possible, links are provided to articles on line. Some of the better books include Goldfield (1987) on the decline of the US labor movement; Tillman and Cummings, eds. (1999) on grassroots efforts to change the labour movement for the better; Luce (2004) for expanding the conceptualisation of labor to include the fight for a “living wage”; Rose (2000) and Clawson (2003) for building coalitions with organisations not usually considered in the labour movement; Turner, Katz and Hurd, eds. (2001) and Milkman and Voss, eds. (2004) for collections of articles on rebuilding and rethinking the labour movement; Lopez (2004) for an in-depth study of efforts to reform SEIU (Service Employees International Union) local unions in the Pittsburgh, Pennsylvania area; and Fletcher and Gapasin (2008) for an examination of the labour movement after the 2005 split and the emergence of the Change to Win labour center. An earlier collection that brought together research on union strategies, and is still valuable, is Bronfenbrenner, Friedman, Hurt, Oswald, and Seeber, eds. (1998).
15. The dollar values provided are the top level for each quintile in 2005 dollars, except for the top quintile, which is artificially ended by the government at the 95th per centile. This is obtained from www.census.gov/hhes/www/income/histinc/f01ar.html.) This amount can be translated into current dollars for any year from 1800 to 2008 by use of “The Inflation Calculator” at www.westegg.com/inflation/.
16. On 19 April 2009, as I was preparing this article, I double-checked this chart. They have a score of .440 for 2005, as reported. However, they have a Gini score of .444 for 2006, which is plausible, but they have a Gini score for 2007 as .432, which is

totally implausible and must be seen as a mistake. Historical Income Tables-Families, Table F-4.

- 17 When the CIA presents Gini scores, it writes them with only one digit to the right of the decimal. Thus, the US Gini score in 2004 is presented as 45.0. Their scores have been converted by this author to the usual style of presentation, .450. Note that the CIA's 2004 measure of inequality (Gini score) in the United States is .450, while the Census Bureau's measure in 2007—based on 2005 data—is “only” .440. Obviously some different assumptions were made by statisticians for the two agencies: I use the CIA's higher Gini score in comparison with other countries on my assumption that measurements made within the same agency are more likely to be consistent than between agencies.
- 18 In an article written just before passage of the last tax cut bill by Congress, David Cay Johnston reported, “The Tax Policy Center ... estimated yesterday that 80 per cent of the tax savings will flow to the top 10 per cent of taxpayers and that almost a fifth of the benefits will flow to the top one-tenth of one per cent.” Johnston further noted, “The official estimate of the bill's cost ... \$69 billion. But this assumes tax breaks will be in place only for one year or two. If they were to continue for the next decade—which President Bush and his Republican supporters want—the cost would be more than 15 times as great, estimates by the Congressional Budget Office, an arm of Congress, show.” Included with the article is a chart by the Tax Policy Center, suggesting the average tax saving per taxpayer (in 2005 dollars) would vary by income: those making less than \$10,000 would get an increase of \$0 in savings; those making between \$50,000-75,000 would get \$112; those making between \$75,000-100,000 would get \$406; those making between \$200,000-500,000 would get \$4,527; and those making over \$1 million would get \$42,766 (Johnston 2006).

An article reporting a study by the non-partisan Congressional Budget Office on earlier Bush tax cuts began by saying “Families earning more than \$1 million a year saw their federal tax obligations drop more sharply than any group in the country as a result of President Bush's tax cuts...”. Families in the middle fifth of annual earnings—with annual earnings of \$56,200 in 2004—saw tax cuts of approximately \$1,180, while families in the top one per cent of earnings, with average incomes of \$1.25 million, got tax cuts of approximately \$58,000 (Andrews, 2007). For an important discussion of tax cuts implemented during the first term of the Bush Administration, see Piven (2004: 41-47).
- 19 At approximately the same time, foreign investors have been pouring money into long-term US securities of all types, including Treasury bonds and notes, government-backed agency securities, and corporate bonds and stocks. Floyd Norris reports that between October 1, 2004 and September 30, 2005, “foreigners put a net of \$1.01 trillion into long-term American securities.... It was the first time the 12-month total topped that threshold. It is a figure that works out to almost \$2 million of investments per minute (Norris 2005).
- 20 This is not the cause of the current financial crisis, because the housing market collapsed before things could get this far. However, this reality confronts the

government as the Obama Administration confronts this crisis: should investors, particularly foreign ones, decide not to invest at current interest rates, these rates will have to be raised to secure the capital needed—with additional terrible results for the domestic economy.

- 21 The US Bureau of Economic Analysis (BEA) provided data on the “Balance on Current Account” from 1997 to 2006. Data is released as scheduled, and then usually a “revision” is published, which corrects mistakes and any other data that is not correct to produce a revised “Balance on Current Account.” Scott reported the original data, which was -\$857 billion. The revised amount for 2006 was -\$811.5 billion. There is something very interesting about the data: the revised “Balance of Current Account” has grown consistently (with the single exception of 2001) from -\$140.7 billion in 1997 to -\$811.5 billion in 2006 (US Bureau of Economic Affairs 2007-Table 2).

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The Palestinian Paradox

Helena Cobban

When I interviewed Salam Fayyad in Ramallah at the end of February, he was a worried man — and with reason. In June 2007 Mahmoud Abbas, head of the Fatah movement and the elected president of the Palestinian Authority (PA), had installed Fayyad as the PA's "emergency" prime minister. That was right after the clashes in which US-trained Fatah forces were thrown out of the Gaza Strip by security forces loyal to elected Hamas Prime Minister Ismail Haniya.

Abbas hoped that the marriage of Fayyad's widely publicised managerial skills with large amounts of US and US-encouraged funding — \$1.8 billion delivered in 2007, for the West Bank's population of just 2.5 million — would enable the Fatah-controlled West Bank to flourish. Palestinian voters in Gaza, squeezed tight by the illegal blockade Israel had imposed following the 2006 election there, would then renounce the preference for Hamas they had displayed in the elections and restore Fatah to power.

But it did not work out. Opinion polls conducted in late January — shortly after the end of Israel's devastating twenty-two-day assault on Gaza — found Hamas more popular than Fatah. Indeed, Hamas was more popular in the West Bank than it was in war-shattered Gaza. No wonder Fayyad was gloomy. He greeted me by saying, in the economist-speak that is his preferred jargon, "Things are, as always, getting incrementally worse. But now the increments are getting bigger." Two weeks later he tendered his resignation.

In the interview, Fayyad focused on the Israeli authorities' failure to let him do his job, in two key respects. First, Israel's continued building of settlements in the West Bank was limiting the possibility that a viable Palestinian state could be salvaged from the land that remained. And second, frequent Israeli military incursions were hampering the PA's ability to govern in areas that are supposed to be under Palestinian control. "We have proved we have restored law and order throughout the West Bank, so they have no pretext to send their own forces in," Fayyad told me. "Every time they do that, it undermines us very seriously."

Fayyad is far from alone in thinking the clock might be running out for the two-state solution. The prospect of building an independent Palestinian state

in all or nearly all of the territories occupied by the Israel Defense Forces (IDF) in June 1967 — the goal that most Palestinian secular nationalists have adhered to since 1974 — looks very remote absent a major change of behaviour by Israel. As this prospect has dimmed, many Palestinians and a small group of stalwarts in the ruins of Israel's peace movement have returned to an older idea that was once more popular in both cultures: that of a single, binational state stretching from the Jordan River to the Mediterranean Sea.

As secular Palestinians' hopes for a two-state solution have receded, a surprising degree of support for it has come from an unlikely source: Hamas. Given that Hamas has always formally adhered to the goal of a single Islamic state in the whole of historical (Mandate-era) Palestine, this seems paradoxical. Further, if there is truth to the widely held argument that Palestinian statehood is necessary to Israel's long-term continuation as a Jewish state, then it is only Hamas's continued adherence to the PA project that is keeping alive the prospect of Israel's survival as a Jewish state.

In 1994, when Yasir Arafat returned to the occupied territories to establish the Palestinian Authority, few Palestinians imagined that the PA would still be around fifteen years later. The PA was only meant to be a temporary fix, pending the implementation of a final peace between Israel and the Palestinian Liberation Organisation (PLO). The 1993 Oslo Accord, the historic agreement from which the PA sprang, was opposed not only by Islamists but also by many leading secular nationalists. They argued that by recognising Israel up front, Arafat had ceded the Palestinians' claims to 78 per cent of their ancestral homeland in return for the uncertain possibility that Israel would allow the PLO to establish a severely curtailed "state" in some portion of the remaining 22 per cent. But even those who supported Oslo never dreamed that the PA would last so long. According to the agreement, final-status negotiations were to be finished by 1999. Ten years past the deadline, that still hasn't happened; meanwhile, the "temporary" PA has acquired a constitution, the "basic law" that mandates holding regular elections for the president and the legislature.

When the PA held its first parliamentary and presidential elections in 1996, Hamas — opposed to Oslo and all that flowed from it — boycotted them. In 1996 many Hamas activists were deeply engaged in vicious tit-for-tat violence with Israel, including the dispatch of suicide bombers to places packed with civilians deep inside Israel proper. That was in line with the militant principles on which the group had been founded in 1987, in the tumultuous early days of the first intifada. The founders were members of the Muslim Brotherhood who had already built strong educational and social-service networks in the occupied territories and used them as a springboard to intervene in nationalist politics.

Hamas means “zeal”; it is also an acronym for Harakat al-Muqawama al-Islamiyya, the Islamic Resistance Movement. The concept of “resistance” is at the heart of the group’s self-definition, but Hamas has always practised many different forms of resistance, including sumoud (grassroots-based civil resistance) and armed struggle.

By 2005, though, Hamas had reconsidered its boycott of PA elections. Arafat died in late 2004; Abbas, his political heir, handily won the presidential election in January 2005. Throughout that year, Abbas spearheaded negotiations with Hamas, Israel and the United States to lay the ground rules under which Hamas could participate in the parliamentary race scheduled for January 2006. At the same time, Abbas and Hamas were cooperating in policing the “unilateral” cease-fire that allowed Israeli Prime Minister Ariel Sharon to evacuate all the Israeli troops and settlers from Gaza without harassment.

Sharon and the Bush administration signed off on the rules for Hamas’s inclusion in the elections. Very few people (except a handful of Hamas leaders) expected the party to win. But a combination of Hamas’s impressive grassroots organising and the chaos and disunity that had wracked Fatah for twenty years gave Hamas a stunning seventy-four of the chamber’s 132 seats. Israel and the Bush administration responded with the siege of Gaza and began working to quarantine and, if possible, overthrow the Hamas government. That was the main rationale for the security assistance that US Gen. Keith Dayton gave to the Ramallah-based Palestinian security forces.

In June 2007, however, as Fatah strongman Muhammad Dahlan was preparing his US-trained forces to move against Hamas in Gaza, Hamas preempted him. Dahlan’s forces scattered in disarray, and the brief experiment in “national unity” fell apart. Ismail Haniya set up a Hamas-dominated government in Gaza, and Abbas appointed Fayyad to form his separate, US-backed administration in Ramallah.

So much has happened in the Palestinian territories since 2006 that few Westerners have paid heed to the momentous nature of Hamas’s decision to participate in the elections that year. For the first time, Hamas was buying in to an important part of the PA project. In late 2005, as Hamas precinct captains were building up and tallying their voter lists, their Damascus-based leader, Khaled Meshal, was talking more frankly than ever before about Hamas’s willingness to consider entering into a decades-long hudna (truce) with Israel, if Israel agreed to withdraw its troops and settlers totally from the lands occupied in 1967. With a few further tweaks, the Hamas concept of a lengthy hudna looked intriguingly like an emerging position of support for a two-state-based final peace.

That position could strengthen prospects for unification between Hamas and Fatah. In February of this year, shortly before the opening of key reconciliation talks the Palestinian parties held in Cairo, I interviewed Hamas parliamentarian Ayman Daraghmeh in Ramallah. Daraghmeh, a sombre and well-organised physician in his early 40s, said the two key issues on which reconciliation depended were reform of the PLO and reform of the PA's security forces. "Forming the new PA government will not be so hard, compared with those," he said. These talks — like the parallel, Egyptian-mediated negotiations between Hamas and Israel over solidifying the January cease-fire and lifting the siege of Gaza — have continued fitfully and remain inconclusive.

On 2 March, in Hebron, I interviewed Daraghmeh's colleagues Nizar Ramadan and Azzam Salhab, both of whom had recently been released from prison terms in Israel that started before the 2006 election (they ran for office from their cells and were part of the Hamas team that made a clean sweep in Hebron's nine-seat constituency). The two men said they were hopeful about the chances of success in the reconciliation talks. "It will be good to bring the two wings of occupied Palestine together," Ramadan said, spreading his hands to represent two wings — the geographically separated West Bank and Gaza.

Even though Hamas commands considerable support in the West Bank — fifty-two of the seventy-four Hamas parliamentarians elected in 2006 are based there — its ability to exercise its power has been severely hampered not only by Israel, which holds thousands of Hamas members in detention at any given time and forty-four parliamentarians, but also by the PA. Ramadan told me that the Ramallah-based PA security forces were holding "around 700" Hamas prisoners — seventy of whom had been arrested since the opening of the reconciliation talks in Cairo. In a predawn raid on 19 March, IDF snatch squads punched deep into various portions of the West Bank and arrested or rearrested ten leading Hamas politicians. Daraghmeh, Ramadan and Salhab were among those picked up that night, and they have been incarcerated ever since (Washington remained shamefully silent on this assault against democracy).

What struck me about the Hamas parliamentarians was the discipline with which they stuck to a unified message, the seriousness of their demeanour, their thoughtfulness and intelligence — and the fact that, despite the immense grief and suffering they and their supporters have endured since 2006, they all talked as though Hamas's participation in PA institutions was valuable and likely to continue for some time. The only hint that this might change came when Ramadan said, "Hamas is wise because it doesn't want to get trapped

into allowing Israel to drag out the negotiations for another fifteen years, like the fifteen years they have already won from this present PA leadership.”

The Gaza war marked the culmination of a long-term campaign that all Israeli governments have waged since 1996: to constrain the power of the PA as much as possible. The Israeli grip on the occupied territories has prevented the PA from building anything faintly resembling a functioning “national” economy. Poverty levels have soared. Gaza has been transformed into a disaster zone. In the West Bank, Israel maintains and tightly controls a gruesome archipelago of small, nominally Palestinian-controlled land-blobs — cut off from one another by Israeli settlements, Israeli-only roads and more than 600 IDF-controlled checkpoints, gates, earth mounds, fences and ditches. A large proportion of the population of the West Bank has been forced onto a dependency-inducing form of international dole. Harvard’s Sarah Roy speaks of “the engineering of the Palestinians into a nation of perpetual beggars — in the West Bank, as well as Gaza.”

Some Hamas leaders — including, crucially, the Gaza-based foreign minister, Mahmoud Zahhar — have argued that if the Gazan economy could be freed from Israeli control, then a Palestinian administration based there could become the embryo of a much larger Palestinian state. Zahhar, Haniya and their Hamas colleagues in Gaza invested a lot in that project, but Israel joined forces with Egypt to prevent it from happening. And then, as we know, Israel received *carte blanche* from the Bush administration to launch the military assault on Gaza — ostensibly to halt a barrage of rocket attacks into Israel but in effect to destroy the Hamas government, or at least to bring it to its knees.

Despite all the destruction the IDF wrought in Gaza, Hamas was not broken, and it did not cry uncle. Though the IDF assassinated two second-level Hamas leaders, killed an additional 300 to 400 fighters and destroyed most of the mosque-based offices used by the group’s social-service networks, Hamas did not buckle or back down from its core demand that any cease-fire must include the lifting of the Israeli siege. The “big war” ended in an uneasy standoff on 18 January, when both sides instituted unilateral cease-fires. But far from lifting the siege, the Israeli government tightened it further; it has even refused to allow the basic building materials for reconstruction to be shipped in. The United States, Europe and Egyptian President Hosni Mubarak have colluded in maintaining this policy of collective punishment. The Haniya-Zahhar team has thus far been unable to change those stark facts, and the humanitarian situation in Gaza remains dire.

Haniya and Zahhar do not, however, form the national leadership of Hamas, as the PA president does of Fatah. Hamas’s highest decision-making body, the political bureau, is located outside the occupied territories. Hamas

therefore has a resilience and strategic depth that Fatah lacks. Hamas's internal organisation is also considerably stronger, more disciplined and robust than that of Fatah — as evidenced during the 2006 election and many times since.

Another paradox of recent Palestinian political life is that the large amount of international (mainly European) funding the Bush administration mobilised to strengthen Fatah's hand against Hamas has instead left Fatah much weaker relative to Hamas than it would have been. Money that could have been spent underwriting the emergence of a sturdy proto-national economy has instead been poured into the salaries and pensions of Ramallah's often idle civil servants and the members of its bloated security forces. This has further fuelled the corruption and clientelism of Fatah and its allies, hastening their internal decay.

And what have Ramallah's well-funded security forces been doing in recent years? The always well-informed Mustafa Barghouti gave me the answer. Barghouti is a physician and well-regarded former grassroots organiser who founded the Union of Palestinian Medical Relief Societies. Today he heads the small, largely social-democratic Palestinian National Initiative Party. He was one of two party members elected to Parliament in 2006 and was minister of information in the short-lived unity government of 2007. During a late-February interview in Ramallah, Barghouti gave several recent examples of incursions that the IDF had made into supposedly PA-controlled areas in Ramallah and elsewhere. "Palestinian security forces are under standing orders to hide whenever the Israelis come into the areas where they are patrolling," he added. "But if they get caught by surprise because the Israelis have not given them advance notice, then the Palestinian forces have orders to put their guns on the ground and turn their backs on whatever it is the Israelis are doing." He said he thought Abbas and Fayyad could change those standing orders. But so far, they have chosen not to do so.

Given the weakness of both Gaza and Ramallah, the centre of gravity of the Palestinians' national leadership has started to move out of the occupied territories: flowing to key centers among the more than 5 million Palestinians living in exile and to the 1.2 million Palestinian citizens of Israel. This shift has big implications, since these are the two Palestinian constituencies whose needs were most notably ignored when Arafat signed the Oslo Accord. Oslo and the negotiations that flowed from it gave very short shrift to the longstanding Palestinian demand that refugees be allowed to return to the homes and properties their forebears fled in the territory that became Israel in 1948. In addition, Oslo and the entire concept of the two-state solution are based on an ethno-nationalist view of statehood that felt threatening to many Palestinian

Israelis. In both groups, there is understandable enthusiasm for a unitary, binational state.

People in Israel's newly ascendant right have also been touting some alternatives to a two-state outcome. Prime Minister Benjamin Netanyahu has revived his former, never feasible idea of a purely "economic" peace with the Palestinians. He and other Israeli rightists also speak of trying to offload the problems of Gaza and the West Bank onto Egypt and Jordan, under what they dub the "regional" approach.

Since the beginning of his term, President Obama has called for speedy progress toward a two-state solution. But thus far, his administration has done nothing to challenge any of the actions by which Israeli policies make this outcome increasingly impossible. The people of Israel and Palestine are thus perilously poised between very different versions of the future. In the luxurious cafes and shopping malls of Tel Aviv, it is easy to imagine that the present situation can be effortlessly sustained. But for the deeply hurting Palestinians, maintaining the status quo is not an option. Unless Obama moves rapidly to throw power behind his so-far empty rhetoric, Palestinians could soon face another destabilising crisis.

The potential for implosion is high. Already, a rising chorus of voices among the secular nationalists, looking at the debilitating train wreck that the PA has become, is starting to ask whether it might be better to abandon the PA altogether, hand the costs and responsibilities of running Israel's occupation of the West Bank and Gaza back for Israel to bear directly, and restart negotiations (or resistance) from scratch. Fatah can no longer bear the weight of the PA project on its own. If Hamas withdraws its support from it, the fragile structure of Palestinian politics will collapse — and will likely bring regional stability down with it.

There are other scenarios for renewed conflict between Israelis and Palestinians, too. Today, Hamas is much stronger among Palestinians, and more popular among Muslims worldwide, than it was nine years ago, when Ariel Sharon's provocative visit to Jerusalem's sacred Haram al-Sharif/Temple Mount area sparked the outbreak of the second intifada. If another incident of that sort provokes a new round of fighting, it will be Hamas, much more than Fatah and Mahmoud Abbas, that will determine the Palestinians' future.

The conditions for another explosion of violence in Jerusalem are frighteningly ripe. Successive Israeli governments since 1967 have built vast, thick rings of settlements around the occupied eastern portion of the city. Those settlements cut its 270,000 Palestinian residents off from their compatriots and close relatives in the rest of the West Bank; and now the twenty-five-foot concrete

wall reinforces that excision. In recent years, too, settler activists have accelerated their push to establish residential “outposts” deep within the remaining Palestinian residential areas. To do this they have acquired titles — sometimes real, sometimes forged — to numerous Palestinian properties and summarily evicted their owners. The pro-settler municipality has also used zoning regulations to designate thousands of Palestinian-owned buildings “illegal”; and the fear of summary demolition is deepened by municipal bulldozers that have taken down 109 Palestinian homes since 2008, according to UN estimates (in Silwan, a strongly Palestinian portion of the city, the municipality recently announced that eighty-eight homes would be demolished to make way for a Jewish-themed history park. Secretary of State Hillary Clinton said that such actions are “unhelpful”).

Palestinians in Jerusalem are particularly vulnerable. Most are not Israeli citizens; they hold Israeli-issued IDs that allow them to live in the city of their birth, but they live with the constant fear that Israel will withdraw these IDs at any moment. Israeli laws prohibit them from holding public political gatherings. The four men elected from Jerusalem to the Palestinian Parliament in 2006 are all in Israeli prisons.

Quietly, and with help from many Palestinian citizens of Israel (who can travel to Jerusalem quite freely, unlike the Palestinians of Ramallah or Hebron), Jerusalem’s Palestinians do what they can to resist. On a windy day in early March I talked to Um Kamel al-Kurd, a woman in her early 60s who has been living in a tent on a bare lot since November, when she and her husband were thrown out of their longtime home in the Sheikh Jarrah neighborhood. The eviction came at 3:30 am and was carried out by a massive detachment of armed police. Kurd’s husband died shortly thereafter.

“Why do they do this to us?” she asked as we warmed our hands over a brazier. “All we want to do is have the three religions of people here live together in peace, but the settlers come from the four corners of the world and throw us out of our own homes!” Israeli police have demolished Kurd’s tent six times, but each time she has returned. And every day a stream of supporters make their way to stand at her side.

Crisis as Opportunity: New Directions for Regulating Finance

C.P. Chandrasekhar

The financial meltdown triggered by the sub-prime mortgage crisis has changed the terms of the debate over financial regulation, offering an opportunity for major, even radical, reform. We can, therefore, think of elements of a new regulatory structure that go beyond what seemed feasible thus far. This article discusses certain directions in which we can hope to go, using as its point of departure the kind of regulatory structure that the Basel framework implied and the problem with that structure as illustrated by the ongoing financial crisis.

At the centre of the Basel framework was a set of beliefs on how financial markets functioned and therefore should be regulated. The first was that if norms with regard to accounting standards and disclosure were adhered to, capital provisioning, in the form of an 8 (or more) per cent capital adequacy ratio, was an adequate means of insuring against financial failure. Second, this was to be ensured by requiring that the size of regulatory capital was computed not on the actual value of assets but on a risk-weighted proxy of that value, where risk was assessed either by rating agencies or by the banks themselves by using complex algorithms. Risk-weighting was expected to achieve two results: it would inflate the size of regulatory capital required as the share of more risky assets in the portfolio of banks rises; it would discourage banks from holding too much by way of risky assets because that would lock up capital in forms that were near-barren. Third, this whole system was to be made even more secure by allowing the market to generate instruments that helped, spread, insure or hedge against risks. These included derivatives of various kinds. Fourth, use of the framework was seen as a way of separating out segments of the financial system that should be protected from excessive risk (for example, banks, in which depositors trusted their money) and those where sections which could be allowed to speculate (high net worth individuals) can legitimately do so (through hedge funds, private equity firms, and even investment banks)

Implicit in these beliefs was the idea that markets, institutions, instruments, indices and norms could be designed such that the financial system could regulate itself, getting off its back agencies that imposed structural and behavioural constraints to ensure the “soundness” of the financial system. The intervention of such agencies was seen as inimical to financial innovation and efficient provisioning of financial services. There was an element of systemic moral hazard involved here. If the system is seen as designed to self-regulate and is believed to be capable of self-regulation, then any evidence of speculation would be discounted. In fact, it would be seen as a legitimate opportunity for profit, leading to responses that reinforce such speculation.

The Contours of the Financial Crisis

The financial crisis has demonstrated in many ways the utter inadequacy of this form of regulation from the point of view of limiting exposure to risk and of preventing financial failure. It has also demonstrated that soon this crisis translates into a real economy crisis that could be severe. It is, therefore, useful to briefly survey the main features of the crisis as it evolved, even if at the cost of traversing territory that is now well-known. There is a degree of implicit agreement that the crisis can be traced to forces unleashed by the transformation of US and global finance starting in the 1970s. Prior to that, the US financial sector was an example of a highly regulated and stable financial system in which banks dominated, deposit rates were controlled, small and medium deposits were guaranteed, bank profits were determined by the net interest margin or the difference between deposit and lending rates, and banks were restrained from straying into other areas like securities trading and the provision of insurance. To quote one apt description (OECD 2000), that was a time when banks that lent to a business or provided a mortgage, “would take the asset and put it on their books much the way a museum would place a piece of art on the wall or under glass – to be admired and valued for its security and constant return.” This was the “lend and hold” model.

A host of factors linked, among other things, to the inability of the United States to ensure the continuance of a combination of high growth, near full employment and low inflation, disrupted this comfortable world during the 1970s. With wages rising faster than productivity and commodity prices—especially prices of oil—rising, inflation was emerging as the principal problem. The response to inflation resulted in higher interest rates outside the banking sector, threatening the banking system (offering low or negative inflation-adjusted returns) with desertion of its depositors. Using this opportunity, non-bank financial companies expanded their activities. With US banking being

predominantly privately owned, this situation where there were more lucrative profit opportunities outside of banking but banks were not allowed to diversify into those activities was untenable. There appeared to be a contradiction between private banking and strict regulation. In the circumstances banks sought to diversify by circumventing regulation and increased pressure on the government to deregulate the system. The era of deregulation followed, paving the way for the transformation of the financial structure.

That transformation, which unfolded over the next decade and more, had many features. To start with, banks extended their activity beyond conventional commercial banking into merchant banking and insurance, either through the route where a holding company invested in different kinds of financial firms or by transforming themselves into universal banks offering multiple services. Second, within banking, there was a gradual shift in focus from generating incomes from net interest margins to obtaining them in the form of fees and commissions charged for various financial services. Third, related to this was a change in the focus of banking activity as well. While banks did provide credit and create assets that promised a stream of incomes into the future, they did not hold those assets any more. Rather they structured them into pools, “securitised” those pools, and sold these securities for a fee to institutional investors and portfolio managers. Banks transferred the risk for a fee, and those who bought into the risk looked to the returns they would earn in the long term. This “originate and distribute” model of banking meant, in the words of the OECD Secretariat (OECD 2000), that banks were no longer museums, but parking lots which served as temporary holding spaces to bundle up assets and sell them to investors looking for long-term instruments. This meant that those who originated the credit assets tended to understate or discount the risks associated with them. Moreover, since many of the structured products created on the basis of these credit assets were complex derivatives, the risk associated with them was difficult to assess. The role of assessing risk was given to private rating agencies, which were paid to grade these instruments according to their level of risk and monitor them regularly for changes in risk profile. Fourth, the ability of the banking system to “produce” credit assets or financial products meant that the ultimate limit to credit was the state of liquidity in the system and the willingness of those with access to that liquidity to buy these assets off the banks. Within a structure of this kind periods of easy money and low interest rates increased the pressure to create credit assets and proliferate risk. Fifth, financial liberalisation increased the number of layers in an increasingly universalised financial system, with the extent of regulation varying across the layers. Where regulation was light, as in the case of investment banks, hedge funds and private equity firms, financial companies could borrow huge amounts

based on a small amount of own capital and undertake leveraged investments to create complex products that were often traded over the counter rather than through exchanges. Finally, while the many layers of the financial structure were seen as independent and were differentially regulated depending on how and from whom they obtained their capital (such as small depositors, pension funds or high net worth individuals), they were in the final analysis integrated in ways that were not always transparent. Banks that sold credit assets to investment banks and claimed to have transferred the risk, lent to or invested in these investment banks in order to earn higher returns from their less regulated activities. Investment banks that sold derivatives to hedge funds, served as prime brokers for these funds and therefore provided them credit. Credit risk transfer neither meant that the risk disappeared nor that some segments were absolved from exposure to such risk.

That this complex structure which delivered extremely high profits to the financial sector was prone to failure has been clear for some time. For example, the number of bank failures in the United States increased after the 1980s. During 1955-81, failures of US banks averaged 5.3 per year, excluding banks kept from going under by official open-bank assistance. On the other hand during 1982-90 failures averaged 131.4 per year or 25 times as many as 1955-81. During the four years ending 1990 failures averaged 187.3 per year (Kareken 1992). The most spectacular set of failures, was that associated with the Savings and Loan crisis, which was precipitated by financial behaviour induced by liberalisation. Finally, the collapse of Long Term Capital Management pointed to the dangers of leveraged speculation. Each time a mini-crisis occurred there were calls for a reversal of liberalisation and increased regulation. But financial interests that had become extremely powerful and had come to control the US Treasury managed to stave off criticism, stall any reversal and even ensure further liberalisation. The view that had come to dominate the debate was that the financial sector had become too complex to be regulated from outside; what was needed was self-regulation.

In the event, a less regulated and more complex financial structure than existed at the time of the S&L crisis, was in place by the late 1990s. In an integrated system of this kind, which is capable of building its own speculative pyramid of assets, any increase in the liquidity it commands or any expansion of its universe of borrowers (or both) provide the fuel for a speculative boom. Increases in liquidity can come from many sources: deposits of the surpluses of oil exporters in the US banking system; increased deficit-financed spending by the US government, either based on the printing of the dollar (the reserve currency) or on financing from abroad; or reductions in interest rates that expand the set of borrowers who can be fed with credit.

Factors like this also fuelled the housing and mortgage lending boom that led up to the sub-prime crisis. From late 2002 to the middle of 2005, the US Federal Reserve's federal funds rate stood at levels which implied that when adjusted for inflation the "real" interest rate was negative. This was the result of policy. Further, by the middle of 2003, the fed funds rate had been reduced to 1 per cent, where it remained for more than a year. Easy access to credit at low interest rates triggered a housing boom, which in turn triggered inflation in housing prices that encouraged more housing investment. Many believed that this process would go on.

Sensing an opportunity based on that belief and the interest rate environment, the financial system worked to expand the circle of borrowers by inducting subprime ones, or borrowers with low credit ratings and high probability of default. Mortgage brokers attracted these clients by relaxing income documentation requirements or offering sweeteners like lower interest rates for an initial period, after which they were reset. The share of such subprime loans in all mortgages rose sharply, from 5 per cent in 2001 to more than 20 per cent by 2007. Borrowers chose to use this "opportunity" partly because they were ill-informed about the commitments they were taking on and partly because they were overly optimistic about their ability to meet the repayment commitments involved.

On the supply side, the increase in this type of credit occurred because of the complex nature of current-day finance centred around the "originate-and-distribute" model. Financial players discounted risk because they hoped to make large profits even while transferring the risk associated with the investments that earn those returns. There were such players at every layer involved. Mortgage brokers sought out willing borrowers for a fee, turning to subprime markets in search of volumes. Mortgage lenders and banks financed these mortgages not because they wanted to buy into the interest and amortization flows associated with such lending, but because they wanted to sell these instruments to less regulated intermediaries like the Wall Street banks. The Wall Street banks bought these mortgages in order to expand their business by bundling assets with varying returns to create securities that could be sold to institutional investors, hedge funds and portfolio managers. To suit different tastes for risk they bundled them into tranches with differing probability of default and differential protection against losses. Risk here was assessed by the rating agencies, who not knowing the details of the specific borrowers to whom the original credit was provided, used statistical models to determine which kind of tranche can be rated as being of high, medium or low risk. Once certified, these tranches could be absorbed by banks, mutual funds, pension

funds and insurance companies, which can create portfolios involving varying degrees of risk and different streams of future cash flows linked to the original mortgage. Whenever necessary, these institutions can insure against default by turning to the insurance companies and entering into arrangements such as credit default swaps. Even government sponsored enterprises like Freddie Mac and Fannie Mae, who were not expected to be involved in or exposed to the subprime market had to cave in because they feared they were losing business to new rivals who were trying to cash in on the boom and poaching the business of these specialist firms.

Because of this complex chain, institutions at every level assumed that they were not carrying risk or were insured against it. However, risk does not go away, but resides somewhere in the system. And given financial integration, each firm was exposed to many markets and most firms were exposed to each other as lenders, investors or borrowers. Any failure would have a domino effect that would damage different firms to different extents.

The problems began with defaults on subprime loans, in some cases before and in others after interest rates were reset to higher levels. As the proportion of default grew, the structure gave and all assets turned illiquid. Rising foreclosures pushed down housing prices as more properties were up for sale. On the other hand the losses suffered by financial institutions were freezing up credit, resulting in a fall in housing demand. As housing prices collapsed the housing equity held by many depreciated, and they found themselves paying back loans which were much larger than the value of the assets those loans financed. Default and foreclosure seemed a better option than remaining trapped in this losing deal.

It was only to be expected that soon the securities built on these mortgages would lose value. They also turned illiquid because there were few buyers for assets whose values were unknown since there was no ready market for them. Since mark-to-market accounting required taking account of prevailing market prices when valuing assets, many financial firms had to write down the values of the assets they held and take the losses onto their balance sheets. But since market value was unknown, many firms took much smaller write downs than warranted. But they could not hold out for ever. The extent of the problem was partly revealed when a leading Wall Street bank like Bear Stearns declared that investments in two funds it created linked to mortgage-backed securities were worthless. This signalled that many financial institutions were near-insolvent.

In fact, given financial integration within and across countries, almost all financial firms in the US and abroad were severely affected. Fear forced firms from lending to each other, affecting their ability to continue with their business or meet short term cash needs. Insolvency began threatening the best and largest

firms. The independent Wall Street investment banks, Bear Stearns, Lehman Brothers, Merrill Lynch, Morgan Stanley and Goldman Sachs, shut shop or merged into bigger banks or converted themselves into bank holding companies that were subject to stricter regulation. This was seen as the end of an era where these independent investment banks epitomised the innovation that financial liberalisation had unleashed. In time closures, mergers and takeovers became routine. But that too was not enough to deal with fragility forcing the state to step in and begin reversing the rise to dominance of private finance, even while not admitting it.

The Response to the Crisis

After much dithering, high drama and every effort to avoid the inevitable for fear that it would straightjacket capitalism, governments in the developed industrial countries bought new equity in private banks to recapitalise them, effectively nationalising a large part of the private banking system.

These moves came at the end of a long series of interventionist efforts that pointed in two directions. First was that governments believed that the problem facing the financial sector in the wake of the subprime crisis was not one of generalised insolvency, but one of inadequate liquidity resulting from fear and uncertainty. The second was that to the extent that there were individual firms faced with insolvency, the problem could be resolved on a case by case basis, through closure (Lehman), merger (Wachovia) or state take over (American International Group). It was only when efforts based on these perceptions failed to stop the slide that measures to deal with generalised insolvency, such as buying out all impaired assets or recapitalising banks with public investment were resorted to. But even these are focused on the banking system. In a world where non-bank financial institutions play an extremely important role and the banks themselves are integrated in various ways with these institutions, it is unclear whether these steps would be enough.

The perception that the problem was one of liquidity because financial markets were freezing up given the difficulty of assessing counterparty risk yielded a host of responses, especially in the US, that filled the media with acronyms: MLEC (Master Liquidity Enhancement Conduit), TAF (Term Auction Facility), TSLF (Term Securities Lending Facility) and PDCF (Primary Dealer Credit Facility) (Shiller 2008). By the end of it the Federal Reserve in the US had offered to accept as collateral the bundles of worthless assets that were lying with financial firms, and extend its credit facilities to entities outside the regulated banking system. Interest rates too had been substantially cut to make credit cheaper. When even this was not yielding the expected results and halting

a slide in stock markets, recognition that other measures were needed dawned. Some effort at dealing with insolvency was called for.

But even this was initially half-hearted and pursued on a case-by-case basis. Further, across cases the attitude was different. JP Morgan Chase was paid off to take over Bear Stearns cheap. Lehman was allowed to go. Fannie Mae and Freddie Mac were nationalised. AIG was rescued with a huge infusion of public funds, triggering allegations of conflict of interest on the grounds that this was an effort at protecting Goldman Sachs that was substantially exposed to the insurer. Treasury Secretary Paulson came from Goldman and still held a significant stake in the firm. But as the number of cases multiplied and the lack of a clear strategy became obvious, the danger of a financial collapse intensified.

This was when the first signs of recognition that there was a problem of potential generalised insolvency emerged. The first response was TARP (Troubled Assets Relief Program). Declaring that the system was faced with financial collapse of a kind that could drive the economy to recession, the Treasury Secretary backed by the Chairman of the Federal Reserve, badgered Congress into authorising a \$700 billion bailout package, which was primarily geared to buying out the near-worthless or “impaired” mortgage-related assets from financial institutions, as also any other assets from any other party so as to “unclog” their balance sheets and get credit moving.

This plan too did not clearly recognise that generalised insolvency was a potential problem. This was clear from the fact that the bailout plan sought to use market-based methods to buy up troubled assets. Since the prevailing market price of those assets was close to zero, this would imply that the institutions selling those assets would have to take large write-downs onto their balance sheets and reflect these losses. This would undermine their viability and result in failure unless they were recapitalised with an infusion of new funds.

It was the UK, having experimented with liquidity infusion and limited nationalisation, which first went beyond the Bush administration. Gordon Brown announced that his government would resort to an “equity injection” to buy ordinary and preference shares worth £37 billion in three of the biggest banks in the country: Royal Bank of Scotland, Lloyds TSB and HBOS.

Existing shareholders have the option of buying back the ordinary shares from the government. But if they do not, as seems likely, then the government would have a stake of 60 per cent in RBS and 43.5 per cent in the combined entity that would emerge after the ongoing merger of Lloyds TSB and HBOS. This clearly amounts to State takeover, which brings with it new obligations. The three banks will not be able to pay dividends on ordinary shares until they

have repaid in full the £9bn in preference shares they are issuing to the government. The Treasury appointed new directors to the boards of RBS and the combined Lloyds-HBOS to oversee the government's interests. And restrictions were imposed on executive salaries and bonuses that had ballooned during the years of the speculative boom.

The decision to nationalise was forced on the UK government because the problem facing the banking system was not just one of inadequate liquidity resulting from fears generated by the subprime crisis. Rather credit markets had frozen because the entities that needed liquidity most were those faced with a solvency problem created by the huge volume of bad assets they carried on their balance sheets. To lend to or buy into these entities with small doses of money was to risk losses since that money would not have covered the losses and rendered these banks viable. So money was hard to come by. This is disastrous for a bank because rumours of its vulnerability trigger a run that devastate its already damaged finances.

What was needed was a large injection of equity to recapitalise these banks after taking account of losses. Wherever the sum involved was small, a private sector buyer could play the role, otherwise the State had to step in. Thus, in the case of some banks recapitalization through nationalization was unavoidable because, as UK chancellor Alistair Darling put it, "this is the only way, when markets are not open to certain banks, they can get the capitalisation they need." Others such as Barclays hoped to attract private investors so as to avoid being absorbed by the government.

What needs to be noted, however, is that nationalisation is not the end of the matter. In addition, the UK government has chosen to guarantee all bank deposits, independent of their size, to prevent a run. It has also decided to guarantee inter-bank borrowing to keep credit flowing as when needed.

Once the UK decided to take this radical and comprehensive route, others were quick to read the writing on the wall. What followed was a deluge. Germany with an estimated bill of •470 billion, France with •340 billion, and other governments with as yet unspecified amounts pitched in, with plans to recapitalise banks with equity injections, besides guaranteeing deposits and inter-bank lending. The banking system was being saved through State take-over, not just with State support.

Finally, the US, which was seeking to avoid State acquisition fell in line, but in a form the shows the influence that Wall Street exerts over the Treasury. It too has decided to use much of the \$700 billion of bailout money to acquire a stake in a large number of banks. Half of that money is to go to the nine largest banks, such as Bank of America, Citigroup, Wachovia and Morgan Stanley. The minimum investment will be the equivalent of one per cent of risk-weighted

assets or \$25 billion—whichever is lower. With capital adequacy at a required 8 per cent, this is indeed a major recapitalisation. Further the government, through the Federal Deposit Insurance Corporation, is guaranteeing all deposits in non-interest bearing accounts and senior debt issued by banks insured by the FDIC.

However, Wall Street's influence has ensured that this intervention is biased in favour of Big Finance. The support comes cheap: banks will pay a dividend of just 5 per cent for the first five years, only after which the rate jumps to 9 per cent. During that time, they have the option of mobilising private capital and buying out the government. Interestingly, the government is not taking voting rights and would be able to appoint directors only if the bank misses dividend payments for six quarters. While there are restrictions on payment of dividends to ordinary shareholders before clearing the government's claims and limits on executive compensation, the government only reserves the right to convert 15 per cent of its investments into common stock. In sum, the American initiative overseen by Henry Paulson, an old Wall Street hand from Goldman Sachs, has virtually cajoled the banks to accept a government presence, unlike what seems true in the UK and Europe.

Whether it occurs in part-punitive fashion or as a sop, the back-door takeover of major private banks is a desperate attempt to stall the financial meltdown in the advanced economies resulting from the decision to allow private financial players unfettered freedom to pursue profits at the expense of all else. That threat has forced governments to drop their neo-conservative bias against State ownership and markets that hollered at government intervention in the past have now applauded such action.

Fall-out for the Real Economy

However, the threat of recession has not receded. Even if the banks are safe, though there is no definite guarantee as yet, there are many other institutions varying from hedge and mutual funds to pension funds that have suffered huge losses, both from the subprime fiasco and the stock market crash, eroding the wealth of many. Moreover, housing prices are still falling sharply. The effects of that wealth erosion on investment and consumption demand are only now unravelling, indicating that there is much to be told in this story as yet.

The crisis had a number of consequences in the developed countries. It made households whose homes were now worth much less more cautious in their spending and borrowing behaviour, resulting in a collapse of consumption spending. It made banks and financial institutions hit by default more cautious in their lending, resulting in a credit crunch that bankrupted businesses. It

resulted in a collapse in the value of the assets held by banks and financial institutions, pushing them into insolvency. All this resulted in a huge pull out of capital from the emerging markets: Net private flows of capital to developing countries are projected to decline to \$530 billion in 2009, from \$1 trillion in 2007 (World Bank 2008). The effects this had on credit and demand combined with a sharp fall in exports, to transmit the recession to developing countries. All of these effects soon translated into a collapse of demand and a crisis in the real economy with falling output and rising unemployment. This is only worsening the financial crisis even further.

As 2008 entered its final month, predictions of where the world economy is heading turned dire. The World Bank projected world output to grow by a mere 0.9 per cent in 2009 (as compared with 2.5 per cent in 2008 and a high of 4 per cent in 2006) and world trade to contract by a significant 2.1 per cent (compared to positive rates of growth of 6.2 per cent in 2008 and a high of 9.8 per cent in 2006).. Moreover, the World Bank could identify no possible driver for a recovery in the coming months.

Other projections are even more pessimistic. Chapter 1 of the UN's World Economic Situation and Prospects 2009, released in advance at the Doha Financing for Development conference, estimates that the rate of growth of developed country output which fell from 4.0 per cent in 2006 to 3.8 per cent in 2007 and 2.5 per cent in 2008 is projected to fall to 1.0 per cent in 2009 as per its baseline scenario and to -0.4 per cent in its pessimistic scenario.

Finally, the recently released preliminary edition of the OECD's Economic Outlook for end-2008 shows that GDP in most OECD countries declined in the third quarter and is likely to fall also in the fourth. In the event, GDP growth in the OECD area which fell from 3.1 per cent in 2006 to 2.6 per cent in 2007 and 1.4 per cent in 2008 is projected to fall to -0.4 per cent in 2009, and the unemployment rate which rose from 5.6 per cent to 5.9 per cent between 2007 and 2008 is expected to climb to 6.9 per cent in 2009 and 7.2 per cent in 2010.

If these predictions turn out to be true the prognosis is that what was a recession in 2008 could turn into a depression in 2009. Looking back, 2008 was a year when the recession unfolded. The recession in the US, reports indicate, is not recent but about a year old and ongoing. Short term indicators are disconcerting, but do not convey the real picture. Preliminary estimates of GDP growth in the United States during the third quarter of 2008 point to decline of half a percentage point. But GDP growth during the previous two quarters was positive at 2.8 and 0.9 per cent respectively. The only other quarter since early 2002 when growth was negative was the fourth quarter of 2007. Thus, going by the popular definition of a recession—two consecutive quarters of decline in real gross domestic product—the US is still to slip into recessionary contraction.

But the independent agency which is the more widely accepted arbiter of the cyclical position of the US economy is the Business Cycle Dating Committee of the National Bureau of Economic Research (2008). This committee, which adopts a more comprehensive set of measures to decide whether or not the economy has entered a recessionary phase, has announced that the recession in the US economy had begun as early as December 2007. That already makes the recession 11 months long, which has been the average length of recessions during the post-war period. There is much pessimism on how long this recession would last as well. According to the OECD, for most countries “a recovery to at least the trend growth rate is not expected before the second half of 2010 implying that the downturn is likely to be the most severe since the early 1980s, leading to a sharp rise in unemployment.”

In fact, differentials in the distribution of the impact of the recession and a recovery in 2010 are the only positive elements in analyst predictions. Most predictions, as for example that of the World Bank, hold that the decline in growth rates in emerging markets would be much less than in the US. Thus, growth in developing countries as a whole is expected to fall from 6.3 percent in 2008 to 4.5 per in 2009, only to recover to 6.1 per cent in 2010. This is mainly due to China and India without which the figures are a more disappointing, but still relatively creditable at 5, 2.9 and 4.7 per cent respectively.

However, even here, the numbers are proving to be disconcerting. China’s growth has been slipping even if still relatively high. But nobody can ignore the fact that manufacturing, which is the engine of growth in that country is hugely dependent on exports to developed country markets, especially the US. Second, according to Bank of Korea estimates, South Korea’s economy will contract in the last quarter of 2008 and grow at its slowest pace in 11 years in 2009. According to its estimates, the economy, the fourth largest in Asia, would shrink by 1.6 per cent in the fourth quarter of 2008, and grow only at 2 per cent in 2009, and 3.7 per cent for full 2008. And the month-on-month annual rate of growth of India’s Index of Industrial Production fell by 0.4 per cent in October, for the first time in 15 years.

These developments make predictions of a significant growth recovery in 2010 appear optimistic. A question that troubles analysts is how long this recession will last. The recovery assessments are based on the assumptions that the crisis in financial markets would be resolved soon and that there would be no negative feedback loops both between the real sector and the financial sector (which would exacerbate the financial crisis) and within the real sector (which would intensify the crisis in the real economy), before the positive effects of intervention by governments materialise in full. Such assumptions are indeed tenuous, increasing the lack of certainty about a recovery. Thus, job losses in

the US are increasing the number of housing foreclosures. Around 7 per cent of mortgage loans were reported to be in arrears in the third quarter of 2008, and another 3 per cent are at some stage of the foreclosure process. According to the Mortgage Bankers' Association, about 2.2 million homes will have entered foreclosure proceedings by the end of 2008. This would intensify the financial crisis as well as dampen consumer spending, and could worsen the downward spiral.

Yet, unemployment figures suggest that at the moment the recession is only intensifying. On 5 December 2008, the Bureau of Labour Statistics in the US reported that employers had reduced the number of jobs in their facilities by 533,000, taking the unemployment rate in the US to 6.7 per cent. This reduction—which is the highest monthly fall in 34 years—comes after job losses of 320,000 in October and 403,000 in September.

Total job losses through 2008 are 1.9 million. This means that the 2.5 million jobs that President-elect Obama is promising to deliver through his fiscal stimulus package would just about recover the jobs lost during the recessionary period preceding his swearing in, and leave untouched the backlog of unemployed and those entering the labour force during this period. Thus even the coming of new government in the US does not give cause for optimism.

A crisis of this nature requires holes to be plugged at many places simultaneously. While there is wide agreement that what is needed is a globally coordinated and huge fiscal stimulus, the actual effort on the ground remains fragmented and meagre. Because of this results are disappointing, threatening to make this crisis the most protracted in a long time. Year 2008 is likely to be remembered as a year in which a crisis of immense proportions unfolded.

The Lessons

What then are the lessons to be learnt? To start with, it is clear that when private players make financial decisions, limited interventions such as accounting standards, disclosure norms, behavioural guidelines and capital adequacy requirements, are inadequate restraints on the extent of risk accumulation in the system. If there are no structural and behavioural constraints, such as the restrictions on cross-sector activity put in place by Glass-Steagall, financial firms find ways of increasing profits by circumventing regulation. One form that took was the transition in banking from a buy-and-hold to originate-and-sell strategy, which allowed a geographically extensive banking system to create credit assets far in excess of what would have been the case in a more regulated system. This had a number of implications. First, the role of banks as mere agents for generating the credit assets that could be

packaged into products meant that risk was discounted at the point of origination, since banks felt that they were not holding the risks even while they were earning commissions and fees. Their capital adequacy requirements did not constrain the overhang of risk in the system they created, making Basel a poor instrument to control systemic risk exposure. Second, a risk-weighted CAR based on either ratings by private firms or internal models really meant that this regulation could be diluted by 'obtaining' a high rating on assets that were risky. That this did happen is reflected in the fact that highly rated assets were rendered worthless in a short period when the crisis began. Third, the transition in banking meant that though banks were important from the point of view of depositors and real economy borrowers looking for short term capital, other segments of the financial system became as or more important within the overall financial structure. The Wall Street investment banks, which epitomised financial innovation, were not banks in the conventional sense and were therefore lightly regulated and not subject to the kind of capital adequacy requirements applicable to banks. They, along with the hedge funds, private equity firms and insurance companies, came to occupy crucial intermediary positions within the financial system. Moreover, the circumvention of regulation resulted in banks, which were in search of higher returns, exposing themselves to these institutions involved in more risky and highly leveraged operations. This damaged the belief implicit in the Basel framework that regulation of banks is regulation of the core of the financial system and that guidelines which treated banks differently so as not to expose ordinary depositors to high risk were effective in cordoning off the banking sector. Fourth, the thirst for profit meant that the earnings of top managers were linked to the (accounting) profits their firms made, through bonuses that exceeded salaries. As a result, the appetite for risk among private decision-makers increases tremendously. What was introduced as an incentive for performance became an incentive to speculate. Fifth, so long as fully private players adopted these aggressive strategies, even government sponsored entities and public banks had to follow this route if they were not to lose their business to private players. Public or quasi-public ownership became meaningless from the point of view of regulating behaviour. Nothing illustrated this more than the fate of Fannie Mae and Freddie Mac. Sixth, the freedom to innovate resulted in maturity mismatches in the system, as was true for example of auction rate securities which used liquid short term funding for long term purposes. When liquidity froze, those who were convinced that they were holding liquid securities found them to be illiquid, worsening the crisis. That is innovation increased the areas of vulnerability. Finally, capital adequacy proved meaningless when the crisis came because losses stemming

from this structure of asset holding were adequate to wipe out the capital base that had been provided for by many banks, necessitating equity infusion and nationalisation.

The Way Ahead

These lessons from the ongoing financial crisis make clear that the accumulation of risk and the manufacture of crisis are inevitable in a private-led, deregulated financial system that makes short term profits the prime objective. Limited intervention cannot fundamentally alter financial behaviour to avoid such an outcome. When financial markets are left unfettered, the system goes through a sequence of events that inevitably generate a financial and real economy boom that soon goes bust. Strong regulation is called for. One form that such regulation can take is that put in place since the passing of the Glass-Steagall Act. This in itself may not be a full solution today, and there could be contexts where a degree of financial integration could play a role. In particular, countries which want to use the financial structure as an instrument to further broad-based growth may need to opt for universal banks that follow unconventional lending strategies, when compared with the typical commercial bank. Many years ago Gerschenkron had pointed to the role which certain institutional adjustments in the financial sector played in the success of late-industrialisers like France and Germany. Basing his arguments on the roles played by *Crédit Mobilier* of the brothers Pereire in France and the 'universal banks' in Germany, Gerschenkron (1962) argued that the creation of "financial organisations designed to build thousands of miles of railroads, drill mines, erect factories, pierce canals, construct ports and modernise cities" was hugely transformative. Financial firms based on the old wealth were typically in the nature of rentier capitalists and limited themselves to floatations of government loans and foreign exchange transactions. The new firms, were "devoted to railroadisation and industrialisation of the country" and in the process influenced the behaviour of old wealth as well.

As Gerschenkron argued:

The difference between banks of the credit-mobilier type and commercial banks of the time (England) was absolute. Between the English bank essentially designed to serve as a source of short-term capital and a bank designed to finance the long-run investment needs of the economy there was a complete gulf. The German banks, which may be taken as a paragon of the type of the universal bank, successfully combined the basic idea of the credit mobilier with the short-term activities of commercial banks (Gerschenkron 1962: 13).

The banks according to Gerschenkron substituted for the absence of a number of elements crucial to industrialisation:

In Germany, the various incompetencies of the individual entrepreneurs were offset by the device of splitting the entrepreneurial function: the German investment banks—a powerful invention, comparable in economic effect to that of the steam engine—were in their capital-supplying functions a substitute for the insufficiency of the previously created wealth willingly placed at the disposal of entrepreneurs. But they were also a substitute for entrepreneurial deficiencies. From their central vantage points of control, the banks participated actively in shaping the major—and sometimes even not so major—decisions of the individual enterprises. It was they who often mapped out a firm's paths of growth, conceived far-sighted plans, decided on major technological and locational innovations, and arranged for mergers and capital increases (Gerschenkron 1968: 137).

An Opportunity in the Current Bail-out

Thus, setting up Chinese Walls separating various segments of the financial sector may not be the best option. Nor could investment banks and hedge funds be abolished. What could however be done is to monitor investment banks and hedge funds and subject them to regulation, while seeking an institutional solution that would protect the core of the financial structure: the banking system. Fortunately, the current bail-out has provided the basis for such a transformation by opting for state ownership and influence over decision making.

Can this be an important step in shaping an alternative regulatory structure in developing countries, in particular? Public ownership of banks could serve a number of overarching objectives:

- It ensures the information flow and access needed to pre-empt fragility by substantially reducing any incompatibility in incentives driving bank managers, on the one hand, and bank supervisors and regulators, on the other. This is a much better insurance against bank failure than efforts to circumscribe its areas of operation, which can be circumvented.
- By subordinating the profit motive to social objectives, it allows the system to exploit the potential for cross subsidisation and to direct credit, despite higher costs, to targeted sectors and disadvantaged sections of society at different interest rates. This permits the fashioning of a system of inclusive finance that can substantially reduce financial exclusion.

- By giving the state influence over the process of financial intermediation, it allows the government to use the banking industry as a lever to advance the development effort. In particular, it allows for the mobilisation of technical and scientific talent to deliver both credit and technical support to agriculture and the small-scale industrial sector.

This multifaceted role for state-controlled banking allows policies aimed at preventing fragility and avoiding failure to be combined with policies aimed at achieving broad-based and inclusive development. Directed credit at differential interest rates can lead economic activity in chosen sectors, regions and segments of the population. It amounts to building a financial structure in anticipation of real sector activities, particularly in underdeveloped and under-banked regions of a country.

The importance of public ownership to ensure financial inclusion cannot be overstressed. Central to a framework of inclusive finance are policies aimed at pre-empting bank credit for selected sectors like agriculture and small-scale industry. Pre-emption can take the form of specifying that a certain proportion of lending should be directed at these sectors. In addition, through mechanisms such as the provision of refinance facilities, banks can be offered incentives to realise their targets. Directed credit programmes should also be accompanied by a regime of differential interest rates that ensure demand for credit from targeted sectors by cheapening the cost of credit. Such policies have been and are still used in developed countries as well.

Credit pre-emption, aimed at directing debt-financed expenditures to specific sectors, can also be directly exploited by the state. In many instances, besides a cash reserve ratio, the central bank requires a part of the deposits of the banking system to be held in specified securities, including government securities. This ensures that banks are forced to make a definite volume of investment in debt issued by government agencies. Such debt can be used to finance expenditures warranted by the overall development strategy of the government, including its poverty alleviation component. Beyond a point, however, these roles have to be dissociated from traditional commercial banks and located in specialised institutions.

Inclusive finance of this kind inevitably involves the spread of formal financial systems to areas where client densities are low and transaction costs are high. Further, to ensure sustainable credit up-take by disadvantaged groups, interest rates charged may have to diverge from market rates. This regime of differential or discriminatory interest rates may require policies of cross-subsidisation and even government support to ensure the viability of

chosen financial intermediaries. Intervention of this kind presumes a substantial degree of “social control” over commercial banks and development banking institutions.

It implies that “social banking” involves a departure from conventional indicators of financial performance such as costs and profitability and requires the creation of regulatory systems that ensure that the “special status” of these institutions is not misused. In sum, “inclusive finance” as a regime is defined as much by the financial structure in place as by policies such as directed credit and differential interest rates. To ensure compliance with financial inclusion guidelines, governments can use and have used public ownership of a significant section of the banking/financial system to ensure the realisation of developmental and distributional objectives. This was recognised by governments in many countries in Europe, where banking development in the early post-World War II period took account of the vital differences between banking and other industries. Recognising the role the banking industry could play, many countries with predominantly capitalist economic structures thought it fit either to nationalise their banks or to subject them to rigorous surveillance and social control. France, Italy and Sweden are typical examples in this respect. Overall, even as late as the 1970s, the state owned as much as 40 per cent of the assets of the largest commercial and development banks in the industrialised countries (United Nations 2005). An example of a more recent successful transition to inclusive finance through nationalisation of a significant part of the banking system is India post-1969.

Public Ownership and Inclusive Finance in India

India’s achievements with regard to financial sector development after bank nationalisation have been remarkable. There was a substantial increase in the geographical spread and functional reach of banking, with nearly 62,000 bank branches in the country as of March 1991, of which over 35,000 (or over 58 per cent) were in rural areas. Along with this expansion of the bank branch network, steady increases were recorded in the share of rural areas in aggregate deposits and credit. From 6.3 per cent in December 1969, the share of rural deposits in the total rose to touch 15.5 per cent by March 1991 and the rural share of credit rose from 3.3 per cent to 15.0 per cent. More significantly, with the target credit-deposit (C-D) ratio set at 60 per cent, the C-D ratios of rural branches touched 64-65 per cent on the basis of sanctions. Sectorally, a major achievement of the banking industry in the 1970s and 1980s was a decisive shift in credit deployment in favour of the agricultural sector. From an extremely low level at the time of bank nationalisation, the credit share of the sector grew to nearly 11

per cent in the mid-1970s and to a peak of about 18 per cent (the official target) at the end of the 1980s.

Conclusion

This example illustrates the positive effects that public ownership can have in varying contexts. But this is not to say that this one advance can resolve the crisis and guard against future instances. Unfortunately, efforts are already on to prevent such a direction in policy. In November 2008, Nout Wellink, Chairman of the Basel Committee, announced plans to formulate “a comprehensive strategy to address the fundamental weaknesses revealed by the financial market crisis related to the regulation, supervision and risk management of internationally-active banks.” “Ultimately, our goal is to help ensure that the banking sector serves its traditional role as a shock absorber to the financial system, rather than an amplifier of risk between the financial sector and the real economy,” Wellink reportedly said. However, many feel that if we drop the hyperbole this amounts to nothing more than choosing to apply grease paint on a spent actor. By way of curtain raiser all that the Committee can offer are likely decisions “to strengthen capital buffers and help contain leverage in the banking system arising from both on- and off-balance sheet activities.” According to the Committee’s press release, the key building blocks of the strategy would include:

- strengthening the risk capture of the Basel II framework (in particular for trading book and off-balance sheet exposures);
- enhancing the quality of Tier 1 capital;
- strengthening counterparty credit risk capital, risk management and disclosure at banks; and
- promoting globally coordinated supervisory follow-up exercises to ensure implementation of supervisory and industry sound principles.

In short, more of the same, perhaps with a new title such as Basel III. Coming after a crisis that showed that the Basel framework is no insurance against a crisis and in fact contributes to precipitating it by permitting banks to operate with inadequate reserves, this is an unconvincing response at best. In fact, many see it as a manoeuvre to avoid much-needed reregulation. Others see it as an exercise to salvage the Basel framework, which some policymakers have demanded should be scrapped.

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The Global Financial Crisis and the Developing World

Jayati Ghosh

Now that it is clear that global capitalism has now entered a new phase, one that is unprecedented in its history, questions arise about which direction it will take. The still-unfolding financial crisis has already gone way beyond the predictions of even relatively pessimistic observers. The actual financial collapse - the so-called “Minsky moment” of pure meltdown - at the heart of the international economy was only just averted. But even so, the large industrial economies of the world have entered what promises to be a major recession. And developing economies across the world are already affected by this, even if they had not part in either the financial boom or the subsequent bust.

Of course, this particular crisis reflects contradictions at the heart of the capitalist system, including those emanating from its dependence upon inelastic expectations about the value of money, which are inherent to the smooth functioning of capitalism (Patnaik 2008). Indeed, much of this could easily have been predicted even by policy makers in the US and elsewhere if they had not so strongly been in denial about the very dubious and fragile foundations of the recent boom on the US. There is now no doubt at all that the financial deregulation of the 1980s and 1990s, aided by the incentives to finance provided by successive governments, is essentially responsible (Kregel 2008; Crotty 2008). This financial liberalisation allowed banks and other financial institutions not only to behave in completely irresponsible and greedy ways, but to do it in such a non-transparent manner that they themselves were unaware of the full extent of their own exposure and vulnerability. But officials and market analysts all tended to underplay this, arguing that finance companies would be efficient at regulating themselves simply because they stood to lose in the event of failure. This argument even determined the new codes of conduct of the Bank for International Settlements, in its “Basel II norms,” which effectively put the onus on banks to assess their own risks and thereby regulate themselves. So the malaise spread beyond the US to other countries, such as the UK and even developing countries in Asia and elsewhere.

The bubble in the US attracted savings from across the world, including from the poorest developing countries, so that for at least five years the South as a whole transferred financial resources to the North. Now all this is also under threat, as the list of creditors who directly and indirectly have transferred funds to troubled US financial institutions includes not only central banks of all major developing countries but also workers' pension funds from developing countries as far apart as Malaysia and Chile.

Three aspects of the current crisis and the way it is being dealt with are worthy of closer examination. First, the myth of "efficient" financial markets that function better without government regulation has been effectively blown. Second, the problem of moral hazard is even more significant today, given the nature of attempts to manage the crisis. Third, the implications for the global economy and for developing countries in particular are profound, especially if there is no radical restructuring of the international financial regime.

The Implications of Deregulated Finance

It is now clear that this crisis will mark at least the temporary end of the recent era of freewheeling and deregulated finance. The financial liberalisation of the past two decades across the world was based on two mistaken notions. First is the "efficient markets" hypothesis beloved of some economists and many more financial players, which asserts that financial markets are informationally efficient, in that prices on traded financial assets reflect all known information and therefore are unbiased in the sense that they reflect the collective beliefs of all investors about future prospects. Second is the notion that financial institutions, especially large and established ones, are capable of and good at self-regulation, since it is in their own best interests to do so. And therefore external regulation by the state is both unnecessary and inefficient.

Both of these presumptions are now in tatters, completely destroyed by the waves of bad news that keep coming from the financial markets, and by the growing evidence of foolish and irresponsible behaviour that was clearly indulged in by large and respectable financial players. It has emerged that unreliable behaviour is not the preserve of a few relatively small fly-by-night operators, but is endemic even among the largest private players in the financial system (Kregel 2008; Chandrasekhar 2008a).

It is also increasingly clear that deregulated financial markets today are characterised by huge conflicts of interest: between the different functions that investment banks have taken on in recent times, between investment banks and regulators, between financial interests and the media, and so on (Augar 2006). Financial deregulation allowed financial institutions to take on different

activities that were earlier clearly segregated. Thus banks could take on non-bank financial services, and vice versa. The integration of broking and underwriting, of proprietary and customer trading, of market research and investment advice, all gave rise to huge conflicts of interest within the leviathan investment banks, which were inadequately regulated. As a result, banks could carry on with problematic practices because they made their profits on commissions and fees rather than on actual repayment by borrowers. Such a situation was obviously not sustainable and ultimately led to an enormous mess in the very heart of capitalism.

But the problem was not confined to the developed countries. Nor is it the case that developing countries are simply suffering the after-effects of the financial tsunami unleashed in the US. Indeed, it can be argued that financial liberalisation has been even more damaging for developing countries because of its negative impact on the development project. Unregulated allocation of financial resources means that private rather than social returns would determine the allocation of savings and investment. This has several adverse implications. Investment allocations may not be such as to ensure the profile of production needed to raise saving and investment rates over time, there by affecting the growth trajectory. Certain sectors such as the rural sector in general or agriculture in particular and the small industrial sector may be largely excluded from formal sector credit provision on the grounds that the transaction costs associated with such lending are high or that default risk is greater. Unregulated financial entities are more likely to direct their investment financed with the savings of depositors to “sensitive” or risky sectors such as real estate and stock markets, leading to speculative bubbles and subsequent collapses.

It is now widely accepted that financial liberalisation has resulted in an increase in financial fragility in developing countries, making them prone to periodic financial and currency crises. These relate both to internal banking and related crises, and currency crises stemming from more open capital accounts. Greater freedom to invest, including in sensitive sectors such as real estate and stock markets, ability to increase exposure to particular sectors and individual clients and increased regulatory forbearance all lead to increased instances of financial failure. In addition, the emergence of universal banks or financial supermarkets increases the degree of entanglement of different agents within the financial system and increases the domino effects of individual financial failures.

In addition, open capital accounts generate tendencies whereby capital movements occur because of unpredictable changes in investor confidence (Ghosh and Chandrasekhar 2008). This affects both inflows and outflows in

ways that the governments concerned cannot control. One very common conclusion that has been constantly repeated since the start of the Asian crisis in mid 1997 is the importance of “sound” macroeconomic policies, once financial flows have been liberalised. It has been suggested that many emerging markets have faced problems because they allowed their current account deficits to become too large, reflecting too great an excess of private domestic investment over private savings. This belated realisation is a change from the earlier obsession with government fiscal deficits as the only macroeconomic imbalance worth caring about, but it still misses the basic point. With unregulated capital flows, it is not possible for a country to control the amount of capital inflow or outflow, and both movements can create consequences which are undesirable. If, for example, a country is suddenly chosen as a preferred site for foreign portfolio investment, it can lead to huge inflows which in turn cause the currency to appreciate, thus encouraging investment in non-tradeables rather than tradeables, and altering domestic relative prices and therefore incentives. Simultaneously, unless the inflows of capital are simply (and wastefully) stored up in the form of accumulated foreign exchange reserves, they must necessarily be associated with current account deficits. Thus, it was no accident that all the emerging market economies that received substantial financial capital inflows also experienced property and real estate booms, as well as stock market booms around the same time, even while the real economy may have been stagnating or even declining. These booms, in turn, generated the incomes to keep domestic demand and growth in certain sectors growing at relatively high rates. This soon resulted in signs of macroeconomic imbalance, not in the form of rising fiscal deficits of the government, but a current account deficit reflecting the consequences of debt-financed private profligacy.

Large current deficits are therefore necessary by-products of the surge in capital inflow, and that is the basic macroeconomic problem. This means that any country which does not exercise some sort of control or moderation over private capital inflows can be subject to very similar pressures. These then create the conditions for their own eventual reversal, when the current account deficits are suddenly perceived to be too large or unsustainable. What all this means is that once there are completely free capital flows and completely open access to external borrowing by private domestic agents, there can be no “prudent” macroeconomic policy; the overall domestic balances or imbalances will change according to the behaviour of capital flows, which will themselves respond to the economic dynamics that they have set into motion. This knowledge is at least partly responsible for the paradoxical tendency of developing countries across the globe to hold excess reserves, even when they

reflect capital inflow, rather than use such resources to increase domestic absorption. This strategy of increasing reserves not only builds a cushion against capital flight in the event of a change in investor confidence, but also prevents the currency from appreciating. But it creates the bizarre global result of financial liberalisation, that poor countries end up financing the expansion and consumption of the richest economies, especially the US, rather than investing in their own development. That is why the current liberalised system did *not* provide for a net transfer of resources to the developing world. In the past six years, there has been a net flow of financial resources from every developing region to the North, primarily the US, even as global income disparities have increased.

In addition to creating the conditions for greater internal and external fragility, financial liberalisation has generated a bias towards deflationary macroeconomic policies in developing countries. To begin with, the need to attract internationally mobile capital means that there are limits to the possibilities of enhancing taxation, especially on capital. Typically, prior or simultaneous trade liberalisation already reduces indirect tax revenues, and so tax-GDP ratios deteriorate further. This then imposes limits on government spending, since finance capital is generally opposed to large fiscal deficits and fear of capital flight will restrict governments from running deficits in such a context. This not only affects the possibilities for countercyclical macroeconomic stances of the state but also reduces the developmental or growth-oriented activities of the government.

Such a tendency is exacerbated by the fact that financial deregulation can lead to the dismantling of the financial structures that are crucial for growth and development (Chandrasekhar 2008a). While the relationship between financial structure, financial growth and overall economic development is complex, the basic issue of financing for development is really a question of mobilising or creating real resources. In the old development literature, finance in the sense of money or financial assets came in only when looking at the ability of the state to tax away a part of the surplus to finance its development expenditures, and the obstacles to deficit-financed spending, given the possible inflationary consequences if real constraints to growth were not overcome. By and large, the financial sector was seen as adjusting to the requirements of the real sector. But this need not happen when the financial sector is unregulated or covered by a minimum of regulation, since market signals then determine the allocation of investible resources and therefore the demand for and the allocation of savings intermediated by financial enterprises. This aggravates the inherent tendency in markets to direct credit to non-priority and import-intensive but more profitable sectors, to concentrate investible funds in the hands of a few

large players and to direct savings to already well-developed centres of economic activity. The socially necessary role of financial intermediation therefore becomes muted. This certainly affects employment-intensive sectors such as agriculture and small-scale enterprises, where the transaction costs of lending tend to be high, risks are many and collateral not easy to ensure. The agrarian crisis in most parts of the developing world is at least partly, and often substantially, related to the decline in the access of peasant farmers to institutional finance, which is the direct result of financial liberalisation (Patnaik 2005). Measures which have reduced directed credit towards farmers and small producers have contributed to rising costs, greater difficulty of accessing necessary working capital for cultivation and other activities, and reduced the economic viability of cultivation, thereby adding directly to rural distress. In India, for example, there is strong evidence that the deep crisis of the cultivating community, which has been associated with a proliferation of farmers' suicides and other evidence of distress such as mass migrations and even hunger deaths in different parts of rural India, has been related to the decline of institutional credit, which has forced farmers to turn to private moneylenders and involved them once more in interlinked transactions to their substantial detriment (Ramachandran and Swaminathan 2005).

It also has a negative impact on any medium term strategy of ensuring growth in particular sectors through directed credit, which has been the basis for the industrialisation process through much of the twentieth century. Indeed, it is hard to think of any country that has reached "developed" status without relying to greater or lesser extent on directed credit. For late industrialisers, the necessity is even more evident, because capital requirements for entry in most areas are high; because technology for factory production has evolved in a capital-intensive direction from its primitive industrial revolution level; because of competition from established producers within and outside the country.

Bailouts and Moral Hazard

Financial crises bring out all sorts of worms from cupboards. Mostly, these reflect ineptitude, irresponsibility and unrestrained greed, which are usually responsible for having created the internal conditions for the crisis, even if there could be other proximate or external factors that are associated with the crisis. But the strategies of dealing with any crisis have to confront another huge problem, one which could even lead to future financial crises: that of moral hazard.

The *Palgrave Dictionary of Economics* defines moral hazard as "actions of economic agents in maximising their own utility to the detriment of others, in

situations where they do not bear the full consequences.” In financial markets, these problems are especially rife because such markets are anyway characterised by imperfect and asymmetric information among those participating in the markets. The moral hazard associated with any financial bailout results from the fact that a bailout implicitly condones the earlier behaviour that led to the crisis of a particular institution. Typically, markets are supposed to reward “good” behaviour and punish those participants who get it wrong. And presumably those who believe in “free market principles” and in the unfettered operations of the markets should also believe in its disciplining powers. But when the crisis hits, the shouts for bailout and immediate rescue by the state usually come loudest from precisely those who had earlier championed deregulation and freedom from all restriction for the markets. This has been very marked in the current crisis hitting the US economy, reflected in the failure of major mortgage institutions, insurance companies and Wall Street banks.

The arguments for bailout are related either to the domino effect - the possibility of the failure of a particular institution leading to a general crisis of confidence attacking the entire financial system and rendering it unviable - or to the perception that some institutions are too large and too deeply entrenched in the financial structure, such that too many innocent people, such as small depositors, pensioners and the like, would be adversely affected. It is this latter perception that has apparently led to the recent decisions of the US government to bail out several major financial institutions in the past few months. When the collapse of Lehmann Brothers did actually have a sharp negative sentiment on market sentiment, the US government had to move in with even larger bailouts, culminating in the still evolving \$700 billion Troubled Assets Relief Programme (TARP). Indeed, as the large Wall Street banks and finance institutions reveal the full extent of the problems that they have accumulated in the latest housing finance boom, the issue of more and possibly even bigger bailouts is likely to become more pressing.

Each of these huge bailouts is being presented as a once-off, inevitable move designed to save the system. However, if they are not simultaneously accompanied by stringent measures and regulations to control irresponsible or risky behaviour, each bailout ultimately may encourage banks and other financial institutions to take more risks in the belief that the government will step in if they run into trouble. Furthermore, given the oligopolistic nature of the banking and financial system, fears are already being expressed that each bailout actually gives an errant large bank a competitive advantage over its rivals. For example, the enormous and sequential bailout of Citigroup in late November, led to a company that was perceived as the sick part of the industry

and on the verge of collapse, becoming not just immediately healthier than its rivals but also able to command capital market funds at lower rates. This creates strong incentives for banks to line up for government bailouts, and tilts the scales very unfairly against smaller banks, who are unlikely to be the recipient of government largesse because they are too small for their collapse to have any significant ripple effects on the system. So the already concentrated banking industry is likely to get even more concentrated as a result of this entire process.

Of course, what is happening in US capitalism today is only a repeat the pattern of the financial crises that spread across the developing world in the 1990s and early 2000s. In all those cases, those who were responsible for the policies and financial actions that created the crisis, and who were the major beneficiaries of the preceding boom, did not pay the costs of the crises. These costs were borne by workers who lost their jobs directly because of the crisis, as well as those who were then affected by the stabilisation measures imposed to control the crisis, including small businesses that collapsed because of the high interest rate-tight money regime that is a typical post-crisis response. Because those responsible for the crisis do not have to pay for it, they are likely to have no compunctions in once again creating the same conditions – and in fact that is what is happening now in many of the formerly crisis-ridden emerging markets.

Of course there are issues of fairness and equity, because the same US government that has thus far refused to come to the aid of small borrowers who are being thrown out of their homes because they cannot repay their loans, quickly summoned all its power and financial resources to bail out the financial elite that has created the mess with its greedy and irresponsible practices. Instead of a progressive nationalisation that would seek to direct finance to serve the ends of the real economy and the working people, this is basically the socialisation of the risks and losses of capitalists, to be borne by taxpayers in the US and by developing countries. The class bias of the Bush government could not be more apparent, while the extent to which an Obama administration would really change this strategy has yet to be seen. And of course the ability to bail out at all stands in stark contrast to the way the same administration has treated financial crises in other countries, where it and the IMF have forced governments to let banks and other companies fail, causing unemployment, falling living standards and depression as the “necessary pain” of adjustment. The lesson is not lost on the developing world: once again the US government has set different rules for itself and its own friends, from what it imposes on others.

The Impact on the Developing World

The past months have made it clear that the developing world is far from immune to the storms raging in financial markets in industrial countries. Stock prices in emerging markets have gone on similar roller coaster rides to those in New York and Europe, in a manner reminiscent of the behaviour of stock indices in the last major international financial upheaval in 1929/30 – the Great Depression. The credit crunch and freezing of interbank lending have been only too evident even in developing countries whose economic “fundamentals” were apparently strong and whose policy makers believed that they could decouple from the global trends.

This almost immediate diffusion of bad news is partly the result of financial liberalisation policies across the developing world that have made capital markets much more integrated directly through mobile capital flows, and created newer and similar forms of financial fragility almost everywhere (Akyuz 2008). But the international transmission of turbulence is only one of the ways in which the global financial crisis can and will affect developing countries.

A medium-term implication is the impact on private capital flows to developing countries, which are likely to reduce with the credit crunch and with reduced appetite for risk among investors. The past five years witnessed an unprecedented increase in gross private capital flows to developing countries. Remarkably, however, this was not accompanied by a net transfer of financial resources, because all developing regions chose to accumulate foreign exchange reserves rather than actually use the money. Thus, there was an even more unprecedented counter-flow from South to North in the form of central bank investments in safe assets and sovereign wealth funds of developing countries, a process which completely shattered the notion that free capital markets generate net financial flows from rich to poor countries.

The likely reduction of capital flows into developing countries is generally perceived as bad news. But that is not necessarily true, since the earlier capital inflows were mostly not used for productive investment by the countries that received them. Instead, the external reserve build-up (which reflected attempts of developing countries to prevent their exchange rates from appreciating and to build a cushion against potential crises) proved quite costly for the developing world, in terms of interest rate differentials and unused resources. While some developing countries may indeed be adversely affected by the reduction in net capital inflows, for many other emerging markets this may be a blessing in disguise as it reduces upward pressure on exchange rates and creates more emphasis on domestic resource mobilisation.

Similarly, it is also very likely that the crisis will reduce official development assistance to poor countries. It is well known that foreign aid is strongly procyclical, in that developed countries' "generosity" to poor countries is adversely affected by any reversal in their own economic fortunes. But in any case development aid has also been experiencing an overall declining trend over the past two decades, even during the recent boom. In fact, the developed countries were extremely miserly even in providing debt relief to countries whose development prospects have been crippled by the need to repay large quantities of external debt that rarely contributed to actual growth. Notwithstanding the enormous international pressure for debt write-off, the G-8 countries have provided hardly any real debt relief. When they have done so, they have provided small amounts of relief along with very heavy and damaging policy conditionalities and in a blaze of self-serving publicity. So the speed and extent of the debt relief provided to their own large banks by the governments of the US and other developed countries, even when these banks have behaved far more irresponsibly, has not gone unnoticed in the developing world.

One major source of foreign exchange that will certainly be affected is remittance incomes, especially from workers based in Northern countries. Already, the Inter-American Development Bank estimates that 2008 will be the first year on record during which the real value of inward remittances will fall in Latin America and the Caribbean. Remittances into Mexico (which are dominantly from workers based in the US) in August were already down 12 per cent compared to a year previously, and this will only get worse. There is also evidence of declining remittances from other countries that relied strongly on them, such as the Philippines, Bangladesh, Lebanon, Jordan and Ethiopia. In India, where around half of inward remittances currently come from the US, the same pattern of decline is likely.

Exports of goods and services, like remittances, are going to be affected by the global economic downturn. For most developing countries, the US and the European Union remain the most important sources of final export demand, and as they inevitably tip into recession, exports to these markets will also decline. All the loose talk of China emerging as the alternative engine of growth for the world economy has died down after China's exports contracted in the last two months of 2008 and domestic manufacturing stagnated. Chinese growth, which has pulled along many other Asian developing countries in a production chain, has been largely export-led. The US, EU and Japan together account for more than half of China's exports, and as their economic crisis intensifies, it is bound to affect both exports and economic activity in China. Even if China's policy makers respond by shifting to an emphasis on the

domestic economy, for example through expansionary fiscal policy of along the lines suggested by the declared fiscal stimulus of \$340 billion over two years, this is unlikely to generate levels of international demand that will come anywhere near to the meeting the shortfall created by recession in the developed countries. China's share of global imports is still too small for it to serve as a growth engine on the same scale.

Across the developing world, one additional detrimental effect of the current crisis is likely to be the postponement or even cancellation of large investment projects whose ultimate profitability is now in doubt. This will have negative multiplier effects, as cancelled orders and lost jobs further reduce demand. The construction sector has already been hit, and many large projects are being cancelled even in economies that are still growing. The aviation sector is going through a major shakeout, which is evident even in India where there has already been a tendency towards mergers and worker retrenchment. The tourism and hospitality sector, which had emerged as an important employer in many developing countries, is facing cancellations and declining demand across both luxury and middle class segments.

The recent crisis has also signalled the end of the commodity boom, which is bad news for those developing countries dominantly reliant on commodity exports, and good news for commodity-importing developing countries. This follows a period of unprecedented increase in oil and other commodity prices, led largely by speculative investor behaviour. For example, world oil prices, which had increased to nearly \$150 per barrel in early July, fell to less than \$40 per barrel by December 2008. (Brent Crude futures) fell to less than \$70 per barrel from nearly \$150 in early July. One important index of commodity prices, the Reuters-Jefferies CRB index, in early December was more than 50 per cent below its all-time high in July. While speculative behaviour was clearly behind the volatility in commodity prices over the past year, it is likely that such prices will continue to decline or stagnate at low levels for some time now because of the broader economic slowdown.

This may provide some breathing space in terms of inflation control for importing developing countries, especially oil importers. But the food crisis still rages for possibly a majority of the population of the developing world, and the current global economic crisis will certainly not make it better. While world prices of important food items have also declined in the recent past, they are still too high for many developing countries with low per capita incomes and a large proportion of already hungry people. And retail prices of food have hardly declined in most developing countries. Indeed, the financial crisis may actually make it more difficult for many governments of poor developing countries to secure adequate commodity supplies to meet their people's needs.

These are forces that will affect all or most developing countries, but they will be felt differently in different places. In particular, the extent of financial contagion and possible local financial crisis depends on how far the developing country concerned has gone along the road of financial liberalisation. Countries with large external debts and current account deficits will face particular problems. Already, it is apparent that financial markets are estimating the risk of default (in the form of the price of credit default swaps) for countries such as Pakistan, Argentina and Ukraine as high as 80 per cent or more. Sometimes, as in Kazakhstan and Latvia, it is because of their highly leveraged banking systems. In other cases, as for Turkey and Hungary, it is because of the very high current account deficits. The developing countries that have gone furthest in terms of deregulating their financial markets along the lines of the US (for example Indonesia) have been the worst affected and may well have full blown financial crises of their own. By contrast, China, which has still kept most of the banking system under state control and has not allowed many of the financial “innovations” that are responsible for the current mess in developed markets, is relatively safe. In India, which still has a nationalised banking system and greater degree of regulation, is better off than Indonesia, but recent reforms that the NDA and UPA government have pushed through despite Left protests, along with the growing current account deficit, have rendered the Indian economy more fragile and potentially vulnerable than China.

Of course, developing countries are still bit players in this global drama. This particular financial crisis has so many ramifications mainly because it is occurring in the very core of capitalism, and originated in the US, the country that had the global power and influence to impose its own economic model on almost all of the rest of the world. And the depth and severity of the crisis are likely to signal global political economy changes that will shape the world for the next few decades. Geopolitical shifts are likely to result from such glaring exposure of economic vulnerability in the global hegemon. Large bailouts and the planned Obama fiscal stimulus in the US will lead to a big increased in the US public debt. It will also make it harder for the US to maintain its military dominance, which has been a major source of the strength of the US dollar.

While the drama is still being played out and the ultimate denouement is still unclear, what cannot be denied is that US dominance of world economics and politics is now under severe question, and has suffered a blow from which it may not recover. The changes in the world in the next decade will not be linear or unidirectional, and there are bound to be savage conflicts over resources and much else, but the recent pattern of global imperialism has been severely disturbed. But even more than the geopolitical or economic shift, a

bigger shift may come about from the clear failure of the economic model of neoliberalism. The notions that markets know best, and that self-regulation is the best form of financial regulation, have now been completely exposed as fraudulent. And so this pervasive financial crisis, which is still to fully play out and work through in real economies, may have create a genuine opportunity not only for questioning the economic paradigm that has been dominant for far too long, but also replacing it with more progressive and democratic alternatives.

International Financial Architecture and the Role of the IMF

Progressive change will require fundamental changes in the system of organising global finance and the institutions that govern trade and finance. But such changes will not come easily. The global financial and trading system is one that for many generations has been almost exclusively determined by the governments of western former colonial powers, and their writ still runs large in all the global institutions. Thus, the G-7 which leaves out Russia and China, not to mention India and Brazil, still presumes that it has the right to redesign the international financial architecture. The Financial Stability Forum of the Bank for International Settlements excludes any representation from developing countries. The tiny countries of Belgium, Netherlands and Luxembourg, with a total population of less than 28 million, have more votes in the IMF than China, Brazil or India.

The role of the IMF has once more assumed significance in this changed context. It has been some time now since the IMF lost its intellectual credibility, especially in the developing world. Its policy prescriptions were widely perceived to be rigid and unimaginative, applying a uniform approach to very different economies and contexts. They were also completely outdated even in theoretical terms, based on economic models and principles that have been refuted not only by more sophisticated heterodox analyses but also by further developments within neoclassical theory.

What may have been more damning was how out of sync the policies proposed by the IMF have also been with the reality of economic processes in developing countries. The 1990s and early 2000s were particularly bad for the organisation in that respect: their economists and policy advisers got practically everything wrong in all the emerging market crises they were called upon to deal with, from Thailand and South Korea to Turkey to Argentina. In situations in which the crisis had been caused by private profligacy they called for larger fiscal surpluses; faced with crisis-induced asset deflation they emphasised high interest rates and tight money policies; to address downward economic

spirals they demanded fiscal contraction through reductions in public spending. The countries that recovered clearly did so *despite* their advice, or in several cases because they actively pursued different policies. And the recognition became widespread among governments in the developing world that IMF loans were too expensive because of the terrible policy conditions that came with them. So returning IMF loans early became something of a fashion, led by some Latin American countries.

In the past few years an even more terrible fate had befallen the IMF: that of increasing irrelevance. From 2002 onwards, the IMF and the World Bank became net recipients of funds from developing countries, as repayments far exceeded fresh loans. The developing world turned its attention to dealing with private debt and bond markets, which is where the action was. Less developed countries found new sources of aid finance and private investment from other sources, as China, Southeast Asia and even India to a limited extent, began investing in other developing countries.

So the IMF was not really a significant player in the international economic scene in the recent past, and the reasons for its very existence were often called into question. However, every crisis is also an opportunity, and the IMF has been quick to seize on the current global financial crisis as an opportunity to increase its own influence, by offering its services to emerging markets. As the crisis spreads and engulfs developing countries, and as global credit markets seize up and create credit crunches, more and more developing and transition countries are going to need access to emergency liquidity. Already several countries have lined up for this and signed agreements with the IMF: Pakistan, Ukraine, Hungary, Iceland. Some European governments have called for a strengthening of the IMF and even implored surplus countries like China to put more money into the IMF's coffers.

But with its current personnel and ideological framework, such strengthening of the IMF will only mean that the conditionalities it imposes will make things much worse for the developing world. The guiding principles of IMF lending are clear: countries in the midst of financial crisis are supposed to do fiscal contraction, whether they like it or not. When the government account is in deficit, it must be reduced or converted into a surplus: when it is already in surplus, that surplus must be increased. If this is pro-cyclical and causes the crisis to spread to the real economy and create a sharp downswing, that is just too bad; this is after all, the "right" medicine and the necessary pain must be gone through to recover eventually. This is why so many developing countries have experienced even sharper and more prolonged economic downturns after turning to the IMF.

But in its recent World Economic Outlook released in October 2008, the IMF clearly exposes very blatant double standards for industrial and developing countries. Contrary to its past prescriptions, countercyclical macroeconomic policy is apparently all right for industrial countries. “*Macroeconomic policies in the advanced economies should aim at supporting activity*, thus helping to break the negative feedback loop between real and financial conditions, while not losing sight of inflation risks...*Discretionary fiscal stimulus can provide support to growth* in the event that downside risks materialise, provided the stimulus is delivered in a timely manner, is well targeted, and does not undermine fiscal sustainability” (IMF 2008:34, emphasis added). But for developing countries, who have this time been caught in a crisis that is not of their own making, the same advice is not tenable at all. “While emerging economies have greater scope than in the past to use countercyclical fiscal policy should their economic outlook deteriorate ...this is unlikely to be effective unless confidence in sustainability has been firmly established and measures are timely and well targeted. More broadly, general food and fuel subsidies have become increasingly costly and are inherently inefficient.” In fact, the IMF believes that in developing countries, despite the economic slowdown, there is room for tightening on all fronts, both fiscal and monetary! “Greater restraint on spending growth, including public sector wage increases, would complement tighter monetary policy, in the face of rising inflation, which is particularly important in economies with inflexible exchange regimes” (IMF 2008: 38).

So the IMF seems to have one rule for industrial countries in crisis, no matter how irresponsible the run-up to the crisis; and another rule for developing countries, even the most prudent and fiscally “disciplined” of them. Given this clearly unbalanced and potentially disastrous approach of the IMF, the need to examine alternative and less destructive sources of emergency finance for crisis-affected developing countries is urgent. And over the medium-term, the need is to create a more democratic and less rigid international financial regime.

What is to be Done?

Everyone now recognises the need to reform the international economic regime. But the idea should not simply be to fix a system that is obviously broken: we need to exchange it for a better model. That is because, as noted above, the current financial architecture has failed to meet two obvious requirements: of preventing instability and crises, and of transferring resources from richer to poorer economies. Not only have we experienced much greater volatility and propensity to financial meltdown across emerging markets and now even industrial countries, but even the periods of economic expansion have been

based on the global poor subsidising the rich. These global failures are so immense that they constitute enough reason to abandon this system. But there are other associated failures in terms of what the regime has implied within national economies: it has encouraged pro-cyclicality; it has rendered national financial systems opaque and impossible to regulate; it has encouraged bubbles and speculative fervour rather than real productive investment for future growth; it has allowed for the proliferation of parallel transactions through tax havens and looser domestic controls; it has reduced the crucial developmental role of directed credit.

So we clearly need a new system, even if the goals remain the same as that of the original Bretton Woods: to ensure currency stabilisation through international monetary co-operation; to encourage the expansion of international trade in a stable way; and to promote development by facilitating productive investment. To achieve this in the current context, four elements are crucial. First, the belief that self-regulation supported with external risk assessment by rating agencies is an adequate way to run a financial system has been blown sky-high. There is no alternative, therefore, to systematic state regulation of finance. Second, since private players will inevitably attempt to circumvent regulation, the core of the financial system - banking - must be protected, and this is only possible through social ownership. Therefore, some degree of the socialisation of banking (and not just socialisation of the risks inherent in finance) is also inevitable. In developing countries it is also important because it enables public control over the direction of credit, without which no country has industrialised. Third, to cope with the adverse real economy effects of the current crisis, fiscal stimulation is essential in both developed and developing countries. Enhanced public expenditure is required to prevent economic activity and employment from falling, to manage the effects of climate change and promote greener technologies (Pollin 2008), and to advance the development project in the South. Fourth, the international economic framework must support all this, which in turns means that capital flows must be controlled and regulated so that they do not destabilise any of these strategies.

The Indian Government's Response

By the end of 2008, it was very evident that the Indian economy was far from immune to the global economic problems. The stock market predictably swung wildly in gyrations around a broadly declining trend and the rupee experienced quite a sharp depreciation, as the foreign institutional investors who had entered the Indian stock market found it necessary to head back to cover losses and improve their liquidity positions in their home markets. At the same time,

exports dropped sharply, declining by 17 per cent in November 2008 compared to the same month in the previous year. Aggregate growth projections were continuously revised downwards by both official and other analysts, as the expectation that GDP growth would remain above 7 per cent for the year 2008-09 was tempered by the realisation of a likely sharp decline in the second of the year. The impact on employment was immediate: in early December it was estimated that more than 1 million jobs had already been lost, especially in the construction and small-scale export manufacturing sectors. Agriculturalists, especially those producing export crops whose prices had collapsed, faced growing difficulties on top of their existing financial problems.

The initial responses of the government focussed on the financial side of the current crisis. There were measures to infuse liquidity into a banking system that had become very constrained by reducing the Cash Reserve Ratio and the Statutory Liquidity Ratio, to reduce interest rates by bringing down repo and reverse repo rates, and to provide some relief to non-bank financial institutions, particularly insurance companies. These were confidence-building measures that became necessary not because the international contagion was spreading to the banking system but because the Indian banking system had (in a less extreme form) several of the fragilities that undermined the US banks. But these monetary all proved to be lacking and did not ease credit conditions in any meaningful way. This was of the liquidity trap characteristics of the situation: banks were unwilling to lend to any but the most credit-worthy potential borrowers, but such potential borrowers were unwilling to borrow because of the prevailing uncertainties and expectations of slowdown. Meanwhile, all other enterprises, even those who desperately required working capital just to stay afloat, found it increasingly difficult to access bank credit even as they faced more stringent demand conditions. Some of the measures seemed to be more designed to push up the stock market than to revive the real economy, but even this was unsuccessful because of dampened expectations of real revival.

In such a situation, reducing interest rates does not solve the basic problem of tightened credit provision, even though it may marginally reduce costs for those who are able to access bank credit. And the real economy cannot be revived through such measures in the absence of a strong fiscal stimulus. It is well known that there is really no alternative to the standard Keynesian device of using an expansionary fiscal stance to create more economic activity and demand, and thereby lift the economy from slump. Even so, the Government of India took an inordinately long time to announce the required fiscal stimulus, and when the much awaited fiscal package was finally announced, it turned out to be relatively small. It allowed for only up to Rs. 20,000 crore of direct additional spending through the Planning Commission in unspecified areas.

This would be less than 0.5 per cent of GDP, a tiny fiscal input which is too small to be really countercyclical or even to change the expectations of private agents in any meaningful way.

This direct spending was combined with a tax cut measure, on domestic duties – reducing the ad valorem Cenvat rate by 4 percentage points. But the point about such economic situations is that price responses do not work, and therefore output has to be addressed directly through spending. In any case, even price changes would not necessarily follow, since tax cuts would have an impact in terms of supporting economic activity only if producers respond by cutting prices, and such price cuts generate demand responses. But neither is inevitable. For example, the Government of India cut the administered price of aviation fuel in October 2008, but this was not passed on to consumers by the airline companies, and even two months later only one carrier – the public sector Air India – promised to reduce the aviation fuel surcharge. So that particular measure simply became an additional subsidy to shore up profits of airline companies. Across the world, governments have been finding that in these times of economic uncertainty, tax cuts are much less effective in stimulating activity than direct government expenditure. Similarly, measures that try to provide additional export incentives (such as interest reductions for export credit) to exporting sectors such as textiles, garments and leather would not counteract the effect of big losses of export orders as the major markets start shrinking. What is required was a more serious and systematic attempt to allow these industries to keep producing at technologically efficient levels and shift demand to other markets.

But what is even more significant is what the stimulus package announced in November 2008 left out. Not only was the overall size of the package too small to have much effect, but some of the most critical areas of spending were ignored or neglected. These areas include resource allocation to state governments, direct investment to ensure mass and middle-class housing and interventions to improve the livelihood conditions of farmers.

By the middle of 2008, state governments had already started feeling the resource constraint as their tax revenues were affected by the economic downturn. Yet they are responsible for most of the public services that directly affect people, such as those relating to agriculture and rural development, health, sanitation, education and so on, but unlike the Centre, the States face a hard budget constraint. So the overall conditions of life of the citizenry are likely to be affected. Yet the Centre could so easily have announced some measures to provide fiscal relief to the States to help them cope with the adverse effects of the downturn. Such measures could include reducing interest rates, providing more central funds and most of all relaxing fiscal responsibility norms that are

inappropriate for the current situation and which the Centre itself has already discarded.

Similarly, the food crisis has been forgotten in all the excitement about the financial crisis, but food insecurity remains widespread and may even be spreading, given the significant rise in prices over the past two years. While overall inflation has been easing, food inflation in India continues despite large food grain stocks. And the real incomes of workers and cash crop cultivators have not kept pace with this. Poor or inadequate nutrition is already a big problem, which will deteriorate as the downturn worsens. A major positive role of crisis management would be played if it involved the allocation of significantly increased resources towards expanding, universalising and improving the functioning of the Public Distribution System. This would at least partly alleviate the problems of those who are already at the margin of survival, as well as those who could be tipped over into poverty by recent economic processes. Similarly, specific interventions are required to ensure the financial viability of cultivators, especially those who have been hit by falling output prices even as their own costs have kept rising.

The construction industry is a major employer and it has been hard hit already by the downturn. Yet the shortage of affordable housing remains acute across our cities and towns. Part of the problem is that private developers have increasingly focussed on the luxury segment of the market, without addressing this very obvious and basic need. It is important to expand the provision of middle class and mass housing, which is easily possible through public sector organisations, and can even be done through schemes that will be largely self-financing.

While monetary policies are not sufficient to address the current economic problems in India, this does not mean that the financial sector can be neglected. In particular, what is most obvious is that financial sector liberalisation has to be reversed, given the knowledge of the huge imperfections in such markets and the ability of unregulated finance to create massive scams that also destabilise real economies. Across the world, and especially in the major industrial countries, banking and insurance institutions are being effectively nationalised – yet in India there are moves towards more privatisation! The UPA government in mid-December actually placed a bill in Parliament that would raise the cap on FDI in the insurance sector to 49 per cent, along with several other liberalising moves, even though the need is so obvious to exercise strong and effective regulation on insurance companies and prevent private domestic savings from being misused and exported out of the country. Further, the rapid expansion of retail credit since the early 2000s – with very large volumes of often unsecured lending in the form of housing loans, vehicle loans

and credit card debt – provokes concerns about domestic financial fragility, especially as the economic slowdown bites into incomes and employment.

The point is that the current global crisis provides a real opportunity to initiate and develop alternative policies, both internally and domestically. A change in economic paradigm is essential; without it the international economy will continue to lurch from crisis to crisis and the developing world will not be able to advance and provide basic needs to citizens. The need for more state intervention in economies is now recognised everywhere: the concern now is to ensure that such state involvement is more democratic and more accountable to the people.

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Impact of the Financial Crisis on the Rural Economy in India: Intensification of the Agrarian Distress?

Arindam Banerjee

Introduction

The contemporary financial crisis that has its roots in the collapse of the sub-prime housing boom in the US is steadily engulfing the global economy. The crisis which is intensifying at a fast pace and pervading the developing economies has multiple implications for the Indian economy. The impact of the crisis on the Indian economy will be of a different nature and degree compared to the western developed nations and many other countries whose banking sectors are under considerable stress and running the risk of a potential capitulation as fallout of the Wall Street debacle.

The partial liberalisation of the financial sector in the Indian economy due to a number of reasons has caused relatively less exposure of the Indian banking sector to international finance. While the banking and financial sectors may not have to line up for bail-out packages as in the West, the real sectors of the Indian economy will be significantly affected given their dependence on export-led growth strategies in recent times. The shrinking of aggregate demand in the world market as a consequence of the crisis will hurt the exporting manufacturing industries in the country. This is already evident in certain export-driven industries like the textiles, leather or gems and jewellery, where there have been significant job-losses with the onset of the crisis. This, along with a squeeze in the high-income service sectors like financial services, hospitality or tourism will lead to a reduction in consumption spending and overall demand within the domestic economy. A direct consequence of this is a simultaneous loss of existing informal sector employment and lower generation of new non-farm employment in the economy.

In this emerging context, there is a clear possibility of an aggravation of the current situation of agrarian distress in the rural areas. The implications of the financial crisis for the rural economy can be identified as the intensification of

three constraints on the production systems of the rural economy. This is not to ignore other multiple effects of the crisis on rural livelihoods but to identify three fundamental impacts of the crisis. Two of these constraints can be categorised as direct impact of the financial crisis, namely, plummeting product prices of agricultural commodities and declining availability of credit to small-scale agriculture. The third constraint is more indirect in nature arising due to the shrinkage of non-farm employment opportunities in the secondary and tertiary sectors and increasing pressure of the work force on the primary sector.

A major impact of the current crisis is an imminent depression in the world demand and prices of primary agricultural products which are cultivated on a commercial basis with the purpose of export. We can locate this phenomenon in the context of the already declining real returns from agricultural production, especially for commercial crops, in the post-liberalisation period. The onset of a global economic crisis will further the income deflation that the primary sector in the country has witnessed over the last decade or so.

The other direct impact of the world financial crisis will occur in the arena of credit availability to the small-scale agriculture and other rural livelihoods in the near future. Given the nature of the financial crisis comprising of high default rates and a plunging of lenders' confidence, it is very much plausible that the banks increasingly adhere to stringent credit disbursal norms. This implies that small and petty producers in the rural economy are most likely to be excluded from credit coverage, which will further accentuate the already disturbing trends of withdrawal of institutional credit from rural areas under the neoliberal economic regime. The stranglehold of private moneylenders on the peasant economy that has strengthened in this period as shown by NSS Debt and Investment Survey data, promises to be intensified in such a scenario.

The indirect consequence of the crisis on the rural sector will originate from the slowdown experienced by the secondary and tertiary sectors. The agrarian crisis that precipitated over the last decade had perforce caused a shift in the employment pattern in the economy towards more non-farm employment, particularly self-employment in the informal sector. This can be largely viewed as a coping response from the rural populace in the face of the compression that agricultural activity faced under a liberalised trade regime and often returns in such non-farm employment has been meagre. The fact that the present crisis will potentially decelerate the manufacturing and services sectors imply that occupational diversification, even if on unfavourable terms, will be more difficult to achieve. A relative increase in dependence of the workforce on agriculture will only compound the problems manifold given the

direct adverse impacts of the crisis on the primary sector production as outlined above. The financial crisis, therefore, threatens to worsen the agrarian crisis, intensify the income deflation that is already a feature of the rural economy and consequently aggravate the alarming levels of hunger and malnutrition that currently exist in the countryside.

Assessing the Constraints in a Historical Framework

It is important to review the possible scenario in the agricultural sector in a historical time-frame precisely for the reason that the sector was not booming during the high growth regime in the Indian economy. The stagnation and crisis that has already afflicted the rural economy over the past one and a half decades imply that the onset of the global crisis will only serve to intensify the existing adverse trends in the primary sector. We will therefore assess the different impact in the backdrop of the processes that were occurring in the period of economic reforms.

Falling Output Prices

The real returns in agriculture were already declining, particularly for commercially cultivated crops, under the economic reforms period. Since the liberalisation of trade in agricultural commodities in the mid-nineties, the movements in food-grains prices have mostly been unfavourable relative to the product prices of non-food-grains and other commercial crops. The world prices of primary products declined since the mid-nineties till around the end of the millennium as a result of an excess supply in the world market. The falling prices adversely affected the farmers in India and across the developing countries, especially those who had shifted to the cultivation of commercial crops, entailing large investments. The strategy of producing and exporting commercial crops and importing food at cheaper prices did not succeed due to the price trends in the world market during this period. Food prices also declined towards the end of the nineties, but at a far lower rate than the primary product prices.

On the other hand, the primary product prices started rising since the turn of the century. Along with that food prices also increased in the world market in the new century at least at a similar rate, if not faster. An implication of this phenomenon for the small-scale primary producers in the developing world (who are mostly net food buyers) was that the *real* product prices they faced secularly declined over the last one and a half decades. The rising food prices in the new century, especially the phenomenal upsurges in global food and

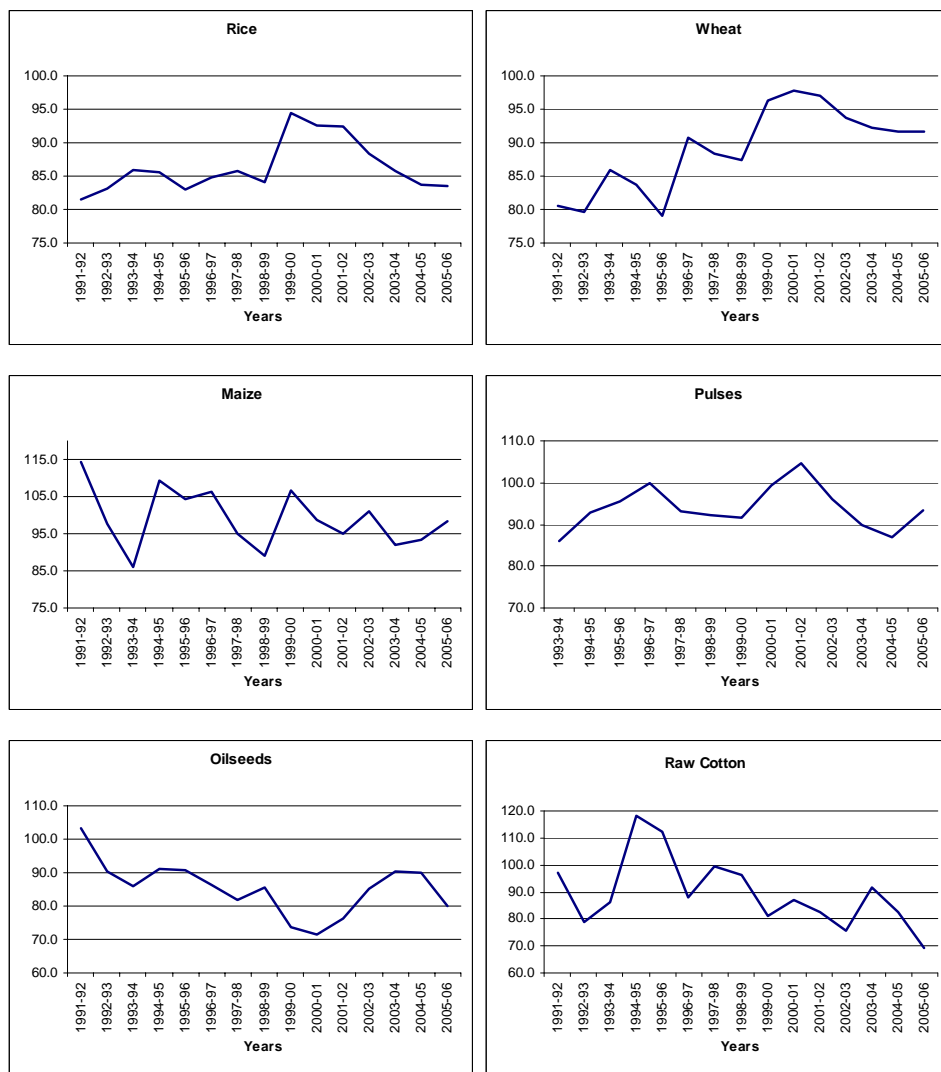
fuel prices witnessed in the last couple of years, also meant that real returns in agricultural activity in the Third World had turned even more unfavourable in recent times. Moreover, with world prices affecting domestic prices under a trade-liberalized regime, the returns to agricultural production started falling even within the domestic economies, further compounding the problem for the large rural populace in these countries.

To understand this phenomenon, we look at the trends in the real producer prices for major crops in the post-reform period. The movements in the real producer prices in India are unambiguously portrayed by Figure 1, where we have plotted the *real* Wholesale Price Indices (at 1991-92 prices) for different crops and product-groups for the period between 1991-92 and 2005-06. We have used the Wholesale Price Indices for Rice, Wheat, Maize and Raw Cotton and product groups like pulses and oilseeds available in the various reports of the Commission for Agricultural Costs and Prices (CACP). The nominal price indices have been deflated using the Consumer Price Index for Agricultural labourers (CPI-AL).

With certain assumptions, the real producer prices capture the changes in the purchasing power of cultivators. The trends in the wholesale price indices deflated by the CPI-AL represents the changes in the capacity of the producers to purchase a particular commodity basket over time, assuming that the costs of cultivation as a proportion of output and the output share appropriated by middlemen and commission agents have remained more or less unchanged with time. The first assumption is a particularly strong one given that with deregulation of input markets under the neoliberal economic regime, prices of seeds and chemical inputs have undergone significant upward revisions.

The real producer prices for rice remained stable throughout the nineties but experienced a surge in the late nineties. However, this gain quickly tapered off and the real prices reached the early nineties level due to stagnated nominal prices and higher inflation in the new century. In contrast, the real value of wheat prices sharply increased initially when the economy was opened up in the mid-nineties and again towards the end of the decade. However, like rice, the real prices for wheat also faced stagnation since 1999-00 and a downturn in the period thereafter. Similar trends are visible for pulses where the real prices have fast declined post 2001-02 to the early nineties levels after a brief upsurge at the turn of the century. On the other hand, the trend for maize have been more volatile, declining significantly in the early nineties followed by occasional upturns, but importantly, the real maize prices have consistently remained below the 1991-92 level throughout the period.

Figure 1: Trends in real Wholesale Price Indices for different Crops and Crop-Groups (at 1991-92 prices)



Source: Based on Wholesale Price Index data published in various reports of the CACP.
 Note: The period of analysis for pulses is 1993-94 to 2005-06 as the price indices for Pulses as a group are not available for the years 1991-92 and 1992-93

The trends for the real prices for the non-food products are significantly different from what we observed for the food crops. The real producer prices for oilseeds have secularly declined in the nineties to low levels. The subsequent

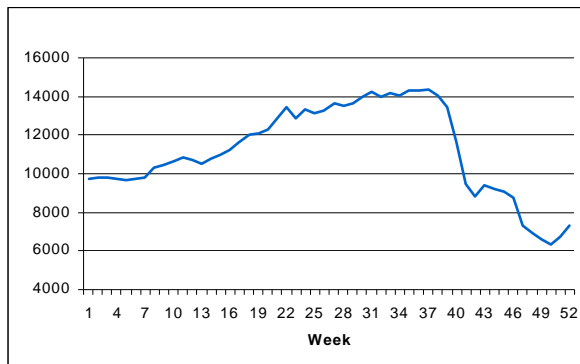
rise for oilseeds after 2000-01 was more due to inadequate supply and poor quality production, owing mainly to the drought conditions in the early years of the new century; this implies that no real benefits were accrued by producers due to this increase which also got partially reversed in the last three years of the period of analysis. Raw Cotton, which has been at the centre of the agrarian crisis in the country, exhibits an unambiguous declining trend in real prices ever since the markets were liberalized in the mid-nineties. From a high in 1994-95, the real prices have fast dwindled and even slipped under the low value that existed in 1992-93.

These price trends explicitly reveal a more systemic income deflationary process under trade-liberalisation for commercially cultivated crops like cotton or oilseeds rather than mere intermittent shocks. For food crops also, there is a clear erosion of real value of prices from around the year 2000. In the event of rising cultivation costs in agriculture unlike what we have assumed, the decline in the purchasing power of the producers is even greater than what we observe from the graphs.

In the face of this ongoing income deflation in agriculture, renewed price shocks triggered by the financial crisis will further intensify the pressure of inadequate output prices in cultivation. Over the last couple of years, prices of most commercial crops witnessed a surge inducing more cultivators to shift to cultivating these crops. However, the simultaneous phenomenal surge in global food and fuel prices and the high inflation rates in 2008 in the Indian economy also meant that their real returns did not increase as much as the nominal prices did. Moreover, the volatility of commercial crop prices is of a nature such that the periods of high prices have not been long-lasting. Often, the premium of high prices at the start of a growing season withers well before the harvesting season or by the next growing season preventing any significant rise in the average rate of return from cultivation of these crops. In fact, farmers who were induced to shift to these crops due to the high export prices are prone to accumulate sizeable losses due to the investments that they have already undertaken for growing these crops.

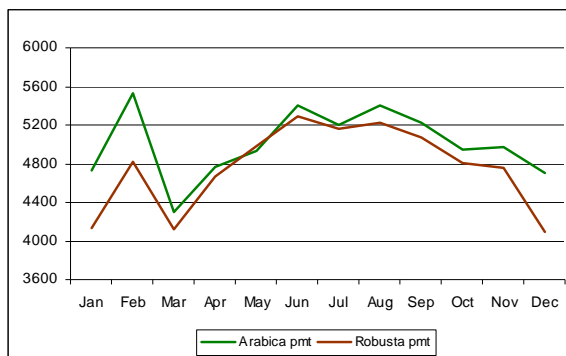
The recent price trends of some major commercial crops illustrate this fact. The weekly rubber prices in the Kottayam market exhibits a steady increase in 2008 till the onset of the global financial crisis (Figure 2). The prices crashed in mid-October (38th week) and returned to levels much lower than that in the initial weeks of 2008 when prices started increasing. Such a short cycle of prices where high prices do not persist for even a full year is grossly disadvantageous to the grower. Similar trends are visible for coffee prices also (see Figure 3) where the prices are declining since September. For Robusta coffee, the prices by December were already as low as that in March.

Figure 2: Weekly Rubber Prices (RSS-1) in 2008: Kottayam
(in Rs./quintal)



Source: Rubber Board, Ministry of Commerce and Industry, GOI

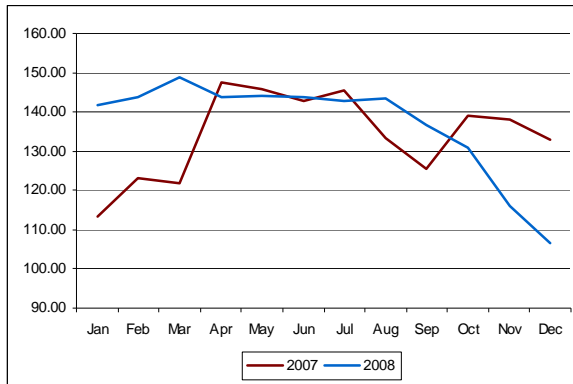
Figure 3: Raw Coffee (Parchment) month-end prices, 2008: Karnataka
(in Rs./50 kg)



Source: *Market Information*, Coffee Board of India (www.indiacoffee.org)

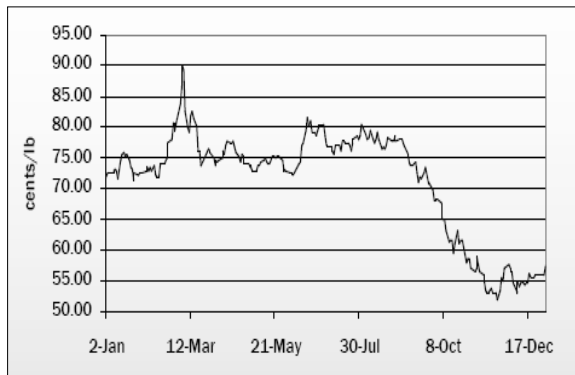
The pepper prices (Figure 4) in contrast started rising in early 2007 and sustained till September, 2008 when the financial crisis started pushing the prices downwards. The world cotton prices as represented by the Cotlook A Index (Figure 5) also sustained high levels for the entire 2007 and most part of 2008. However, the prices crashed in October, 2008 with the meltdown of the financial markets and reached abysmally low levels that were reminiscent of the period in early 2007 when speculative activities started gaining at the New York Commodity Exchange. For both these crops, the high price regime lasted for at least a year suggesting that growers may have made some gains during this period unlike rubber or coffee growers. However, given the crash in

Figure 4: Monthly Pepper Prices (Kochi): 2007 and 2008:
(in Rs./Kg)



Source: *Monthly average domestic prices of different spices in India*, Spices Board of India, Ministry of Commerce, GOI

Figure 5: Cotlook A Index during 2008



Source: Cotlook Monthly, December 2008, Vol 1, Issue 12.

prices in recent months, growers are likely to accumulate losses, especially on count of any long-term investments that they had made for cultivating these crops.

In the gross analysis, the short-lived character of high prices in the case of commercial crops causes hardships for small-scale farmers in the form of poor average returns. Given that backdrop, the crash in prices due to the financial crisis will accentuate losses particularly for those farmers who shifted to commercial crops and undertook large investments, attracted by the high prices, within the last couple of years.

Worsening Rural Credit Availability:

The other direct impact of the world financial crisis will occur in the arena of credit availability to small-scale agriculture and other rural livelihoods in the near future. There is a possibility that a regime of credit rationing by banks will be triggered by the crisis in which case, small and petty producers in the rural economy will find it all the more difficult to access formal credit. This will further expedite the alarming trend of a gradual and systemic retreat of the institutional banking services from the rural areas under the reforms period since 1991.

Table 1: Trends in number of branches, credits and deposits of SCBs in rural India

Year	No. of bank branches		Credit advanced		Deposits	
	Rural (number)	% to total	Rural (in Rs. crores)	% to total	Rural in (Rs. crores)	% to total
1981	19453	51.2	3600	11.9	5939	13.4
1991	35216	58.1	19688	14.7	33163	15.1
2000	32673	48.7	48753	10.6	120539	14.7
2001	32640	48.3	54431	10.1	139431	14.7
2002	32443	47.8	66682	10.2	159423	14.2
2003	32283	47.4	77153	10.2	176502	13.8
2004	32107	46.8	85021	9.7	195082	12.9
2005	31967	45.7	109976	9.5	213104	12.2
2006	30610	43.2	126078	8.3	226061	10.8
2007	30393	41.5	154898	8.0	253014	9.7

Sources: Ramachandran and Swaminathan (2002) for the figures pertaining to 1981, 1991 and 2000 and Banking Statistics: Basic Statistical Returns, RBI for 2001-2007.

The banking statistics for Scheduled Commercial banks (SCBs) reveal a gradually shrinking trend of the institutional banking sector in the rural areas (Table 1). The percentage of rural branches in total branches started declining post-1991; the decline in the nineties and afterwards not only offset the increase during the eighties but also went further below the level of 1981. Nearly 5000 rural bank branches have been closed between 1991 and 2007 citing their 'inefficient' functioning. During these seventeen years, the share of rural areas

in total bank branches came down from 58.1 to 41.5, a reduction of more than 16 percentage points.

On the other hand, the percentage of rural credit to total credit advanced also exhibits a similar trend. This figure increased from 11.9 percent to 14.7 percent between 1981 and 1991 and has fallen sharply to 8.0 percent by 2007. In contrast, the share of rural deposits did not show any significant reduction at least till 2001. However, after 2001, the percentage of rural deposits also started falling rapidly for SCBs; by 2007, this share was only 9.7 percent compared to 14.7 percent in 2001. This can be attributed as a joint outcome of a decade of continuous income-deflationary policies, aggressive financial reforms and the precipitation of an agrarian crisis.

From these figures, it is adequately clear that the banking sector has been steadily curbing its operations in the rural credit market in the face of a crunch in the rural economy. The foundations of the financial reforms were laid down by the recommendations of the Committee on the Financial System (CFS) under the chairmanship of M. Narasimhan constituted in 1991. The priority sector lending norms that effectively served agriculture, small industry and self-employment after the nationalisation of banks in 1969 were sought to be phased out by the Narasimhan committee.

The immediate result was a decline in the priority sector lending by banks, which consistently fell short of the target of 40 percent till 1996. The share of the priority sector lending started increasing after 1996 but that was mainly due to the redefinition of the norms and inclusion of new categories under the priority sector. The inclusion of investments in new infrastructure funds and special bonds of State Financial Corporations and credit advances to the food processing industry under the new definition meant that even loans disbursed to multinational companies like Pepsi or Kelloggs qualified as priority sector lending. As a result, the lending to agriculture by the banks kept on declining even after 1996. This served to increase the vulnerability of cultivator households to private moneylenders at a rapid pace in several parts of the country.¹

The situation of credit availability in the rural areas in the recent past is better illustrated if we look at the issue from the lens of the rural households. The NSS-conducted All-India Debt and Investment Surveys of 1991-92 (48th round) and 2002-03 (59th round) reveals a decrease in the share of institutional credit sources in the total outstanding cash dues of rural households from 64 percent in 1991-92 to 57.1 percent in 2002-03 (NSS Report No. 420 and 501).

**Figure 6: Percentage of Formal credit in total outstanding dues:
All Rural Households**

Source: Based on data from AIDIS, 48th and 59th round
(NSS Report No. 420, 501)

* The data for 2002-03 also includes the new states formed
through bifurcation of these states

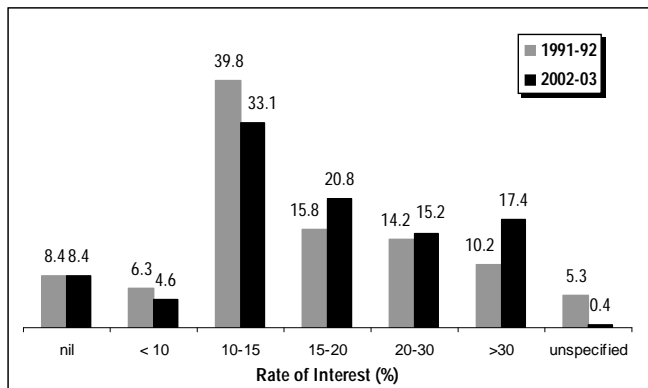
During the same period, all major states, except Maharashtra and Orissa experienced significant declines in this variable (see Figure 6). While the access to formal credit for rural households was already low for states like Andhra Pradesh and Rajasthan in 1991-92, others like Bihar, Punjab and Haryana witnessed large declines in this share during this period. Most of the other states experienced a moderate fall in this share including Kerala and West Bengal, the two states where the access to institutional credit for rural households were highest in 1991-92. As a result, by 2002-03, we observe an increase in the number of states where informal credit sources were dominating the rural credit markets i.e. supplying more than half of the credit requirements of rural households. In this respect, Haryana, Bihar and Tamil Nadu joined the ranks of Andhra Pradesh and Rajasthan by 2002-03; the latter were already in that situation in 1991-92.

The shrinkage in institutional credit for rural household implies a greater stranglehold of private moneylenders and traders, charging usurious interest rates, on the credit markets. As a result, the interest rate structure of the credit market shifts towards higher rates causing a greater diversion of money capital from the production system in the primary sector to meet the demands of credit monopoly.

The changes in the interest rate structure in rural areas for the country between 1991-92 and 2002-03 can be observed from Figure 7. For all-India, the distribution of cash loans shifted in favour of the higher interest rates between

the 48th and the 59th round. The percentage of credit taken by rural households that had an interest rate between 10 and 15 per cent was lower at 33.1 per cent in 2002-03 compared to 39.8 per cent in 1991-92. While this bracket still remained the dominant range of interest rate on credit, its share has undergone a decline over this period. The share of cash loans with an interest rate of less than 10 per cent has also declined by a small percentage in this period. As opposed to this, the share of the higher interest rate brackets has increased. The percentage of cash loans with an interest rate between 15 and 20 per cent shows a significant rise of 5 per cent over this period. However, what is most disconcerting is that the highest range of interest rates (more than 30 per cent) witnessed the largest rise from 10.2 per cent in 1991-92 to 17.4 per cent in 2002-03.

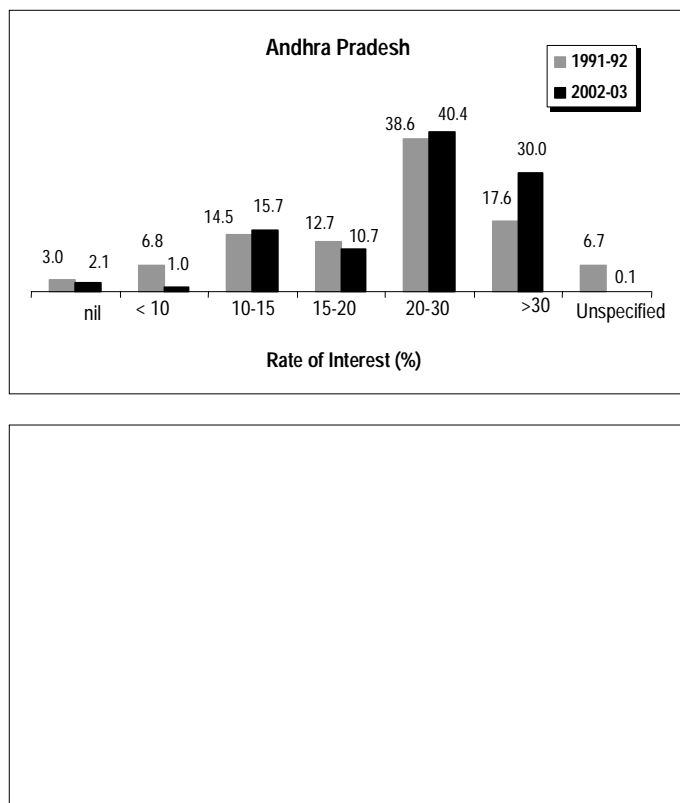
Figure 7: Percentage Distribution of cash loans by interest rates for rural households: All India, 1991-92 and 2002-03



Source: Based on data from AIDIS, 48th and 59th round (NSS Report No. 420, 501)

While looking at the cash loans distribution by interest rate for all the states would be too cumbersome for the scope of this paper, we have tried to look at a few states with two distinctly different situations. We saw earlier that Andhra Pradesh and Bihar were two states where the share of formal credit in rural areas was less than that of informal credit (Figure 6). In such states with low formal credit, we can observe that the shift of the distribution towards higher interest rates was quite large. While for Andhra Pradesh, there is a large increase for the '30 and above' interest rate bracket from 17.6 per cent in 1991-92 to 30 per cent in 2002-03, the same increase in Bihar is even higher (Figure 8). In Bihar, corresponding to this large rise, the share of cash dues in the lower range of 10 to 15 per cent interest rate has drastically fallen from 58.6 per cent to 28.2 per cent in this period.

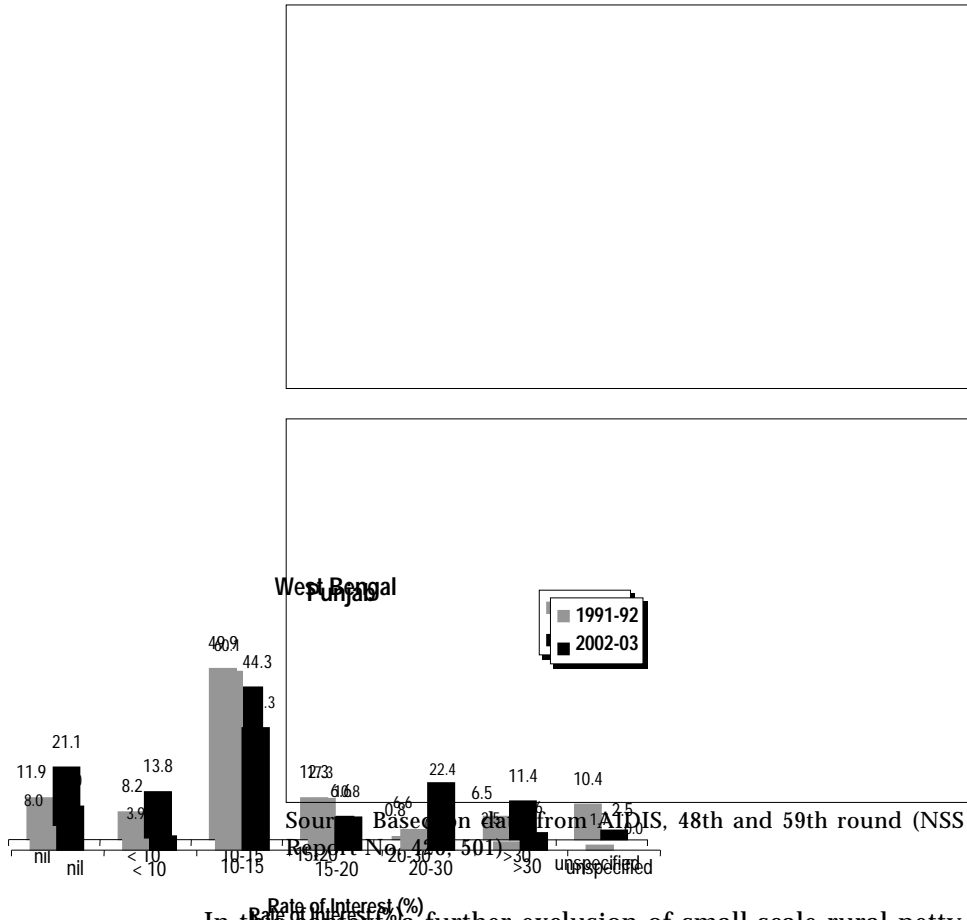
Figure 8: Percentage Distribution of cash loans by interest rates for rural households: Andhra Pradesh and Bihar, 1991-92 and 2002-03



Source: Based on data from AIDIS, 48th and 59th round (NSS Report No. 420, 501)

In contrast, for states like West Bengal or Punjab, where the access to formal credit for rural households was still quite high in 2002-03, the situation is slightly different. The dominant interest rate range in the distribution of cash dues for rural households was still the '10 to 15 per cent' range in 2002-03. However, even in these states, one cannot ignore the fact that the share of the higher interest rate range like the '20 to 30 per cent' or 'above 30 per cent' bracket has increased in the period of economic reforms. This implies that although levels of informal credit are still low in such states, the general increasing trend for informal credit, accompanied with usuriously high interest rates in rural areas, of the country are also visible here.

Figure 9: Percentage Distribution of cash loans by interest rates for rural households: West Bengal and Punjab, 1991-92 and 2002-03



In this context, a further exclusion of small-scale rural petty producers from the institutional credit coverage, as a result of the banks' response to the financial crisis, will accentuate the already tight grip of private moneylenders on the rural credit market. Usurious interest rates and stringent repayment conditions that come along with informal credit will aggravate farm indebtedness that is already a major social and economic problem in many parts of the rural countryside. The current financial crisis, therefore, threatens to adversely affect the supply of cheap credit to agriculture and allied activities. This will not only cripple the production systems of small-scale producers but also intensify the tragic phenomenon of mass suicides of farmers that has been occurring in the country for over a decade now.

Shrinking Non-Farm Employment

Finally, the third route through which of the financial crisis is likely to impact the primary sector is indirectly through a slowdown in the manufacturing and services sector. Certain manufacturing sectors dependent on the export market, like the textiles or leather industry, has already witnessed significant job-losses due to the global financial crisis and the consequent slowdown in demand for manufactured products. On the other hand, export-oriented high-productivity and high-income service sectors like the ICT or the hospitality sector are also witnessing a squeeze due to the downturn in world markets. A consequent contraction of consumption spending on part of those employed in these sectors will have indirect ramifications for other sectors as it will reduce the overall aggregate demand in the economy. Thus, there is a possibility of a significant erosion of existing livelihoods in the informal economy in the rural areas as a consequence of the financial crisis.

This direct and indirect loss of employment in the secondary and tertiary sectors will in turn have a crucial impact on the livelihoods of the populace engaged in primary economic activities. Locating this in the context of the broad changes in employment pattern that have occurred under economic liberalisation helps us to comprehend this issue in a better manner.

Table 2: Per 1000 Sectoral distribution of usually employed (ps+ss) persons: rural

Sector	1993-94	2004-05
Primary	784.1	726.5
Secondary	102.0	136.2
Tertiary	113.9	137.3
Total	1000.0	1000.0

Source: NSS Employment and Unemployment Survey, Report No. 409 and 516

The employment distribution across sectors shows a moderate but significant shift in the nineties. The data from NSS Employment-Unemployment Surveys reveal that the percentage share of the primary sector in total usually employed persons in the rural areas reduced from 78.4 in 1993-94 to 72.6 in 2004-05. In absolute terms, this implies that roughly 18.3 million workers were additionally accommodated in the secondary and tertiary sectors by 2004-05 owing to this sectoral shift in the work force. This can be attributed to the

stagnation in the primary sector and the relatively buoyant performance of the secondary and tertiary sectors.

A large part of this shift from the primary sector in the rural areas has been to the informal sector. A detailed study by Abraham (2008) points to the distress-driven nature of this shift. There has been increasing work participation by the female and aged population in this period of agrarian crisis, which substantiates the character of this shift. Simultaneously, there has been a replacement of paid-labour by family labour in agriculture owing to the low returns in the latter. The relatively lower income in the primary sector during this period caused this shift of the workforce towards non-agricultural activities, even if the new employment opportunities were largely informal in nature at unfavourable terms and conditions of work.

We have to view the impending loss of non-farm employment in rural areas due to the financial crisis in the context of this distress-driven occupational diversification that has been occurring in the recent past. Over this period, there has been no marked increase in the productivity of the agricultural sector and therefore the latter cannot absorb a part of the work-force in the non-farm sector that may lose their employment due to the slowdown. Table 3 shows that the productivity in the agriculture sector has not undergone any significant increase during this period when there has been a shift of the workforce away from the sector. The output-worker ratio in the primary sector increased at a meagre annual rate of 1.4 percent between 1993-94 and 2005-06. This was lower compared to the growth rates in the secondary sector and much below that in the tertiary sector. This underscores the fact that this transition of the work force to non-farm sectors in the recent past has not been accompanied by the pre-condition of rising farm sector productivity that the typical Lewisian theories envisage.

Table 3: Per worker real GDP Sector-wise (at 1999-00 prices)

Sector	1993-94 (in Rs.)	2004-05 (in Rs.)	Average Annual Growth rate
Primary	18048	20894	1.4 %
Secondary	89713	108231	1.9 %
Tertiary	209409	329469	5.2 %
Total	47160	75150	5.4 %

Note: Calculated by the author based on GDP data from the *Handbook of Statistics on Indian Economy* and NSS data on usually employed persons.

**Table 4: Work participation rates (PS + SS) for rural male and female:
Various rounds**

Year	Male	Female	Total
1993-94	553	328	444
1999-00	531	299	417
2004-05	546	327	439

Source: NSS Employment and Unemployment Survey, Report No. 409, 458 and 516

From Table 4, we can see that the work participation rates (WPR) increased between 1999-00 and 2004-05 for both male and female in rural areas. This increase in the WPRs almost compensated for the loss of employment that occurred between 1993-94 and 1999-00. The entry of new sections of populations into the work force was an important component of the increase in the share of non-farm employment. The shift in the work force towards the non-farm sectors is composed of both intra-generational and inter-generational shift. In either case, there is little opportunity to fall back on the stagnated primary sector in the wake of employment losses in the other sectors. There has been a significant migration of labour from rural-rural or rural-urban in the recent years and economic remittances send by these migrants to their native villages have come to play an important role in the backdrop of the low returns to agricultural activities. A drying up of these remittances in the short-run due to loss of non-farm employment will considerably worsen the living standards in the rural areas.

Summary

The discussion in the historical context indicates that the current financial crisis has the potential to adversely affect the production sphere in the rural economy and consequently cause a fall in the consumption and living standards of the rural population. The depression of world prices, especially of commercial crops, will intensify the ongoing process of income deflation under the neo-liberal regime. Moreover, the lack of required credit from institutional sources will drive the peasantry deeper into the grip of private moneylenders charging usurious rates of interest. This implies that the financial crisis directly stands against efforts to arrest the disturbing and tragic phenomenon of debt-driven farmer suicides that has been occurring in recent times. As an indirect effect, a reduction in employment opportunities in the non-farm sector will cause additional pressure on the stagnated agricultural sector and intensify the rural economic distress.

In the context of shrinking demand for world markets and deteriorating prospects for exports, a major emphasis on alternatively revamping

domestic demand in the economy is required. Such an alternative policy to tackle the pitfalls of the financial crisis will require emboldened Keynesian policies in the form of enhanced public expenditure support targeted at the rural economy. Within this broad policy of enhancing domestic demand, several specific policies are necessary with regard to the principle impacts that we have identified.

The crashing prices of cash crops require some enhanced interventions by the different marketing boards in the form of providing the cash crop growers with support prices during the period of low and inadequate market prices. In order to mitigate losses in commercial crop cultivation due to the price crash and prevent any withering of livelihoods in the rural areas, the revamping the marketing boards and their procurement functions is ardently required. Simultaneously, the constitution of a price stabilisation fund can be used to provide a 'minimum living price' to the farmers in the face of the crisis. This is all the more necessary as the agrarian crisis that has precipitated over the last decade is primarily located in the dryland areas cultivating export-oriented commercial crops.

An increased cultivation of food crops in the medium term will be a desirable step for farmers in the face of the collapsing export prices for commercial crops. However, there is a concern with regard to food prices also in the near future. While food crops are relatively less sensitive to the downturn in the export markets, their prices may also decline via the route of the future markets in a situation of crisis. Therefore any shift by the cultivators to food grains cultivation can be facilitated only with a revamped public policy of procurement. Simultaneously, the concern over declining real returns to agricultural activities that we have witnessed over the long run call for a rejuvenation of the public distribution system to pre-Targetted PDS levels that can provide food at cheaper prices to rural households who are mostly net food-buyers.

With regard to the possibility of a squeeze in credit availability in rural areas, an important initiative that needs to be adopted is the building of institutions based on the principle of cooperatives that will provide an alternative framework of livelihood generation in the rural economy as opposed to the dominant logic of markets under capitalism. Institutions like credit unions or Self-Help Groups can go a long way in addressing the problem of waning credit availability for economic activities in the primary sector.

Finally, the phenomenon of a shrink in non-farm employment and its adverse effects on the rural agrarian economy is a serious problem that needs to be tackled. As the agricultural sector will possibly require some time before it is revamped, especially in a situation of economic slowdown, it is necessary to implement employment generating programmes like the NREGA more vigorously with higher allocations. This is necessary to protect the livelihoods of the millions of rural workers whose livelihoods stand threatened by the

financial crisis. The emerging situation calls for a well-drafted framework of economic policies incorporating different measures for effectively tackling the consequences of the global financial crisis on the rural economy in India.

Notes

- 1 The shrinkage of bank operations in rural areas as a result of the Narasimhan Committee recommendations and in particular, the decline of priority sector lending to agriculture, has been discussed and documented comprehensively in Ramachandran and Swaminathan (2002 and 2005) and Chandrasekhar (2004).

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right to abortion associate it with women's rights and freedom. It has become an important issue in elections and in judicial appointments. In short, the right to abortion is the most contentious constitutional issue of the present generation in the United States. It was in the case of *Roe v. Wade* (1973) that this right was declared a constitutional right by the Supreme Court of the United States. The social landscape of the United States changed tremendously as a result of the judgement, and abortion has since then remained high on the agenda of national politics. What is intended here is an analysis of the issue of abortion, its tortured history and the impact and implications of *Roe v. Wade* in the politics of the United States. It also seeks to examine the social and religious dimensions of the question as debated within the United States.

The Criminalisation of Abortion

Abortion, or the induced termination of a human pregnancy, has always been an issue loaded with ethical and religious connotations. As mentioned, for its opponents, it is equated with murder, that of an unborn child. Abortion, self induced or assisted, acquired criminal status in the United States only in the nineteenth century. The Comstock Law of 1873¹ which was intended to advance public morality included in its purview, pornography as well as birth control information and devices including abortion (Wheeler 2004:10-13). Interestingly, the late nineteenth century prohibition, particularly of abortion, in the United States was more for the protection of professional interests than for ethical reasons. The effort to outlaw abortions was led by physicians seeking to drive out quacks engaged in the practice than religious or social leaders. With the formation and the assistance of the American Medical Association, these physicians were able to get legislation passed in every state legislature banning abortions. Leslie J. Reagan (1998:14) states that "physicians entered a new partnership with the state and won the power to set reproductive policy. In the process, women's perceptions of pregnancy were delegitimized and women lost what had been a common-law right." It should be noted that the United States Congress had nothing to do with the issue and there was no national regulatory framework. Nor was there any judicial intervention by federal courts. It was purely a state affair and the essence of most state laws was that women were prohibited from having their pregnancies terminated except when the life of the mother was endangered or when the pregnancy was the result of rape or incest. As a result of these restrictions, hundreds of women were forced to seek illegal abortions. John Irving's (1985) novel, later made into a movie, *The Cider House Rules* portrays the issue of illegal abortions that were performed secretly by the protagonists Dr Wilbur Larch and Homer Wells. The former believed

that by performing abortions he was doing humanity a service and that one way the poor could help themselves would be to be in control of the size of their families. He engaged in this work reluctantly, but was driven by seeing the horrors of back-alley operations.² Given the social and medical restraints of the time, many women may not have received the opportunity of an abortion even if they desired one. "Abortion as a major social, political and ethical issue could disappear beneath the cloak of an emerging profession's claims, there to rest quietly for almost a century" (Ehrenreich 2008:76). During this period Americans lived under a social regime that prohibited abortions and was closely guarded by zealous physicians and guardians of morality.

The late 1960s witnessed a more socially liberal atmosphere in the United States. Accompanying this were other developments that would have an impact on the question of abortion. The first was the thalidomide drug issue and the rubella epidemic that increased foetal abnormalities on a large scale, resulting in physicians and lawyers themselves calling for abortion law reform.³ In 1968 the American Civil Liberties Union "decided to promote actively the idea of repeal of all laws prohibiting abortion prior to the viability of the foetus" (Frankowski 1987:21). So did the Planned Parenthood Federation of America (PPFA), a reproductive health care organisation dedicated to the principle that every individual has a fundamental right to choose whether or not to have a child. The second development was the rise of feminist groups seeking to change laws that restricted the freedom of women. By the end of the 1960s, although some liberalization was made with regard to abortion in some states, the role of the physician, usually white and male, was dominant. The rising feminist movement converted the debate significantly by asserting that abortion was a woman's basic right and that the decision was hers alone. It vociferously maintained that abortion laws had to be repealed comprehensively rather than merely reformed. Claire Pomeroy (2009) refers to "the right to an abortion as integral to a women's right to sovereignty," and that "without abortion, women would unjustly be forced into motherhood." Further, "from a feminist standpoint, denying the right for women to choose to have an abortion forces them into submissive roles in society." In 1969, the National Association for the Repeal of Abortion Laws (NARAL) was formed. NARAL and other groups advocated the right to abortion and mobilized for legislative and judicial changes. Radical feminists went to the extent of demanding abortion on demand (Stetson 1997:111). They also joined with moderates in organising abortion teach-ins and testifying at legislative hearings. All these created an environment for a more liberal approach to birth control and abortion. However, the attitude towards abortion throughout the United States was by the end of the 1960s varied. A majority of the states had a general prohibition of abortion and nearly

all others had significant restrictions.⁴ Eighteen states had significantly modified their longstanding prohibition of abortion, and four of these states had eliminated most restrictions on abortion (Baum 1992:246).

Roe v. Wade

The most significant milestone in the history of abortion was in 1973 when in a 7-2 decision, the United States Supreme Court in *Roe v. Wade* made the option of abortion a constitutional right during the first trimester of pregnancy and a limited right during the second trimester. A Texas law prohibiting abortions was challenged by an unmarried pregnant woman using the pseudonym Jane *Roe*. Following extensive litigation, the Court ruled that restrictions on abortion during the first trimester violated the constitutional right to privacy; abortion could be regulated in the second trimester only for the protection of a woman's well-being, and must be permitted even in the final three months if her health and survival should be at stake. The Court declared that in the first trimester, the right of privacy prevails and the abortion decision must be left to the woman and her physician; in the interest of protecting the mother's health, states may restrict but not prohibit in the second trimester; and in the third trimester states may regulate or even prohibit abortions to protect the life of the foetus except where medical judgment determines that an abortion is necessary to save the mother's life (Friendly and Elliot 1984:207). Although *Roe* did not grant women an unconditional right to abortion, it came close enough since most abortions took place in the first trimester. Justice Harry A. Blackmun, who authored the majority opinion, could not point out to a specific constitutional guarantee to justify the Court's ruling. Instead, he based the decision on the right to privacy protected by the due process clause of the Fourteenth Amendment. The opinion also reiterated that whether human life began at conception or at some undefined later point was a religious question, not a legal certitude. Therefore a woman's right to privacy in controlling her own reproductive life took priority, at least until the health and viability of the foetus gave the state a legitimate right to intervene (Blackmun 1999: 239-243).

The dissenting judges on the other hand were quick to point out what critics have frequently repeated since the decision. The court's judgment was directed by its own dislikes, not by any constitutional compass. In the absence of guiding principles, they asserted, the majority judges simply substituted their views for the state legislatures whose abortion regulations they had invalidated. They argued that such reasoning valued the whim or caprice of the putative mother more than the life or potential life of the foetus. Justice Byron White, one of the dissenters would sum it all in one phrase, "the

convenience of the pregnant mother” (Reiman 1998:43). Lively and Weaver (2006: 219) state that “a central theme of criticism is that a woman’s liberty to choose an abortion was judicially invented rather than grounded in the Constitution.” They further argue that even *Roe*’s detractors who would favour limited regulation believe that the Court “stretched and warped the Constitution to achieve a desired result.” Archibald Cox (1987:334) states that the decision “ran contrary to the moral code prevailing for at least a century” and “lacked significant support in conventional sources of law.”

Since *Roe v. Wade*, on the question of abortion, Americans could broadly be divided into prochoicers and prolife (Bowers 1997). Prochoicers are those who are not necessarily in favour of abortion but are in favour of allowing each woman to decide the question for herself, while prolife are those opposed to abortion and opposed to giving women the option of abortion except in the case of rape or incest or when the mother’s life is in peril. While the former hail the verdict in *Roe*, the latter would want to see the overturning of the verdict or a legislative initiative criminalising abortions. However, while dividing society on the basis of positions one should also bear in mind that contemporary American views regarding the morality of abortion are vastly diverse. One has to look beyond and focus upon social and cultural locations and the intricacies of political, philosophical and religious commitments that form and inform perceptions of abortion. Kathy Rudy (1997) for instance examines attitudes towards abortion within four religious or philosophical systems—Catholicism, evangelical Protestantism, feminism, and liberalism.

With the Supreme Court acquiring a conservative majority in the late 1980s, following what was known as the Reagan Revolution,⁵ many observers expected the *Roe* decision to be overturned. In *Webster v. Reproductive Health Services* (1989), the Court severely qualified the guarantees extended in 1973 but did not invalidate its earlier decision. It prohibited the use of services of public employees or facilities in conducting abortions unless the mother’s life was in danger. Physicians were also to determine whether the foetus “is viable” outside the womb before performing abortions on women who are 20 or more weeks pregnant. Interestingly, Justice Sandra Day O’Connor, a Reagan nominee, tilted the balance in favour of retaining the *Roe* decision. Her position was that state abortion restrictions were permissible provided that they are not “unduly burdensome.” While she voted with her conservative colleagues to uphold the restrictive Missouri statute that was being challenged on the ground that it did not pose an undue burden on women’s rights, she declined to reconsider and overturn *Roe* (Goldstein 1994:34-36). However, what appeared more important was the Court’s willingness to consider new state restrictions on the availability of facilities for abortion and its abandonment of a strong defence of abortion

rights. While continuing to support a woman's right to abortion, it reiterated the government's power to limit the exercise of that right.

Contrary to expectations that it would overturn *Roe v. Wade*, in *Planned Parenthood of Southeastern Pennsylvania v. Casey* (1992), the Supreme Court gave a fragmented decision. While upholding its 1973 decision, justices led by O'Connor stated that the state may take measures to ensure that the woman's choice is informed and that the state, while prevented from prohibiting an abortion, could ensure that there were legal provisions to further the health and safety of a woman seeking abortion. Such measures however, should not be an undue burden on the right. In protecting the right to abortion but allowing greater regulation of the procedure, the court struck a moderate political stance that corresponded to the views of a majority of Americans. The decision in *Casey* appeared like a no-win situation for both prochoicers and pro-lifers. While for the former, the regulations imposed in the decision effectively denied women, especially low income women their rights; the latter believed that their strategy to get rid of *Roe* altogether was doomed (Stetson 1997: 123). In April 2007 the Supreme Court in *Gonzales v. Carhart* upheld the Partial-Birth Abortion Ban Act, 2003 by a 5-4 majority. This law placed restrictions on the medical procedure called intact dilation and extraction. This was the first time the Court allowed a ban on any type of abortion since 1973. The National Women's Law Center (2007) criticised the decision saying that it represented "a retreat from over three decades of constitutional law protecting women's rights." It also maintained that the Court "eroded long-standing protections for women's health and put in jeopardy the fundamental freedom to make important life decisions."

Abortion and U.S. Politics

Since 1973, abortion has become a dominant issue in the politics of the United States, both federal and state. With the right to abortion apparently won in 1973, the women's movements had turned their attention to other issues. This allowed the initiative on abortion to shift to the pro-lifers (Pohlman 2004: 112-121). In response to *Roe* and the liberalisation of national abortion policy, they began seeking means of restoring policies restricting abortion. What they intended was to weaken the judicial decision by legislative and executive initiative and action. Groups, both defending and disparaging abortion turned to state legislative politics to advance their policies. This approach forced candidates for state office to "interrogate" opponents on the abortion issue and also to translate the electoral outcome into new legislation that restricted or enlarged abortion rights. Pro-lifers, at the national level persuaded Congress to reduce or eliminate federal payments for abortion under various programmes

of health insurance and foreign assistance. States and localities on the other hand, using ordinances, some which were initiated by petition and approved in public referendums, invoked zoning, the regulation of public health, and parental rights to restrict access to abortion facilities (Wald 1992: 189).

By the late 1970s the Prolife Movement became a crucial part of the conservative and Republican resurgence that culminated in the election of Ronald Reagan. Reagan (1984) believed that no moral issue was of greater importance than the dignity and sanctity of human life, and hence the opposition to abortion. The conservative movement, with the anti-abortion issue at its core was successful in securing legislation by Congress known as the Hyde Amendments which prohibited the use of federal funds for abortion and in luring away significant number of Roman Catholics and southern white Protestants from the New Deal coalition that had dominated American politics for long.⁶

Today candidates for the presidency, governorship or legislature are expected to have a definite position on the issue of abortion. This is vexing for politicians of both parties because politics could go to any level given the volatility of the issue. For instance when the Idaho legislature in 1990 passed a bill restricting abortion, prochoice groups threatened to boycott Idaho potatoes if the governor signed the bill. Prochoice political candidates deemphasise advocacy of abortion and stress the libertarian position that government has no business, indeed no right, to make this decision for a woman. A liberal Congress reacted to the *Webster* decision by expanding public funding of abortions in Washington DC. In the 1990s while some states liberalised their abortion laws, others made them more restrictive. Another consequence of the decision was the victory of prochoice candidates in the crucial gubernatorial elections and David Dinkins victory in the New York mayoral race, with women voters representing the important component of the winning margin (Cook, Jelen and Wilcox 1994). Congress acknowledged the new political equation by passing a bill, later vetoed by President George H.W. Bush, which would allow the federal government to pay for abortions for poor women whose pregnancies resulted from rape or incest.

Abortion is also important in presidential elections, where among other issues like foreign policy or the economy; candidates are expected to have a definite opinion on abortion. For instance during the last presidential elections in 2008, candidates were queried throughout the campaign on their stances on abortion. While Barack Obama opposed any constitutional amendment to overturn the Supreme Court's decision in *Roe v Wade* and disagreed with the Supreme Court ruling to uphold the Partial Birth Abortion Ban Act, John McCain held the view that *Roe v. Wade* was a flawed decision that must be overturned.

He also stated his support for the Supreme Court ruling upholding the Partial Birth Abortion Ban Act. Both candidates were also reflecting positions of their support bases within the electorate. In the 2004 elections, John Kerry had lost the presidential bid partly because of the controversy on abortion, which is discussed later in this article.

Since the Supreme Court verdict in *Webster* seemed to threaten the fundamental gains that prochoice forces had won in the *Roe* decision, it galvanised the women's movement and triggered demonstrations in scores of cities and communities throughout the United States. On 11 November 1989, Mobilisation Day for Abortion Rights was observed throughout the United States. It forced women's groups to redouble their lobbying efforts in Congress and state legislatures where prolife forces had had a virtual free hand for a very long time. Voting registration increased markedly among prochoice women in the months after *Webster*, as did contributions to and membership in women's organisations like National Organisation of Women (NOW) and NARAL. On the other hand prolife groups organised their own demonstrations and street protests. These included conservative women fundamentalist preachers, Catholic clergy and leaders of the "New Right."⁷ Many women, especially those deeply religious and of low income backgrounds, perceived the feminist vision of self-empowerment as a serious threat. However, there are some women's groups like Feminists for Life of America (FFL) comprising of self-identified feminists who are prolife (Barlow 1998). A radical antiabortion group called Operation Rescue which has become the voice of the prolife activist movement in the United States, had its volunteers prevent women from entering abortion clinics. But they were soon resisted by prochoice demonstrators (Galinsky 2009). Opponents of abortion also directed their efforts towards state legislatures, hoping to load the abortion law with enough regulations to discourage women from terminating their pregnancies.⁸

The Supreme Court in the Post *Roe* Era

Since *Roe v. Wade*, the Supreme Court itself has come under close scrutiny. The composition of the Court, possible resignations from it and new appointments, as well as the viewpoints of nominees on the question of abortion have become crucial issues. Since there was no hope by either of the parties of bringing a constitutional amendment on the issue of abortion, all attention was directed at the Court. The conservatives, since 1973 have wanted Republican presidents to nominate judges holding anti-abortion positions to the Court. The composition of the Court shifted under Ronald Reagan. His elevation of William Rehnquist to Chief Justice in 1986 and his appointments of Sandra Day O'Connor in 1981,

that of Antonin Scalia in 1986 and Anthony Kennedy in 1988 raised new hope among opponents of abortion and instilled fear among advocates of the same. Suzanne Staggenborg (1991) writes that “the Administration’s most potent weapon against abortion was its ability to alter the composition of the courts...through judicial appointments.” However, in the subsequent cases after *Roe*, it was not overturned because as we already saw, Reagan appointee O’Connor herself held a middle ground position. At the time of her retirement, David von Drehle (2005) wrote that “there was a time, in the late 1980s, when she might have overturned the court’s prior rulings on the constitutional right to choose an abortion. Instead, she used her key vote to embed the right to abortion far more deeply than it was when she joined the court in 1981.”

The Court has since moved cautiously down the road towards greater control of abortion policy. The judges have also voiced widely divergent opinions revealing the continuing division over the abortion issue. Abortion has become an important litmus test for judicial appointees, particularly to the Supreme Court. At their Senate confirmations more attention is paid to their stance on abortion than anything else. The Senate did not confirm Robert Bork, in part because of his extremely conservative views on abortion (McBride 2007: 138). A string of retirements gave Reagan the opportunity to refashion the Court in his own conservative image. David Souter’s confirmation hearings in 1990 and that of Clarence Thomas in 1991 raised the issue of abortion explicitly and repeatedly. For Clinton nominee Ruth Bader Ginsburg, not only is *Roe* an important constitutional right but that government ought to pay for abortions in certain circumstances; while another Clinton nominee, Stephen Breyer, described *Roe* as “settled law.” Chief Justice John Roberts and Samuel Alito, both George W. Bush nominees, at their Senate confirmation hearings refused to clarify their positions on abortion, but it is widely believed that their previous careers witnessed opposition to it. Following Souter’s recent retirement from the Supreme Court, Barack Obama appointed Hispanic and Roman Catholic Sonia Sotomayor, a federal judge on the U.S. Court of Appeals for the Second Circuit to be his replacement.⁹ Although she has not dealt with a case dealing directly with abortion rights, in 2002 she upheld the policy of the Bush Administration that the United States would no longer contribute to separate nongovernmental organisations which perform or actively promote abortion as a method of family planning in other nations. She further reiterated that the policy did not constitute a violation of equal protection, as the government is free to favour the anti-abortion position over the prochoice position, and can do so with public funds (Friar 2009). What becomes clear from an analysis of Senate confirmation hearings is that in most instances Democratic nominees

were open in their defence of *Roe*, while Republican nominees left people confused and wondering.

Abortion: Religion and Politics

Abortion is a religious issue too in the United States, with ramifications for politics. There was a time when the Roman Catholic Church was the lone major detractor of abortion. Today it is the Protestant evangelicals who are the most vociferous on the matter of abortion. Until the *Roe v. Wade* decision most of them shrugged off abortion as a Catholic issue. Kilgore (2008) states that evangelical hard-line views on abortion are not a matter of an unbroken tradition. In 1971, before *Roe v. Wade*, when nearly all states maintained abortion bans, the Southern Baptist Convention passed a resolution calling for abortion laws that would recognize exceptions not only in cases of rape and incest, but where the “emotional, mental and physical health of the mother” might be endangered. He reiterates that it is needless to say, that would be considered a radically liberal position among evangelicals today. In the wake of the ban on public-school prayer, the sexual revolution and the exodus to the suburbs that filled the new megachurches, protecting the unborn became the rallying cry of the Christian Right to uphold the traditional family (Kirkpatrick 2007). It proclaimed that its commitment was to family, religion, community and old fashioned morality, and its chief targets were moral relativeness, sexual permissiveness, the Equal Rights Amendment (ERA), prohibitions on school prayer, the secular curriculum in public schools as well as abortion — issues being advocated by the liberals. In the early 1980s, evangelical Christians played an important part in the “New Right” segment of Reagan’s conservative coalition, attempting to advocate their position against abortion. Many overzealous members were disappointed by their failure to achieve their goals, some of which were not widely supported by the population as a whole. They became less active politically in the early 1990s, though they remain a potentially significant force, attempting to change the political landscape (Green, Rozell and Wilcox 2003). As we have already seen, the conservative movement, with the anti- abortion issue at its core, managed to wean away significant number of Catholics and southern white Protestants from the New Deal coalition that had dominated American politics for so long and helped refashion the public agenda of the nation.

Of no less concern is the attitude of the Roman Catholic Church towards abortion. The Church places great importance on human life, which it believes starts at conception. The Second Vatican Council described abortion as an abominable crime.¹⁰ Pope Paul VI’s (1968) encyclical entitled *Humanae Vitae*

states that the Church is “obliged once more to declare that the direct interruption of the generative process already begun and, above all, all direct abortion, even for therapeutic reasons, are to be absolutely excluded as lawful means of regulating the number of children.” Pope John Paul II’s (1995) encyclical *Evangelium Vitae* described abortion as ‘a grave moral disorder’ and a decision against the weakest and most defenceless of human beings. Rev. Thomas D. Williams(2007) in his pamphlet written for the United States Conference of Catholic Bishops (USCCB) states that “abortion deals specifically with the destruction of innocent life,” and that “in its venerable tradition of standing up for society’s most defenceless members, the Catholic Church is uniquely qualified to speak out authoritatively on the abortion issue.” When the decision in *Roe v. Wade* came out, it served to galvanise the bishops into renewed public statements and public action. The immediate reaction of the bishops was to refuse to accept the court’s judgement and to advise people “not to follow its reasoning or conclusions.” In the following years the Church’s political activities have centred on various attempts to reverse *Roe* through a constitutional amendment, launching prolife movements and intervening in electoral politics in this regard (Casanova 1994: 192-193). Of late the Committee for Pro-Life Activities of the USCCB has launched a new effort to dispel myths about *Roe v. Wade*. Brief, informational cards called “Roe Reality Checks” are to be distributed regularly to members of Congress and the media, each highlighting a basic fact about *Roe v. Wade* or its impact. The Roe Reality Checks are part of a broader educational campaign by the Pro-Life Committee called *The Second Look Project*, which presents basic factual information about abortion so that people can take a second look at the issue.

The Roman Catholic Church expects its members to strictly desist from having abortions or support any effort that directly or indirectly assists such an act. This teaching of the Church has led harsh critics like feminist and civil rights advocate Flo Kennedy to the extreme of remarking that “if men could get pregnant, abortion would be a sacrament” (Moon 2001). The adherence of Catholics to the teachings of the church, especially birth control and abortion could be exaggerated. According to Pew Research Center (2008) surveys from 2006 and 2007 on many life and family issues including abortion, the views of Catholics tend to closely resemble the views of the U.S. public as a whole. However, according to a study by Susan B. Hansen, the greater the Catholic share of a state’s population, the lower was the community support for abortion and the more restricted the availability of facilities offering abortion (Wald 1992: 205).

A complicating factor in the issue of abortion is that Roman Catholic Church officials in the United States have from time to time made statements about

excommunicating public officials of the Catholic faith for supporting the right to abortion. Critics believe that such a position goes against the traditional separation of church and state. The most significant controversy in recent times involving a Catholic politician and abortion was when John Kerry contested in 2004 as the Democratic Presidential candidate. Kerry, a Roman Catholic was caught in a morass created by his own church. The charge against him was that his liberal Democratic stance of prochoice was contradictory to official church teaching. Even his own Archbishop of Boston, Sean Cardinal O'Malley, who had in the past given him Holy Communion, said that Catholic politicians who do not vote in line with Church teaching should not attempt coming to the communion rail. Conservative Catholics believe that no public official can simultaneously profess Catholicism and support the right to a legal abortion. Kerry like many other Catholic politicians argued that their religious beliefs need not influence their actions as elected representatives. Prominent Catholic Democrats like Edward Kennedy asserted that religious dignitaries had overstepped the wall of separation between Church and State (Thomas 2004). Catholic opposition to abortion has led many non-Catholics to charge the Church with using political power to impose its own moral viewpoint on those who do not accept it (Greely 1972: 219). Eventually in the election, Kerry lost to George W. Bush. The Pew Center's (2004) analysis is that Bush received a major chunk of the evangelicals' votes and 52 per cent of the Catholic votes which included 56 per cent of the non Hispanic Catholic vote. David V. Barrett (2008) remarks that "American Catholics were pressured, spiritually intimidated, by their own Church leaders into voting for Bush. It's fair to say that the Roman Catholic Church won the 2004 election for George W Bush, by causing Kerry to lose."

In his commencement address at Notre Dame University, a well known Roman Catholic institution, on 17 May 2009, Obama delved into the abortion debate and characterised it as a "heart-wrenching decision for any woman to make, with both moral and spiritual dimensions." He exhorted to work together to reduce the number of women seeking abortions by reducing unintended pregnancies, and making adoption more available, and providing care and support for women who do carry their child to term and favoured "a sensible conscience clause" that would give anti-abortion health care providers the right to refuse to perform the procedure (Obama 2009). Critics were troubled by the fact that Obama has throughout his political career advocated positions that directly contradict Roman Catholic teachings (Miller 2009).

Domestic politics in the United States has its share of effect on foreign policy. For many years the United States along with some of the developed countries believed that the developing world had to decrease its population in

order to assure itself of economic growth and development. It asserted that population control would help in its quest for development. Between 1965 and 1980 the United States contributed more than half of all international assistance for population and family planning which naturally included abortions. It also assisted numerous Third world family planning programmes. When the United Nations Fund for Population Activities (UNFPA) was established in the late 1960s, the United States was a major contributor. However, the resurgence of the Christian Right had a great impact on the Reagan administration. The culmination of the United States' new attitude came at the Second World Population Conference in Mexico City in 1984, where it announced that the UNFPA, as a precondition to receiving US funds had to provide evidence that it did not engage in funding or that it did not support in any way abortion or coercive family planning programmes. Domestic political considerations had an important influence upon the US position (Eager 2004:105). It was such a Republican position that Barack Obama reversed when he signed the executive order that struck down the previous George W. Bush administration's ban on providing federal funds to overseas family-planning organizations that perform abortions or offer abortion counselling.¹¹

Conclusion

Abortion has been the most controversial social, religious and political issue of the United States in the last three and a half decades, and the debate surrounding it is much more complex than it appears. Just as a ban on abortion took place in the nineteenth century, its undoing a century later was reflective of the times. Tensions and passions remain high on both ends of the abortion ideological spectrum, where one side represents the right to life and against mortal sin while the other stands for the right to privacy and against patriarchy. The issue is a good illustration of how the United States political system manages with dexterity the two opposing views and where the potential to create disruption remains high. Today, an end to abortion may not be possible through a constitutional amendment given the intricacies of American federal politics, but more probable through a judicial decision reversing *Roe*. As it appears, the only thing that may turn out to be more controversial than *Roe* would be a judicial decision overturning it. Consequently much attention today is focused on the Supreme Court. While Republicans and the Christian Right look towards the nominees of the former on the bench to take up the initiative to reverse *Roe*; liberals, Democrats and prochoicers look forward to a situation where more liberal and prochoice judges are appointed to the Court. The subsequent three decisions following *Roe* gave the proliferers some hope, but as of date it is remotely

possible that they would be able to see their desired change in the near future. The decisions have to some extent placated prolife concerns, but have not banned abortions outright. There was a time when judges appointed for life relinquished office at a moment when their replacements who reflected their views could be appointed. Many were recently taken by surprise when Republican nominee Souter left the bench giving the opportunity for a Democratic President to appoint a liberal in his stead. On the other hand, political observers predict continuity because both Souter and Sotomayor belong to the centre-left.

The nature of politics in the United States has changed since *Roe v. Wade*. At all levels of elections, the issue of abortion has the potential of making and unmaking political careers of hundreds of candidates. While standing for election they have to formulate a definite position on the issue and garner enough votes, while keeping local sensitivities in mind. Many would wonder why a materialistic society like that of the United States is obsessed with an ethical and religious issue like that of abortion and of its great influence both in politics and religion. Outwardly materialism may appear as a characteristic of American life, but at its core one will find a large number of Americans concerned about their faith and their perceptions of morality. America has been described as a nation with the soul of a church. No wonder abortion continues to be a vexing and controversial issue.

Notes

- 1 The Comstock Laws were named after Anthony Comstock, a social reformer, moral crusader and early agitator against abortion and pornography who successfully lobbied for legislations that outlawed them. In 1873 the United States Congress passed *An Act for the Suppression of Trade in, and Circulation of, Obscene Literature and Articles of Immoral Use*. The legislation was known popularly as the *Comstock Law*, and its avowed purpose was to prevent the mails from being used to corrupt public morals. The Comstock Law made it a crime to sell or distribute materials that could be used for contraception or abortion, to send such materials or information about such materials in the federal mail system, or to import such materials from abroad. Comstock was appointed special agent of the U.S. Post Office and given the express power to enforce the statute, a position he held for the next 42 years.
- 2 The major theme of the book which is set in rural Maine in the first half of the twentieth century is that individuals define their own rules by which to act and live despite societal dictates.
- 3 The United States was saved substantially from the thalidomide peril because the Food and Drug Agency (FDA) refused to give its approval to its marketing in the country. Only 17 deformed babies were born in the United States while about 10,000 were born worldwide. In 1998 the FDA approved its use in the treatment of certain dermatological conditions.

- 4 In order to obtain abortions, women would often travel from a state where abortion was illegal to states where it was legal.
- 5 Conservatism, advocacy of free markets and reduced social spending were some of the major features of the Reagan Revolution.
- 6 Apart from abortion, the other issues that tended to split the coalition and drive many members away were gay rights, affirmative action, and urban riots.
- 7 The New Right was galvanised by the defeat of Barry Goldwater by Lyndon Johnson in 1964 and it formulated strategies to promote strong conservative policies. It differs from the Old Right mainly on the issue of non-interventionism in foreign policy.
- 8 Opponents of abortion also resorted to frequent violent protests against abortion clinics, in the form of arson, firebombing, and vandalism.
- 9 Sotomayor is the first Hispanic to be appointed to the United States Supreme Court.
- 10 The Council asserted that, "Life must be protected with the utmost care from the moment of conception: *abortion and infanticide* are abominable crimes" (Emphasis mine)
- 11 The George W Bush Administration blocked a total of \$244 million in Congressionally-approved funding to the UNFPA.

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Afghanistan, Taliban and the Southern Asian Geopolitics

Happymon Jacob

Afghanistan is widely considered to be the most dangerous country in the world surrounded by a region that is following suit. Afghan geopolitics has always had regional implications, and the turmoil in Afghanistan has been a result of the external interests in Afghanistan. Eight years after the defeat of the Taliban regime in Afghanistan, the Americans and the international community still do not know how to deal with the turmoil in Afghanistan which seems to be on an increase on a daily basis. It is also widely recognised today that it was the cold war rivals and Pakistan under the Zia Ul Haq regime that had given birth to the civil war in Afghanistan which continues till today: players, strategies and objectives have changed but the country continues to be on the boil. This article aims to take a look at the geopolitics in Southern Asia with its focus on Afghanistan and the rise, fall and resurgence of the Taliban. This will be followed by a brief discussion on Indian interests in Afghanistan and whether India and Pakistan can collaborate on making Afghanistan stable.

Afghan Geopolitics in Retrospect

Geopolitics in modern Afghanistan can be categorised into five phases: Pak-Afghan animosity in the 1960s and 1970s; Soviet intervention and the subsequent US-backed *mujahidden* war in Afghanistan; the rise of the Taliban in Afghanistan in the wake of the Soviet withdrawal; ousting of the Taliban regime post-9/11 and; the resurgence of the Taliban. The following brief analysis of the first phase serves as a background for understanding the phases that follow.

Phase I: Pak-Afghan Animosity

In late 1960s, Afghan Prime Minister Sardar Daud provoked Pakistan when he tried to fan Pushtun nationalist sentiments and challenged the validity of the Durand Line. This prompted Zulfikar Ali Bhutto to prop up proxy operations

in Afghanistan. Thus, in October 1973, Pakistan started establishing contacts with Gulbuddin Hekmatyar, Ahmed Shah Masood, Burhanuddin Rabbani, Nabi Mohammedi, Sibghatullah Mojdeddi among others, all of whom later became leaders of the *mujahideen* war against the Soviet occupation. The Inter Services Intelligence (ISI) had reportedly worked out a detailed plan to engage in covert operations against Daud (Gul 2002: 12).

Pakistan's proxy activities not only took Sardar Daud by surprise but also scared him. He worked out a compromise formula with Bhutto. In 1976, as part of the compromise formula, Daud signed a treaty with Pakistan accepting to abide by the Durand Line. Despite these conciliatory moves, the treaty did not continue for long, due to Zia-ul-Haq's coup and Bhutto's execution (Ibid.: 13). The death of Bhutto and the end of democracy in Pakistan neither solved the boundary issue nor did they make Pakistan refrain from its proxy activities in Afghanistan. By now, the Zia regime in Pakistan was determined on getting a lasting stake in the affairs of its western neighbour for its own security. The Soviet intervention in Afghanistan came as a blessing in disguise, followed by the second and most successful Pakistani proxy war in Afghanistan.

Phase II: The Mujahideen War in Afghanistan

Approximately, 80,000 *mujahideens* were trained, thousands of tons of arms and ammunition distributed and several million dollars spent during the Afghan *mujahideen* war. All the covert assistance was channelled through the Afghan Bureau of the ISI, which had its main offices in Quetta, Balochistan, and Peshawar in the North West Frontier Province (NWFP). Peshawar, for all practical purposes, was the beehive of the Afghan resistance movement, as almost all the *mujahideen* political parties, leaders, arms warehouses, resistance bureaucracy and ISI supplies were in that Pathan border city (Yousaf and Adkin 1992: 4-38).

During the Afghan war, Pakistan did the following. First, in 1983, it got the various Afghan factions into a seven-party alliance. It was made clear to them that all the various fighting factions in Afghanistan under the control of various commanders had to be part of one of those seven *mujahideen* parties in order to avail of cash, arms and ammunition (Ibid.: 37). Secondly, the ISI took care of the training of the *mujahideens* and planned most of the combat operations (Ibid.: 3). But for the ISI, the *mujahideens* would not have achieved much. Most importantly, it was the ISI which coordinated the flow of arms, cash and other supplies given by the Central Intelligence Agency (CIA) and the Saudi intelligence. The religious parties in Pakistan made a big fortune out of the Afghan *jihad*, both politically and monetarily. Both *Jamaa't - e-Islami* (JI) and

Jamiat-ul-Ulama-i-Islam (JUI) had innumerable *madrasas* in Pakistan to produce *jihadi* literature, mobilise public opinion, and recruit and train *jihadi* forces. Based mostly in NWFP and Balochistan, these predominantly Deobandi *madrasas* were the intellectual/ideological backbone of the Afghan *jihad*. The US Administration had its own reasons for supporting the *jihadis* fight against the Soviets. The primary objective was to check the spread of Communism over large regions of Asia and – at an emotional level – they wanted Afghanistan to be a Vietnam experience for the Soviets. And, of course, it was about winning the Cold War.

The CIA kept its job limited to giving monetary support, buying arms with the money approved by the US Congress and reaching it to Pakistan (Ibid.: 81). They also provided funds for buying the necessary vehicles for transportation inside Pakistan, took satellite photographs and maps for operational planning, and gave advice on technical matters when requested (Ibid.: 96). Nearly half the money for the *jihad* came from the US, and the rest from Saudi Arabia and rich Arab individuals. The CIA also helped ISI to cultivate opium and produce heroin in Pakistan's northern tribal belt and in Afghanistan. The aim was to make Soviet soldiers drug addicts and to earn additional revenue for the *jihadi* cause (Bedi 2005). US grants were also used on the intellectual war front. The US academic institutions also helped publish textbooks that blasted Marxism and instilled faith in and fervour for militant Islamism.¹

Phase III: The Rise of the Taliban in Afghanistan

A large amount of available evidence suggests that anarchy and Pakistani strategic designs and compulsions were indeed behind the birth of the Taliban. On the one hand, Pakistan did not get the benefit of its long involvement in Afghanistan, and, on the other hand, Afghanistan was becoming a nightmare for Pakistan. Millions of refugees were pouring into Pakistan. Rabbani was getting too close to countries like India; and Hekmatyar, despite all the military help from Pakistan, was found to be incapable of defeating Rabbani and take control of Kabul (Marsden 1999: 128). Ahmed Shah Massoud by then had become the power-centre in Rabbani's government, which meant a serious dent to Pushtun pride. Added to this was the fact that Iran and Turkey were developing strong commercial ties with Central Asian countries (Ibid). It was becoming clear that Pakistan was losing its strategic advantage in Afghanistan. It was left with no choice but create a new force that could safeguard its interests in Afghanistan. Frederic Grare writes that it was at this juncture that Pakistan decided to shift its loyalty from Hekmatyar to the Taliban, as the former was unable "to seize Kabul and give Pakistan the kind of guarantees it required" (Grare 2003: 194). One of the best options before the Pakistani establishment,

Grare writes, was “to facilitate the take over of power in Kabul by an Islamicist Pushtun group” (Ibid.: 175).

We also need to keep in mind four indicators that show how the Pakistani mind worked during the chaotic Najibullah-to-Taliban period. First, by all accounts, Pakistan had unsuccessfully tried its best to unify the various *mujahideen* factions in order to control Kabul (Yousaf and Adkin 1992: 2). Secondly, after the withdrawal of Soviet forces, the US had stopped its aid to the *mujahideens*, their mission unaccomplished and leaving behind the country in turmoil and despondency. That meant additional financial burden for Pakistan. Thirdly, by then, the Benazir Bhutto government had taken over the reins of the country from the military. Nasirullah Babar, the minister and Benazir were not in favour of a soft approach towards Afghanistan. Babar, ever since his days with Zulfikar Ali Bhutto, wanted to promote a trade route to Central Asia taking advantage of the then disintegrating Soviet Union.² The answer again was found in the Taliban. Steve Coll quotes Benazir Bhutto: “So I thought, okay, control of the trade routes is a way to get my country power and prestige” (Coll 2004: 290). Finally, the capture of Spin Boldak arms depot which belonged to Hekmatyar, but manned by Pakistan’s Frontier Corps, was the first real sign of an impending shift in power in Afghanistan (Davis 2001: 46). This huge arms depot, in all probability, was handed over to the Taliban by Pakistan for waging future battles. After this, the Taliban went on to capture the Pasha arms depot, an equally large ammunition dump that had been moved across the border from Pakistan in 1991 (Ibid).

Thus, it would be logical to see the truth in what Robert Kaplan writes: “It was a democratically elected Prime Minister, Benazir Bhutto, along with her Interior Minister, the retired General Nasirullah Babar, who conceived of the Taliban as a solution to Pakistan’s problem” (Kaplan 2001: 238). Another dynamics was being played out in Afghanistan at the same time. For those members of Afghan *jihad* who had fought the Najibullah regime and had then gone home or were continuing their studies in Quetta and Kandahar, the situation was ominous (Rashid 2001: 22). They had to do something. To them, Taliban were the only remedy to anarchy. Many *mujahideen* commanders also felt that the chaos had to be brought to an end. The weapon they created to cut through chaos was putting together a zealous group of students and hence the name Taliban. Thus, as Ahmed Rashid argues, the Taliban were born perceiving themselves as the cleansers and purifiers of a guerrilla war that went off course (Ibid.: 22-23). This is where Pakistan’s role becomes significant in understanding the creation of Taliban.

No doubt, anarchy and Pakistan’s initiatives were the two major reasons for the rise of the Taliban. However, what prepared the ground for it to come to

power was the natural and – more importantly – the intentional undermining, if not elimination, of the traditional leadership in the Afghan society. For instance, as Pervez Hoodbhoy writes: “[T]hroughout the Soviet occupation, the ISI gave only token aid to the Pushtun tribes identified with Zahir Shah and he was not allowed to come to Pakistan to organise Pushtun resistance forces under his banner” (Hoodbhoy 2002: 8). Moreover, when the US was in favour of bringing back Zahir Shah after the Soviet withdrawal, Pakistan resisted the proposal tooth and nail. Pakistan knew that both the Pushtuns and their leader Zahir Shah would not listen to Pakistan. The Pushtuns also did not resonate with the *jihadi* tendencies which were making inroads into the Pushtun land. Moreover, Zahir Shah was liked by almost all of them as he was looked upon as a symbol of Pushtun nationalism. All in all, bringing him back would have been disastrous for Pakistan.

From the start of the movement, Pakistan broadly followed three major strategies to enable Taliban capture power in Afghanistan. First of all, many of the so-called victories of the Taliban were not military victories. It is now well known that those victories were no more than tactful, Pak-engineered surrenders by using cash and coercion. Moreover, it was inarguably Pakistan’s influence with various Afghan commanders that prompted them to join up with the Taliban. The second strategy, that Pakistan adopted, was to give direct military support to the Taliban fighters. Apart from helping them capture large arms dumps in Spin Boldak (Rashid 2001: 28), Pakistan also sent its men to fight alongside the Taliban soldiers. Zalmay Khalilzad, the former US ambassador in Afghanistan, claims, “[W]ithout Pakistani aid, the Taliban would not have been able to score some important initial victories and to sustain its subsequent drive to take over the rest of the country” (Khalilzad and Byman 2001). In the initial days, the usual pattern of *mujahideens’* fighting style had been hit-and-run raids and low-level skirmishing. But, later on, many crucial Taliban operations were being carried out by the *mujahideen* forces with a kind of speed and proficiency they had never shown before (Human Rights Watch 2001). This was also indicative of the Pakistani involvement.

Thirdly, throughout the Taliban rule in Afghanistan, Pakistan supplied them with military hardware, fuel, food, military advisors, and thousands of *madrassa* students. The religious elements in Pakistan did play a very crucial role in promoting and sustaining the Taliban by, most importantly, giving it the ideology, ideologues and foot soldiers. Another important Pakistani influence on the Taliban was its trucking cartels based in the border districts of Quetta and Chaman. It was virtually impossible for truckers based in Quetta and Chaman to trade with Afghanistan and Central Asian countries due to the multiple power centres in Afghanistan caused by *mujahideen* in fighting. The

traders saw no other way but to promote and, eventually, financially support a unified force rather than paying transit fees ten times to as many regional commanders. The same mafia also transported opium and arms (Ibid). No doubt, it was in their best interest to fund the Taliban generously. While during the initial period the mafia gave the Taliban a monthly fee, as the Taliban expanded westwards they demanded more and more money – and got it (Rashid 1998).

On many counts, the US has been directly or indirectly responsible for the rise of the Taliban. First, they were instrumental in defeating the Soviets in Afghanistan. Once done, the US washed its hands off the whole affair, leaving behind the mess in the country. This left the field open for an ultra-religious force like the Taliban to come to power. As Steve Coll notes: “In the early 1990s, US policies towards Afghanistan became indifferent. Bush hardly paid any attention to it. The Soviet Union was dissolving and Germany was reuniting: these were the issues of the day. With Soviet Union gone, Afghanistan had suddenly become a third-tier foreign policy issue” (Coll 2004: 217).

Secondly, the US wanted to curb Iran’s influence in the region. For this, the best bet was Taliban (Matinuddin 1999: 161). The dominant reason for this obsession was America’s other interest in the region – to safeguard its oil interests. Afghanistan was the key route. In this context, the Americans believed that the Taliban “would act as a shield against Russian intrusion into Afghanistan through the Central Asian Muslim republics” (Ibid.: 162). Thus, the US and the US-based oil companies tried to protect the Taliban. Pierre Abramovici writes: “During the civil war fighting in 1995 the first substantial numbers of Taliban appeared, “invented” by the Pakistani ISI and perhaps funded by the CIA and Saudi Arabia. Unocal and its Saudi partner Delta Oil may have even played a major role in buying off local commanders” (Abramovici 2002). Thirdly, the US wanted to checkmate China, more precisely, train Chinese Uighurs for *jihad* in Afghanistan and push them into China (Mir 2005). The US Congress had reportedly set apart a covert US \$ 20 million budget for the CIA to destabilise Iran. Iran says that large part of this aid was given to the Taliban (Rashid 2001: 46).

Marsden mentions that the US was reported as saying that it did not see anything objectionable in what the Taliban had done (Marsden 1999: 130).³ Indeed, the US went even to the extent of expressing happiness about the Taliban takeover of Afghanistan. Senator Hank Brown, a keen supporter of the UNOCAL project is reported to have said, “[T]he good part of what has happened is that one of the factions at least seems capable of developing a government in Kabul” (Ahmad 2001). The Taliban had also been honoured by the visits of high-ranking US officials such as Robin Raphel, Karl Inderfurth, Deputy Secretary

for Political Affairs, Thomas Pickering and, the US Ambassador to the UN Bill Richardson (Ibid).

Phase IV: The Post-9/11 ouster of the Taliban Regime

Keeping the other external reasons aside, the central reason for Taliban's fall was that it suffered from an inherent flaw. The Taliban movement was never a mass-based organisation. It never went through the various, natural stages of organisational growth, but was an outfit concocted and fashioned by interested parties. It managed to get the passive approval of the Afghan people solely for one reason: the people at that time were ready for any power that put a stop to the unending chaos and anarchy in the country. The Taliban happened to be the only option left to them. However, the Taliban did not have the durable, mass-powered dynamics to last for long.

Moreover, it can also be said that the Taliban had outlived its utility for both Pakistan and the US. For Pakistan, it happened due to three reasons. Taliban, once it had an existence of its own, started disobeying its mentors. Unfortunately for Pakistan, the Taliban, like all previous governments, had started raising the issue of Durand Line. Thus the Taliban became both useless and a headache for Islamabad. A singular example of the Taliban's defiance was on the bin Laden issue. It turned a deaf ear to Pakistan's strong advice that it hand over bin Laden to the US and save itself. Secondly, Taliban style of terrorism had eventually become an embarrassment for Pakistan. For once, Pakistan itself was being pushed to the corner by the worldwide consternation over the increasing terrorist violence around the world. The Taliban reportedly hosted terrorist training camps for fighters who had spread radicalism to Tajikistan, Uzbekistan, Xinjiang, Pakistan, and Saudi Arabia, among other countries (Khalilzad and Byman 2001). Besides exporting terrorism, it was also exporting the largest amount of narcotics to the rest of the world arousing a universal outcry. Added to all this was the Taliban's totalitarian and repressive style of governance. Pushed to the corner, Pakistan had no option but to reject the Taliban and so it did. Thirdly, Taliban were proving too expensive for Islamabad. The Kabul regime had no other source of revenue but narcotics trade. Most of what it cost to run the Government came from Pakistan, which itself was in the throes of deficit budget, slow economic growth, large-scale unemployment and rising poverty. Moreover, the illicit trade which the Quetta - Chaman transport mafia conducted through Afghanistan stood to cost the State Exchequer millions of Rupees. Islamabad was also concerned about the future economic sanctions that it may attract from the international community if it does not abandon its support to the Taliban.

As for the US, it had a very good reason to be disenchanted with the regime. The main reason why Washington had supported the regime was, arguably, that it needed Taliban's support in its bid to promote the US oil companies' plan to build a pipeline from Central Asia to Pakistan via Afghanistan. In fact, in December 1997, Unocal, the US energy firm, had invited the Taliban to Texas to negotiate protection for the pipeline when it would be constructed (Callari and Monitor 2002). Khalilzad, the US Ambassador to Afghanistan and a former Unocal employee, was conducting negotiations with the Taliban when Washington found out that the Taliban was busy negotiating the same deal with Bridas, an Argentinean oil company, to build the pipeline. This forced the US to drop the deal. Secondly, the August 1998 bomb attacks on the US embassies in Kenya and Tanzania with its Afghan connections – was a big blow to the Clinton Administration. In retaliation, it fired missiles into Afghanistan. However, the issue that topped it all was bin Laden and his antagonistic rhetoric against Americans.

Phase V: The Resurgence of the Taliban

In order to fully comprehend the Taliban resurgence one needs to understand what had happened to the Taliban after the US had attacked them post-9/11. Reports at the time of US-led attacks on the Taliban and the reports emerging now regarding the resurgent Taliban attacks in Afghanistan suggest one thing: the Taliban leaders and soldiers either fled to or were evacuated to Pakistan before and during the US attacks and are now coming back to resume the fight in Afghanistan. Four factors need to be looked at when studying the alleged Taliban escape to Pakistan. First, in the very beginning itself some senior Taliban members had defected from the Mullah Omar-led militia and fled to Pakistan. Pakistan had accommodated them.⁴ One report mentioned that “almost all of the remaining top 22 Taliban leaders have escaped into Pakistan” (Sydney Morning Herald 2001). The report claimed that it had been briefed by the Pentagon officials. The second factor that helped was Pakistan's evacuation of its troops and ISI officials from Afghanistan. According to India's then National Security Advisor, Brajesh Mishra some 5,000 Pakistanis and Taliban members were airlifted after the fall of Kunduz (*Indian Express* 2002). Reports also mentioned that “several Pakistani planes and helicopters were observed by eye witnesses landing at night and ferrying several hundreds of the 10,000 or so besieged Taliban.”⁵

The US was not unaware of this. Indeed, the US had reportedly allowed Pakistan to send half a dozen flights into a US-controlled airfield in Afghanistan and evacuate Pakistani military personnel (Rediff.com 2001). In fact, as Hersh

noted, the US “administration advised the US Central Command to set up a special air corridor to help ensure the safety of the Pakistani rescue flights from Kunduz to the Northwest corner of Pakistan, about two hundred miles away” (Hersh 2002). Thirdly, many of the Pakistani Army and ISI officials may have left Afghanistan taking many Taliban members with them either because of friendship and familiarity developed over the years, or because if they were captured, they would reveal details of Pakistan’s involvement in Afghanistan. Finally, many Afghan NA commanders had also helped the Taliban to escape to Pakistan either through deals or because they were only concerned with getting their old fiefdoms back and not with what happened to the Taliban men (Dexter and Gall 2001; Baker and Khan 2001).

Resurgent Taliban: Players and Strategies

This section aims to determine the motives and strategies that are being or are likely to be adopted by those parties that will be affected by the resurgence.

Pakistan

Pakistan, as always, wants to safeguard its stakes in Afghanistan. Such a strategy would mean creating its own zone of influence by clandestinely aiding regular armed attacks against Kabul Government positions, both from its NWFP and from Taliban bastions in Afghanistan and, when the time is ripe, negotiate for the accommodation in the Kabul government of a moderate form of Taliban. However, it is necessary to point out that any analysis of the resurgent Taliban needs to be done in two phases. During the first phase which lasted, one could say, till the Pakistani state cracked down on the Lal Masjid militants in July 2007 under Gen. Musharraf’s presidency. What characterised this phase was the complete willingness of the Pakistanis to safeguard the Taliban leadership and promote instability in Afghanistan, despite the clear and present danger of the emerging Taliban. The thinking in Islamabad was that the Taliban is an important strategic asset and that it should be kept alive for future strategic purposes in Afghanistan. Indeed, even the Americans, despite knowing this, were not serious in calling this bluff of the Pakistanis since they were themselves busy with negotiating with the Taliban. Even Karzai, to a great extent, was willing to put up with this as he was also keen to negotiate with the Taliban. The second phase in Pakistan’s approach to the Taliban started with the Taliban takeover of the Swat Valley in end 2008 when Pakistan realised that the Taliban Frankenstein has indeed become a threat to itself and its existence. Today Pakistan realises that the Taliban is a threat to the very existence of Pakistan as we know it. This has made them make a further distinction between Taliban

that can be controlled by the Pakistani state and sections that cannot be controlled: the latter need to be taken out.

Prior to this realisation Islamabad was keen on drawing a strong line of demarcation between Al-Qaeda and Taliban: the former is alien, of foreign origin; the latter is local and not a terrorist group (*Washington Post* 2003). Even as it had reportedly handed over around 500 Al Qaeda activists to the US in the wake of 9/11, none of them were Taliban members (Sly 2003).

Barnett Rubin sums it up convincingly:

The Pakistani military is moving against Al-Qaeda, [but] they're not doing anything against the Taliban. Most of the Taliban activities are not in the tribal territories. They are in the city of Quetta. They are in Balochistan. They are in areas that are firmly under the control of the Pakistan government. Therefore, Pakistan has no credibility. They've been supplied with information about the exact location of various major Taliban leaders. And they have done nothing. Instead, whenever there is pressure on [Pakistan] about the Taliban, they arrest more Al-Qaeda people – meaning people from Arab countries or from small extremist groups. But not a finger is pointed or lifted against the Taliban (Synovitz 2004).

Three elements in Pakistan seem to be giving asylum to the Taliban members who got away from the American strikes: one, some low-level military officers and some ministers of the provincial governments; two, the religious parties and their *jihadi* infrastructure, and; three, the ISI has been proactively working to bring the movement back to life. Resembling the pre-9/11 days and the subsequent U-turn of Pakistan on the Taliban, Pakistani establishment, for a long time, gave a free rein to Taliban leaders who are seen openly roaming around in the cities, giving interviews, discussing their future plans, and calling for *jihad* against the West (Moreau, Yousafzai and Hussain 2003). The Pakistani government is today waking up to the reality that if it does not arrest the growth of this menace at the earliest, the Taliban will pose a threat to the very state of Pakistan.

Islamabad is also trying to see if an alliance could be forged between Gulbuddin Hekmatyar and the Pak-based Taliban leaders (Rubin and Armstrong 2003). Victor Korgun goes to the extent of saying that “previously isolated and scattered Taliban armed groups have accepted Hekmatyar as their commander, and the number of such units is growing” (Korgun 2003). In order to beef up the consolidation of the attacks by the resurgent Taliban forces in Afghanistan, Pakistan has been releasing many of those terrorists who were arrested – about 3,300 of them – in the wake of Musharraf's 2002 speech (Kronstadat and Vaughn 2004).

Indeed, in 2001, soon after the Taliban's fall, Colin Powell and Musharraf agreed in Islamabad that the fallen regime's moderate officials should be allowed to participate in the new government (*St. Petersburg Times* 2001). Of late, however, Pakistan has understood that such differentiation would prove to be costly for the Pakistani state itself. Thus the new strategy seems to be to make a further distinction between moderate Taliban and hard-line Taliban the latter being those who are willing to listen to the Pakistani establishment and would not fight the Pakistani state in the name of jihad.

Hamid Karzai

With resurgence gaining ground every day, what Hamid Karzai needs is a semblance of stability and control in Afghanistan. Thus, he is willing to co-opt the Taliban. In April 2004, Karzai had offered to welcome back the rank-and-file members of the militia into the society, clarifying that "[O]ur problem is with the top Taliban – who may number no more than 150 people – who had links with al-Qaeda" (*UN Wire* 2004). This was not the first time that he spoke on these lines. In September 2003, he called some of the former Taliban leaders 'decent men' who should be allowed to participate in public life (Santoli 2003). He had also called on the former Taliban members to participate in the upcoming parliamentary elections in Afghanistan (Esfandiari 2004). He has reportedly been negotiating with Hekmatyar to switch sides and join his government (Shahzad 2004). Even before he became President, he had made statements in support of the Taliban. Robert Kaplan quotes him: "The Taliban (adherents) were good, honest people....they were connected to the madrasas (Islamic academies) in Quetta and Peshawar, and were my friends from the *jihad* (holy war) against the Soviets" (Kaplan 2001: 234). While Karzai is hopeful that he can engineer splits within the ranks of the Taliban, Taliban watchers like the Pakistani journalist Rahimullah Yousafzai think that most of the Taliban is still intact. Yousafzai says that "[N]inety-five percent of the Taliban is still with Omar" (Schriek 2005).

Talking to the moderates would also mean giving concessions to Pakistan, who has the real hold over them. In return, Karzai has been releasing Pakistani prisoners from Afghan jails despite his public warnings to Pakistan (Pearce 2001). President Karzai renewed his invitation soon after his election victory in October 2004. Karzai, now fighting for another term in office, is more critical of Pakistan today especially due to the lack of support that Pakistani designs have in the minds of the Afghans.

United States

It was obvious ever since the US forces overthrew the Taliban regime that the US would not be interested in a prolonged military presence in Afghanistan. It is believed that once its aim, to oust the Taliban and install a US-controlled government in Kabul, would be more-or-less been achieved, the US would pack their bags and go back. And yet, the Obama administration seems to be in for a long haul. However, Washington is clear that it needs to use all means available to bring stability back to Afghanistan. To fix things, one needs friends, even if they were your declared enemies. So now, Washington has perforce to make a deal with all the players in the Afghan affair – the moderate Taliban included. To appreciate fully the currently emerging scenario, one must understand what motivated the US to use force to throw the Taliban out of Kabul. What forced its hand was the Taliban's intransigence. It bluntly refused to hand over bin Laden despite the fact that the US had publicly offered to spare the Taliban regime if it handed over Laden to the US. Even at that time, Washington's priority was Iraq and not Afghanistan, one can therefore conclude that, today, a Taliban free of Al Qaeda or extremist elements like Mullah Omar would be somewhat acceptable to the US. With this in mind, the US today is busy negotiating with the Northern Alliance commanders, on the one hand, and with the moderate Taliban and Pakistan, on the other.

The US released Taliban's former foreign minister Mullah Muttawakil from its custody in 2003 so that he would persuade the moderate Taliban elements to stop attacking US forces in Afghanistan which he did later on (*Boston Globe* 2003). Early in 2004, Afghan leaders and high-ranking American officials engaged themselves in secret parleys with Taliban chiefs (Ansari 2004). As recently as in May 2004, the US military offered the Taliban a ceasefire if they stopped attacking US military camps and outposts (*Daily Times* 2003). In December 2004, after Karzai won the elections, Khalilzad again offered 'amnesty' to the Taliban. He claimed: "This initiative has the support of the President of Afghanistan" (*Aljazeera* 2004). Another reason for the US to keep the dialogue with the Taliban going is that it would counter-balance the Northern Alliance some sections of which is perpetrating violence to undermine Karzai's governance. In 2004, Government forces attacked Ismail Khan's bases and his son was killed. Reports have indicated that it was done under the supervision of the US forces (Hersh 2004).

However, it is not as if the US is deserting the NA who were its crucial allies during the war against the Taliban. In fact, the US administration would be quite willing to tolerate the reassertion of the 'warlord' control in Afghanistan, just so long as they pledge allegiance to the US-backed Karzai Government. In

the final analysis, before its troops leave for home, the US probably wants to assure itself that there is a regime in Kabul that they can influence, at least through Pakistan, so as to keep strategic competitors like China, India and Russia, at bay. It is, therefore, hardly surprising that Washington would find a moderate Taliban role in the Kabul regime to be just right for its purposes. The US Afgh-Pak policy is nothing but a much more sophisticated US policy approach to Afghanistan with which the Americans hope to stabilise the country.

Having said this, it is necessary to point out that there has been a positive shift in the thinking and strategies of the United States as well as Pakistan regarding the Taliban movement, at least in part, if not completely and comprehensively. This paradigm shift in their approach to Taliban, as pointed out earlier, has come about post-Lal Masjid operations in July 2007 which drove home the stark truth to the Pakistanis as well as the Americans that the threat of the Taliban is real and that keeping it alive and letting it operate in the society freely would become dangerous for the continued existence of the Pakistani state itself (the Pakistan army sustained over 50 casualties in his operation right in the middle of the capital city Islamabad). Therefore, there is a new realisation in Pakistan that the Taliban needs to be contained, not promoted. This realisation gained further ground when the Pakistani state was forced to sign peace deals (read: accept Taliban rule in Pakistan territory) in Swat and Bajaur. While these developments have forced Pakistan to wake up to the impending threat that the Taliban poses, it does not seem to be in a position to effectively fight against the Taliban menace. Learning from these developments the US has also been changing their strategies in Afghanistan vis-à-vis Taliban. Even as the US wishes to continue to have its concerns taken care of in a territory which is easily the world's greatest challenge at the moment, it is today willing to look beyond Pakistan as a partner in its regional strategy: the US is increasingly becoming aware of the need to associate India, and lately, Iran in forging a workable Af-Pak policy.

India's concerns

Traditionally, India has been an important player in Afghanistan, albeit not so directly. Although Afghanistan falls only in India's extended neighbourhood, Afghanistan's geo-strategic location is of great importance for India given its great power aspirations as well as its increasing ties with the Central Asian countries quite apart from the fact that what happens in Afghanistan has implications for India's north-western region. A resurgent Taliban dispensation with deep roots in Pakistan in Afghanistan, therefore, would be a disaster for India for the following reasons:

- Terrorism would be unleashed across the region, particularly in terrorist's old haunt – Kashmir. The inevitable increase in militant activities in Afghanistan and in Pakistan is certain to spill over in to the valley of Kashmir.
- Only a Government free of the Taliban in Afghanistan can ensure the safety of a land route that India is currently building through the Afghan territory. The proposed highway from Chabahar through Afghanistan to Tajikistan (Chabahar-kabul-Kunduz-Badakhshan) will enable India to have a transport corridor to the otherwise inaccessible Central Asian region. While the highway passes through areas traditionally under the influence of the Northern Alliance, the security of the route will be under threat if Taliban returns.
- India at present enjoys good relations with the Karzai Government, is a leading donor in Afghanistan's reconstruction work and the bilateral ties between the two nations are growing. All this will come to an abrupt end with the rise of the resurgent Taliban in Afghanistan.
- Even if the US were to oversee and control the process of accommodating the moderate elements of the resurgent Taliban, it will neither be able to control it comprehensively nor be interested in doing so for any length of time. Moreover, since a Taliban dispensation in Afghanistan is likely to unshackle all extremist elements giving them a field day, the moderate Taliban elements, in all probability, will soon find themselves out of the picture. This will lead to the return of anarchy and instability in the region and India will not escape its effects.
- The Taliban will see to it that India loses even the little presence and influence that it has in the Central Asian States which it has strengthened after the ouster of the Taliban regime
- Any further endeavour on the nascent proposal for an oil pipeline from central Asia through Xinjiang to India would become pointless. Also, as earlier pointed out, an upsurge in militant activities in the region including Xingjiang, would not spare the trade route from India and the proposed oil pipeline would become just a pipe dream.

Indo-Pak Rapprochement in Afghanistan?

While it is true that both India and Pakistan have their strategic stakes in Afghanistan, there is still a need to explore possibilities of India-Pakistan cooperation. Indeed, ever since Pakistan has started facing the blow-back effects

of the resurgent Taliban and the conflict in Afghanistan, there are many who argue that there is an urgent need for both the countries to sit down together to sort out their issues regarding Afghanistan as well as to think of jointly addressing challenges in Afghanistan. Pakistan, many Pakistani analysts argue, fears about India's involvement in Afghanistan and the goodwill it is gaining there for the reconstruction efforts that India is doing there. It firmly believes that India's current involvement as well as interests in Afghanistan is dangerous for Pakistan's interests there.⁶ Pakistan fears the much dreaded two-front situation of an unfriendly Afghanistan allied to India and a militarily powerful and enemy India. It is in this context that it is argued that India and Pakistan could start exploring possibilities of cooperation. One of the things that both the countries can do vis-à-vis Afghanistan is to pledge to maintain 'relative' neutrality in the trouble-torn country. Using the other side of the same argument one could also argue that both the countries can cooperate on a variety of issues areas in the reconstruction process that is currently underway in Afghanistan. For instance, India and Pakistan can think of having joint initiatives in Afghanistan in 'neutral' areas such as education, infrastructure development among others. It was also pointed out that the two countries can also cooperate on preventing drug trafficking. While these things still remain items in a wish list, there are analysts and former policy makers who are pushing for such initiatives in Afghanistan. May Indians and Pakistanis and even the Americans understand today that the NATO and the US forces will not be able to stabilise Afghanistan without taking Pakistan, India, Russia, China and Iran into confidence. Therefore, it is possible that the Americans will push for a greater level of cooperation between India, Pakistan and Iran vis-à-vis Afghanistan in the days to come.

Conclusion

Thus, Afghan geopolitics holds the key to stability in the Southern Asian region. Forty years of Afghan history has proven one thing beyond any doubts: whenever any country(ies) tried to impose its will on the Afghan people and make Afghanistan a client state, the entire region has had to face its repercussions. This article has tried to reconstruct the rise, fall and the resurgence of the Taliban in Afghanistan and identified the various players and their strategies in Afghanistan at various junctures. It also points towards the direction of possible collaboration among the various parties involved in Afghanistan in order to stabilise the region. In one sense, rapprochement between India and Pakistan is perhaps a key to bringing peace to the war-torn country.

Notes

- 1 For instance, textbooks for indoctrinating students in Pakistani *madrasas* and Afghan refugee camps were published in Dari and Pushtun and designed by the Centre for Afghanistan Studies at the University of Nebraska–Omaha under a USAID grant in the early 1980s. See “Pakistan: Madrasas, Extremism and the Military,” *International Crisis Group Report*, 29 July 2002.
- 2 Maj. Gen. (ret'd.) Nasirullah Babar, a Pushtun, was Interior Minister of Prime Minister, Benazir Bhutto during her second term in office. He was the head of the Afghan desk of the ISI during the tenure of Zulfikar Ali Bhutto.
- 3 Ishtiaq Ahmad writes that it was the US State Department Spokesman Glyn Davies who said that the US had found nothing objectionable in the steps taken by the Taliban to impose Islamic law. Ishtiaq Ahmad, “How America Courted the Taliban,” *Pakistan Observer*, 20 October 2001. Available at www.globalresearch.ca/articles/AHM202A.html
- 4 For details on this see, “Taliban cracking up, some dissidents flee to Pakistan: Report”, 4 December 2001. Available at <http://www.rediff.com/us/2001/dec/04ny1.htm>; and Peter Baker and Karman Khan, “Deal-making Let Many Leaders of Taliban Escape,” *Washington Post*, 17 December 2001.
- 5 For more details see the following articles. Rajeev Srinivasan, “What happened in Kunduz? Are the Americans all singing from the same hymn book?” 30 November 2001. Available at <http://www.rediff.com/news/2001/nov/30rajeev.htm>; Dexter Filkins and Carlotta Gall, “Pakistanis again said to evacuate allies of Taliban,” *The New York Times*, 24 November 2001.
- 6 Recent Pakistani and Indian thinking on most critical issues between India and Pakistan have been understood from the recent track-two conferences that were held after the Mumbai terror attacks. The conferences I refer to are the following: 1) Pugwash track-two meeting on Prospects for Restarting the India-Pakistan Dialogue Islamabad, Pakistan, 5-6 March 2009; 2) Confidence Building Between India and Pakistan: Post Mumbai Attacks, Bangkok, 30-31 March 2009, organised by the Delhi-based think tanks Public Policy Research Group and the Institute of Peace and Conflict Studies; 3) Pugwash meeting in the Hague on Regional Stability in Central and South Asia: The situation in Afghanistan, and India-Pakistan relations, 17-20 April 2009. I argue that Indian and Pakistani thinking at the higher levels of strategic community in both the countries can be understood from these track-two conferences because of multiple reasons. One, these meetings were held at a time when there was no official contacts between the two countries; they were attended by formerly high-ranking officials in the Indian and Pakistani establishments and; since these meetings were held under Chatham House rules, the participants were willing to discuss issues in a bare-to-bones to manner. Deliberations of these meetings were held under Chatham House rules and thus while references will be made to these conferences throughout the paper no names or contexts will be mentioned.

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Issues and Challenges in India's Grand Strategy in the New Century

W. Lawrence S. Prabhakar

India's strategic evolution in the post-colonial era has been a theme of extensive debate. The debate has been broadly divided into two streams; the first stream articulates on the lacunae of strategic thinking in India and questions on the nature and location of the sources of its strategic thought and strategic culture; the second stream argues that India's strategic thought is located in its cultural and civilisational roots— embedded in its civilisation and historical legacy in the ancient times (Jones 2006; Subrahmanyam 2005; Bajpai 1994; Tanham 1992). However, the contemporary emphasis of India's quest for great power status and the endeavour to articulate its Grand Strategy is seen more in the quest for developing its comprehensive power evident in economic development, in its growing technological-industrial and the strategic capabilities. It has witnessed the striving for autonomy of action in the foreign policy arena and constitutes a distinctive feature in Indian strategic thinking.

In its theoretical emphasis, Grand Strategy has a strong premise on power and capabilities. Realists as well as neo-realists affirm that the state's political influence and military capabilities must have an economic base that sustains the foundation of economic prosperity—this is a preliminary requisite to expansion and war. Realists affirm that a state's war *capabilities* need to be built with the economic prerequisites that support military build-ups, arms races and sustenance for prolonged massive armed violence (Gilpin 1981: 54).

The expansion of a nation's capabilities and power emerges as a response to the combination of internal pressures, challenges and the threats and opportunities in the external environment. It emerges from the weakness of surrounding states that dictates external compulsion. The regional dominant state finds itself bordering on a power vacuum, compelled by appetite and temptation for aggrandisement to fill the void (Wolfers 1961: 14-15). The quest for national power in the build-up of comprehensive capabilities and power constitutes the basis of strategic autonomy of states. Strategic autonomy

is the key concept that infers the relationship between economic innovation, military capabilities and power rise and eventual hegemony (Tellis 2000: 35-36).

Tellis emphasises the following: a) States would continue to remain important units in the international system with accents of “high politics” in areas of international order and governance rather than individuals, non-government actors and transnational organisations; b) The bases of national power would be derived from the state’s economic and technological *capabilities* and its manifestation in military capability that pertains to the domain of survival, unrestrained by ideological or moral constraints; c) Military capabilities would remain critical in the context of diverse conventional operations, even though nuclear weapons would be the ultimate weapons of last resort and their employment would be highly restricted. Conventional military capabilities would signify flexibility, responsiveness and credibility; d) The technological imperatives in national economic, industrial domains and the defence sector would be critical in terms of information dominance and the military technical revolutions that enhance national capabilities and autonomy. The above inference provides for a very robust realist perspective that predicates military power on economic and technological capabilities of the state as the unitary actor in international relations.

Grand Strategy is the quintessence of comprehensive national power that the aspiring states elucidate. The foundations of comprehensive national power is built on the sinews of the state’s human security, physical security, political stability and cohesion; economic and social development and the fine balance between social, political, civic, economic, industrial and technological power. The growth and nurture of comprehensive national power would constitute the sure foundations of how states articulate their foreign policy and diplomatic strategies. The beginning of this century has witnessed the rise of Asian economic and military power. The rise of Asian power is now being calibrated in strategic terms by quantitative empirical terms that confer China and India to be reviving their ancient strategic realm through contemporary national power development indices.

Causal Foundations of India’s Grand Strategy

India’s strategic thought and the *praxis* of its interests are based on the key issues that would determine its autonomy and capability. They are characterised in: a) territorial integrity, b) economic development and growth; c) autonomy in the strategic domain; and d) the quest for technological capabilities and power. India’s post-colonial period has been the constant quest to attain economic development and growth and the drive for technological capabilities and power

to define India's national interests and its zealous preservation of autonomy of action. The predominant trend in the debates and analysis in contemporary western scholarship has largely focused on the location and the lacunae of India's strategic thinking; centred on the historical concourse; the foreign policy analysis; defence policy analysis; analysis of strategic culture and institutional structures. This trend has been quite logical in its essence since India did not articulate any consistent pattern of grand strategy but continually relied on an adhoc orientation to strategic policy and conduct.

In the attempt to understand the issues and challenges in India's Grand Strategy, it is necessary to infer the sources of India's strategic conduct and its evolution. There is a need to examine India's strategic evolution from the focus of *autonomy-capability-resilience* and how this is evident in India's *intents-capabilities*. The locus of India's Grand Strategy in the contemporary context is evident in the analogy of the three concentric circles that represent the following: the outer-circle represents the domain of foreign policy characterised by the articulation of India's national interests and foreign policy goals dominated by India's diplomatic community; the core circle is the domain of India's defence policy characterised by the military professionals and the operational specialists of the military and civilian community; the intermediate circle that hyphenates the foreign policy circle and the defence policy core circle are the strategic community whose speciality lies in the aggregation of the broad aspects of foreign policy and the focused aspects of defence policy.

In terms of its contribution and work, India's strategic community consists of few institutions and individuals in number. India's strategic thought process has been epitomised in a few individuals and has not been canalised into a policy-institutional framework. The National Security Advisory Board, the Strategic Policy Group, has now become institutional agencies of the government and their objective output in preparing strategic assessments for the country has become limited. India is a *pivotal state* in terms of its core capabilities, strategies, elite integration and sheer size and domain (Cohen 1999). It could be argued that the evolution of India's contemporary strategic thinking is based on its critical interests and augmented by its growing capabilities and resilience (Cohen 2001).

India's Grand Strategy is based on its realist strategic paradigm of being a *core state* encompassed with concentric circles of the immediate, intermediate and the extended strategic theatres. The core state is conditioned by the following premises: (a) it articulates on the strategic conduct and sources of strategic conduct of states in the immediate, intermediate and outer concentric rings in proactive and reactive actions to changing regional and international

security dynamics; (b) it is a realist construct that envisages how states define and dynamically move in the spatial contexts of international relations, driven by the imperatives of strategic autonomy and (c) it envisages the dynamism of alliances by which states conduct themselves' in relation to the changing regional and international setting. The immediate concentric circle of the neighbourhood has always been unstable with intermittent acrimonious relations with Pakistan and China. However, the recent years have seen substantial improvement of good relations with the two states with good economic linkages and trade. But the core state doctrine envisages that the prospect of benign relations in the immediate circle is always a challenge—since adversity on the basis of mutual animosity and unresolved boundary disputes could compound the relations. The intermediate circle comprises of East Africa, the Persian Gulf, Central Asia and Southeast Asia. India has enduring economic, trade and substantial Diaspora ties with several countries in the intermediate circle. Therefore, the accents of its relations with the intermediate circle would be benign and cordial.

The extended outer circle posits that India would have strategic partnership with the great powers that have convergent interests with India and have been source of trade, investment and technology collaboration. In pursuit of its power rise, India has relied on the quest of achieving capabilities as a means to achieve autonomy in its foreign policy. In the concentric circles of India's policy, strategy and operational capabilities, constituting the strategic matrix, the operational capabilities are largely evident in technological capabilities. Technological capabilities are derived from strengths in economy shaping the concourse of policy and strategy (Mohan 2006).

India's quest for strategic autonomy has been its primary strategic objective in the contemporary period. It is often articulated by the strategic elite that India's technological backwardness has been the primary reason of its vulnerabilities to foreign invasions and colonial domination. In synchronising its quests of securing its territory, nurture its economic growth and carving its autonomy, India has augmented its resources and capabilities with the aim of building an industrial-technological base with strong civilian-military applications. Technological and industrial development with dual use capabilities has been viewed as the harbingers of India's technological strength, secure its territorial interests and sustain its strategic outreach. Therefore the primary argument of this perspective would be an exploration of India's strategic evolution is focused as strategic autonomy in *praxis*. The quest for strategic autonomy from Nehru to Manmohan Singh is evident in the process to build India's *autonomy* (independence of foreign policy, nonalignment, and the endeavour to neutralise technology denials through *capability* (economy and

technology) with the aim of enhancing its national power in comprehensive scope.

The quest for technological development had its strong impetus for post-independent India's economic growth in the agricultural, industrial, educational, science-technology, medicine-health, research and development sectors having its critical convergence in the defence-industrial sectors. The implications for India's technological capabilities build-up as a means to comprehensive security had been long realised by Jawaharlal Nehru with sound investments in education and in science and technology spurning India's economic and industrial base with strong defence applications. Nehru envisioned that security was derived from autonomy and self-reliance. He was convinced that India's quests for technology have to be nurtured indigenously with selective international reliance to enhance its economic and industrial growth. As India's economic and industrial profile grew with emergent capabilities, its quest for international sources of technology have been largely restricted by the various technology denial regimes. India was able to manage dual use technologies for military applications more, even as it absorbed the same into its civilian enclaves.

India's contemporary strategic evolution derives its significance from its autonomy in foreign policy and diplomacy, rooted in its defence science applications; its evolving doctrines of operations in the conventional armed forces, force postures and the nuclear forces. It is thus reasonable to attribute that India's strategic autonomy has been largely driven by capabilities evident in its technological developments.

India's strategic evolution in the contemporary period has thus been an eclectic combine of diplomacy, economic development and the quest for technological know-how that caters to the needs of civilian economic development and defence. The challenge to India's strategic evolution has been conditioned by the complexities of the vast pluralistic social-ethnic order; its daunting demographic and economic challenges; the complex challenges of democratic governance; the vexatious internal security situation and the persistence of external threats and challenges. India's contemporary history reflects the varied experience of the nation building process built on stable, equitable political order; viable economic and industrial strengths and an optimal defence-development model that addresses its security concerns. The span and pace of India's strategic evolution has been over the past half-century and its profile has been built on its *élan vital* to weather the various internal and external threats and challenges. Its economic development, technological growth and its military capabilities reflect its steady and sure ascendancy to a major power status (Nayar and Paul 2003).

The significant events of 1991 in India's economic and technological concourse have placed it in the trajectory of its strategic evolution marked by persistence in terms of its autonomy of action, assertion of its capabilities and the quest for its predominant role. Its outreach in the Southern Asia-Indian Ocean Region and growing extended role in Central Asia, South West Asia and Southeast Asia promises to confirm its evolution as a major power. India's strategic evolution is gaining significance with its growth in nuclear, missile, maritime and aerospace capabilities constituting the foundations of its strategic autonomy and its assertiveness in the region. India's quest for autonomy and assertion emerges from the colonial inhibitions that it suffered due to its technological and economic backwardness. In the post-colonial period, India has been targeted for technology denials for the assertion of its growing profile and its serious quest to develop nuclear, missile, space and aeronautical capabilities.

India's decision makers have always viewed technology denials as means intended to arrest India's economic growth. They have made a strong case of non-adherence to the international control regimes like the Nuclear Non-Proliferation Treaty and the Comprehensive Test Ban Treaty on the grounds of its heavy discriminatory slant against India's interests, but have claimed of scrupulously adhering to the principles of the agreements without being parties to it. The analysis of India's strategic evolution would have to address various issues that constitute the matrix of its challenges and responses that it had generated. The quest for autonomy and capability had been largely driven by the systemic complexities and challenges inherent in the process (Bajpai 1994). India's strategic evolution is premised on the strong foundation that it was a "strategic and economic prize" with its current progressive evolution towards a great power. India's core values of security are evident in the security of its territorial domain and its internal security that has emerged as a formidable challenge than the external threat. The territorial security imperative is based on power and capabilities that are economic and military in nature. India's internal security and stability is a vital prerequisite to its resilience and progress. Its strategic elite across the spectrum advocate a strong state as the means to address this challenge. India has enhanced its autonomy of action in its foreign policy by its ability to sustain its mediating institutions in its internal and international fronts (Bajpai 1998)

India's post-colonial experience had been largely affected by the persistence of inter-state and intra-state problems that significantly affected its economic development and political stability. India's strategic evolution has been conditioned by its geography, culture, historical past and its national liberation ethos (Tanham 1992). The concourse of India's strategic evolution is chequered

with its historical legacies of conquests and colonisation. Colonisation and its effects had induced a sense of subjugation that arose out of technological backwardness and associated with the notions of predestination and fatalism. Post-colonial India was confronted by intermittent periods of growth, but largely pegged to slow growth known as the 'Hindu rate of growth'. The institutional capacities of India were beginning to be developed by the various political, administrative developments in the country. India's large demographic base and the social-economic growth were largely premised on an autarkic model that was considered inefficient retarding India's economic growth. But autarky was the only appropriate model to respond in the early stages of India's strategic evolution that had the important priorities of national consolidation and growth.

India's strategic evolution, however, continued with its quest to build the structures of security that emerged indispensable in view of its vast size. Its complex internal situation has a kaleidoscope of ethnic, religious, social, regional conflicts with the spillover of the internal conflicts into its external threats and challenges. Economic development and social change have been the two primary drivers in the Indian quest of stability and growth. In commensurate terms, India's military expenditures have been in the range of 3.5 per cent of its Gross National Product- a modest outlay. Its strategic challenges and threats are largely geo-political in terms of the unresolved disputes with Pakistan and the adhoc agreements with China. India's perennial security challenge has been China's strategic modernisation and its nuclear and missile aid to Pakistan.

India's security praxis has been known to be defensive-defence in the spectrum of posture and response. India's responses to the Chinese-Pakistani nuclear-missile alliance had been in terms of force build-up and technological responses in the form of its nuclear and ballistic missile programmes in place to contend the pervasive threat. India has also to contend with the growing extra-regional naval presence in the contiguity of its southern border in the Indian Ocean region. The emerging Chinese naval presence and access facilities in the region have been the rationales that have induced the strategic build-up in the 1980s and 1990s (Thomas 1986 and 1992; Karnad 1998 and 2004).

Threats Matrices of India's Strategic Evolution

India's strategic evolution has been conditioned and often sapped by its engagement in its host of intra-state civic, political, regional tensions and internal security challenges. These have risen from terrorism, insurgency, and religious

fundamentalism that have aggravated the post-colonial state building processes (Ayoob 1995). India's democracy had been quite resilient in the management and containment of the various insurgencies and militant movements. The implications of these internal security threats have been evident in their linkages with the external sources of support. Pakistan and China have supported various secessionist groups in the border provinces of Punjab, Kashmir and the North East states. India has expended substantial resources and investments by the deployment of its para-military forces for security duties and for the development of these regions. India's border and boundary issues of disputes and secessionist threats have been aggravated and exploited by the two powers. Its predominant security predicament is the high thresholds of escalation triggers of low intensity conflicts into limited wars and limited wars with nuclear weapons.

India's deployments of substantial security forces in the troubled regions have been subject to attrition by the relentless prosecution of low intensity conflicts by Pakistan. Pakistan's strategy of attrition has been with the escalation of the low intensity conflicts that have added to the hostilities in the bilateral relations of India with Pakistan (Paul 2006). The Kargil War 1999 and the escalation of tensions in 2002 have emerged out of the spillovers of the low intensity conflicts that Pakistan had imposed on India. It had necessitated the substantial mobilisation of Indian armed forces with its potential escalatory links to the nuclear space. India's conventional robustness, its force postures and capabilities have reinforced its strengths in asymmetric conflict situations. Its technologically superior armed forces delivered its advantages in the conflict engagement. India's continued contention over internal security threats and the scourge of asymmetric conflicts have had a serious denting effect on its economic growth and its security. It has expended a substantial effort in contending these threats in Kashmir and the Northeast despite the huge outlays in development expenditure and the consistent efforts to improve civilian infrastructure. Yet another challenge in India's strategic evolution has been the defence-development conundrum.

The Defence-Development Paradigm: Economic Growth and Technological Quests

India's defence-development paradigm has been a key issue in its strategic evolution. India has been able to optimise its defence and development priorities that have enabled it to develop a strong technological-industrial base with diverse high to medium range technological and production capabilities. It has been able to address its defence technology needs with a variety of strategies

that have built with the primary objectives of self-reliance in technology needs. It has effectively augmented the assimilation of foreign technologies through select adaptation of the same in its platforms, licensed production and co-production ventures. The abilities of the Indian defence research and development to optimise its production capabilities have, however, been limited with several failures in the Main Battle Tank and the Light Combat Aircraft projects having being affected by severe limitations in its international collaborative partnerships.

The limitations have been due to the sanctions regimes that have denied technology transfers that have been erected to restrain India's nuclear and missile ambitions. Technology denials have, however, led India to adopt long recourse to develop Indian versions of the denied technology by its application of its scientific and technological resources. India's successes in some of the frontier end technologies have prompted the international community to reverse the sanctions regimes for collaboration. India's tryst with technological development has progressed in the following concourse with performance. Self-reliance was the first accent of technology development in India. Here, self-reliance was equated with indigenous strength, and reliance on international technologies was viewed as source of vulnerabilities for India.

Self-reliance was a strong Nehruvian preference. It was meant to enhance India's autonomy and action with indigenous technology (1948-1962). The limitations of indigenous technologies have been constrained by the timescale and obsolescence of the technology resulting in its reliance on imported military hardware that was to provide quality improvements. The second phase of the autonomy-technology concourse saw the emergence of the imported military hardware from the US, UK in the event of the Chinese threat (1962-1965) and it saw restrictions on India's autonomy as it had envisioned the prospect to depend on the US-UK umbrella to contend the Chinese aggression. The third phase was the arms embargo and embargo of spare parts that India had to contend in the event of the India-Pakistan War 1965 that resulted in its vulnerability due to the dependence on imported military hardware and technology. The fourth phase was the Indian reliance on the Soviet Union for its military aid and diplomatic support in the Kashmir issue. The India-Soviet Union bilateral relationship was broadly a strategic partnership of bilateral mutual aid and support that evolved into a US-USSR superpower gambit in the region. In terms of military aid and licensed production of Soviet conventional military hardware, the terms of offer were the best that India gained at affordable levels in terms long-range economic and technological benefits. It provided India the broad scope of defence industrialisation as Soviet military hardware

production and maintenance enhanced the defence-technological base of India with capabilities in co-production, research and design. It also saw the commensurate qualitative enhancement of Indian Armed Forces training and capabilities that merged technology, training and platforms. It resulted in the emergence of the new operational postures in manoeuvre divisions and air and naval operational capabilities that signified expeditionary and special operations capabilities. The technology driven capabilities resulted in the broad expansion of India's regional hegemonic capabilities and its abilities to leverage its military force posture in its foreign policy.

The fifth phase was the economic downturn of the early 1990s that resulted from India's default economic performance and the collapse of the Soviet Union. It also marked the phase of India's transition to the globalised economy and its concomitant defence collaborative ventures and diversification with the United Kingdom, Germany and France. It signified the era of technology upgradation and hybridisation of the ex-Soviet platforms with Western and Israeli systems. The sixth phase is the maturation of India's defence industrial base which witnessed the co-design, development and co-production of weapon systems that include the *BrahMos* Cruise missile, the various Unmanned Aerial vehicles, the development in Aerial early warning and aerial control systems and capabilities, adaptive technologies in aerial refuelling, indigenous naval build-up of the Delhi Class Destroyers, the Advanced Technology vessel, the Light Combat Air Craft, the Light Combat Helicopter etc. The maturation of India's defence industrial base had seen critical developments in its nuclear weaponisation process and its development of its ballistic missiles that have medium and intermediate range capabilities. It has also signified new technological initiatives in missile defence capabilities and the gradual evolution of its dedicated space-based communication and reconnaissance assets.

The significant aspect of the defence-technology developments has been that the defence development programmes have not been at the cost of India's economic performance. Significantly, in the post-1998 period, India had witnessed substantial economic growth in the areas of Information and Communication Technology. The expanding globalisation process and the successful permeation of economic reforms have been quite pronounced. Its considerable advances in its infrastructure strengths and its emergence as an important destination of Foreign Direct Investment added to its strategic profile.

The synergies of India's strengths in the Information Technology have been evident in the Indian armed forces. It has gained significantly in the emerging net-centric capabilities even as new platforms and sensors have been viably

networked. It is thus evident that India's strategic evolution has been marked with a linear progression in phases that commenced from:

- a) Self-reliance premised indigenous technology;
- b) The growing level of technology assimilation;
- c) Its capabilities in technology demonstration in the missile and combat aircraft programmes;
- d) The ability in harnessing its potential to develop alternate routes to denied technology;
- e) The success in gaining co-production of technology with strengths to its operationalisation.

The Quest for Autonomy and Assertion

India's strategic evolution had thus been premised on technological capabilities and sustained economic development that has ranged from 6 per cent to 9 per cent in the last decade that had been instrumental to build its strategic autonomy and assertion. Nehru had built the foundations of post-independent India's autonomy on the premises of nationalism. Nationalism was the ideological cement that gelled with the demands of economic and social development and the nurture of self-reliance based industrialisation. Nehru believed and pursued India's self-reliance in economic and industrial development as means to negate the vulnerabilities of India of its dependence on foreign assistance. His pursuit of non-alignment was a grand strategic diplomacy means to avoid the entanglement in the East-West cold war rivalries, and economic self-reliance largely insulated India from the turbulence of the Cold War rivalries.

Nehru addressed India's vulnerabilities in agriculture and industry by building capacities in technology-oriented projects that redressed the deficits. However, Nehru's disdain for power politics and his rejection of the balance of power politics was another reason of his inability to contend the Chinese threat and aggression. His rejection of the realities of Balance of Power for the apprehensions of being entangled in the Cold War rivalries was optimal. It was perhaps his stubborn insistence to prefer diplomacy premised on a moralist plank that blinded his perceptions of the naked realities of power. India's claims to strength proved hollow in the Sino-Indian War 1962 as diplomatic rhetoric and were not backed by power and capabilities. Nehru's realism was, however, visionary and he had the perspective to nurture the long haul in India's capabilities buildup, but his grasp of the immediate material influences that drove power politics seemed myopic. The 1962 debacle reiterated the imperative of building capabilities. It convinced him to rely on the imperatives to build

capabilities and a sound industrial-technological base. The 1965 war with Pakistan proved successful for India but hamstrung with arms embargoes and the supplies of spare parts to the military hardware by the United States. It saw India being subject to external diplomatic mediation in Tashkent in 1966.

Indira Gandhi emerged in the post-Nehru transition period with a penchant of Machiavellian preferences. Compounded by internal challenges and a fragile external situation, Indira Gandhi effectively managed the food crisis of the 1960s. India was able to withstand US pressure and arm-twisting tactics in terms of the short tether linking food supplies under PL 480 with India's support to the US campaign in Vietnam. Indira Gandhi rebuffed the US pressure with the unilateral cancellation of the PL 480. Indira Gandhi had her focus on the intensive agricultural revolution that comprehensively addressed India's food needs. The Agricultural Revolution and the large-scale industrialisation with defence applications led to the new Indian vistas in nuclear, civilian space rocketry, electronics, and communication sectors in a substantial manner.

Indira Gandhi adopted the iron hand to stabilise the internal situation and preferred negotiations with the Soviet Union for a reliable military arms supplies relationship. This cemented into a bilateral alliance in the Indo-Soviet Treaty 1971 preceding the India-Pakistan War. Indira Gandhi built India's military capabilities with an effective global diplomatic campaign running to the Bangladesh War 1971. Indira Gandhi's campaign highlighting the humanitarian crisis in East Pakistan was followed by the military operations. The India Pakistan War 1971 was India's finest moment in the assertion of its autonomy and the effective and integrated command of War operations management with Field Marshal Sam Manekshaw. The post-1971 period saw the assertion and reemergence of India as a dominant regional power with five critical successes:

- a) India's ability to resist the Nuclear Nonproliferation Treaty Regime and the pressures to give up its nuclear option.
- b) India's ability to withstand the pressures of US intervention in the 1971 war with its decisive operations in the East Pakistan sector and the restraint in the western sector with Pakistan. It saw the deployment of the US naval task force and the responses of Soviet naval deployments;
- c) India's assertion of its autonomy in the post-conflict settlement of the 1971 war in the Simla Agreement wresting the initiatives of diplomatic settlement within the region and restraining US and Soviet post-conflict diplomatic mediation efforts;

- d) India's assertion of its regional domain and its response to the Nuclear Nonproliferation Treaty regime was symbolised by the Peaceful Nuclear Explosion Test 1974;
- e) The *Indira Doctrine* asserted the enunciation of regional hegemony by Indira Gandhi that effectively carved India's regional supremacy insisting on South Asian issues to be resolved bilaterally with India within the region.

The pursuit of regional hegemony was effectively synergised by the fervent buildup of the military-industrial-technological base that was evident in the various licensed production of ex-Soviet military hardware and the simultaneous developments of Indian variants.

The post-Indira Gandhi period saw the continuation of the established pattern of strategic autonomy and assertion of Indian domain that was effective in the various internal security situations in Punjab and the North East and was complemented by the buildup of conventional military capabilities and the recessed/existential nuclear deterrence in being. India's defence technological programmes like the Integrated Guided Missile Development Programme saw the gradual buildup of missile capabilities and its derivation from its civilian space programmes. It also saw the gradual development of its indigenous satellite-buildup capabilities and its limited launch capabilities. One of the significant events in the reinforcement of India's strategic autonomy has been the quiet, yet formidable naval buildup in the 1980s that was sustained into the post-liberalisation period. India's military modernisation has been quite substantial in the mechanisation of its infantry divisions, reorganisation of its fighting formations and the development of special operations forces. The development of expeditionary and amphibious capabilities, its increased sophistication and diverse air operation roles with new platforms, sustenance of carrier based naval aviation were seen as sustained initiatives. Its ambitious conventional submarine acquisition programmes with the abilities and the sustained efforts to build its nuclear propelled submarines armed with nuclear tipped cruise/ballistic missiles have been successful.

India's Strategic Evolution: Strategic Doctrines and Force Capabilities

India's quest in its strategic evolution has been conditioned by the adoption of the following strategies: a) It had pursued the strategy of zealous defence of its autonomy and effectively resisted pressure to sign international treaties like the Nuclear Nonproliferation Treaty, the Comprehensive Test Ban Treaty that

have been inimical to its interests. It had softened the pressure by displaying its salutary adherence to the principles of the treaties thereby adopting restraint and signified that it was not a hostile challenger, but had its valid systemic bases for its rejection; b) It had pursued diligently in its technology acquisition mission (although with setbacks) and had effectively synergised its indigenous defence research and development with technology missions like the nuclear, missile programmes and the space programme. It had been able to efficiently synergise its technological potential in the various home built naval warship building programmes that are in the league with the state of the art.

The growth of Indian capabilities and its economy have been rather steady with the exception of the early 1990s when the Indian economy had suffered systemic aberrations that had its serious impact on its macroeconomic indicators. It had apparently coincided with the largest ever defence expansion in the 1980s that was a response to the primary variables of the second cold war in the Asian-Pacific theatre, the nuclearisation of the Indian Ocean, the Soviet invasion of Afghanistan and the Chinese strategic modernisation. The secondary variables were the collapse of Soviet Union and the loss of India's reliable partner in its defence industrialisation efforts, the Gulf War 1991 and the spurt of oil prices that had its decisive impact on the Indian economy. It had also induced the imperatives of the first generation structural reforms and the gradual shift to India's economy to globalisation that enhanced its effectiveness and performance.

The evolution of India's defence capabilities in synchronising with its operational milieu and doctrines began with its decisive defeat with China in 1962. It saw the gradual expansion and synchronisation of India's military doctrines and force capabilities since the 1960s (Thomas 1992: 43). The first phase of doctrinal evolution was the development of *Sufficient Conventional Defence* (1963-1971) in the post-1962 period that provided robust responses to Pakistan and maintained sufficient defence against China. In terms of capabilities, it was a minimalist spectrum that envisaged a one full war against Pakistan in land, air and sea and a single half war with China of limited land-based border engagement.

The second phase of the doctrinal evolution was emergent from its capabilities with the development of *Limited Conventional Deterrence* (1972-1988). It saw the evolution of Short Range Ballistic Missile (SRBM) capability with targeting options of Pakistan. It was intended to strengthen conventional deterrence against China with testing of Intermediate Range Ballistic Missile capabilities. The period witnessed the spectrum of growing naval capabilities. The growth in capabilities resulted in the demonstration of force capabilities in exercises that simulated real combat in *Operation Brass Tacks* (1986-87) and

Operation Chequer Board (1988). The exercises signified the transitional phase of India's military capabilities that envisaged a one full war and three half-war capabilities. It signified the evolution of a full war with Pakistan in land air and sea, second half war with latent nuclear weapons capability and a third half war with proximate island intervention capability. The third phase of doctrinal evolution has been *Latent Nuclear Deterrence* (1989-1995) that envisaged conventional military superiority with Pakistan with Short Range Ballistic Missile capabilities. It was to sustain sufficient ground forces in the trans-Himalayan borders with developments aimed for an extended Medium Range to Intermediate Range Ballistic Missile capability. It augmented for naval expansion and the defence of the coastline and the exclusive economic zone. The appropriate spectrum of military capabilities saw the evolution of the extended power posture with a force structure for two full and two half-war capabilities. It envisaged a full war against Pakistan on land, air and sea; a second full war capability that had nuclear weapons and Intermediate Range Ballistic Missiles and a proximate island intervention capability.

The fourth phase of doctrinal evolution has been *Regional Nuclear Deterrence* (1996-2008 and beyond) signifying the maintenance of conventional and nuclear deterrent capabilities based on sufficient conventional defence, short range nuclear delivery systems and manned bombers with nuclear payloads vis-à-vis Pakistan; maintain sufficient border ground forces and minimum deterrent capability with China. It postulated for sufficient Intermediate Range Ballistic Missiles; the emphasis on assured second-strike sea-based submerged platforms with nuclear tipped missiles; substantial naval expansion with sea-control and from Straits of Hormuz to Straits of Malacca and South China Sea.

The force structure would entail for the Asian Great Power Posture that is currently in evolution since the nuclear tests, the successive ballistic and cruise missile tests, the force acquisitions of the Russian nuclear attack submarines, the construction of the Indian Advanced Technology Vessel, the two carrier task forces, the high performance Delhi class destroyers, stealth frigates. This posture would entail a three full three half-war capability. It would have a full war against Pakistan in land, air and sea; a second half-war capability with nuclear weapons of IRBMS; sustained power projection in the Indian Ocean; capability to sustain a land engagement with China; proximate island intervention and the effective defence of the exclusive economic zone. These postures are however maximalist in intention and doctrinal vision. It would take a very substantial investment and sustained progress to achieve these objectives although there has been incremental progress over a long gestation period.

The evolution of India's strategic autonomy has been evident in this trajectory. It had adopted the incremental path of technology demonstration and low profile posture to maneuver its position for its peaceful rise. Its technology demonstrations of the nuclear test explosions, missile tests and civilian space activities had attracted increasing international censure and technology denials. India's assertion has been a response to the international community's coequal treatment of its status with Pakistan on issues of nuclear proliferation. While India had adopted restraint and scrupulous adherence to export control issues, Pakistan had proliferated nuclear technology. The international community had been tolerant in Chinese transfers of nuclear and missile technology to Pakistan, while subjecting India to technology denial sanctions in the aftermath of the nuclear test explosions in 1974.

The second systemic response of India has been the operationalisation and weaponisation of technology that had led to its development of its nuclear options and deployment posture of a force-in-being signifying the growing capabilities and responses. The third systemic response of India has been the templates of transformation that India has been able to initiate in terms of its doctrines and operations. The armed forces doctrines of the Indian Army, Indian Navy and the Indian Air Force and the strategic nuclear doctrine have been manifest statements to the evolving strategic and operational capabilities and the technological transformation evident in the armed forces. The sinews of transformation have added immense value to the leveraging of India's diplomacy and strategy. The fourth systemic response has been the accrual of strategic value from defense industrialisation. Defense industrialisation has resulted in the strengthening of strategic autonomy in three myriad ways. One, it paved the way for the development of indigenous technologies for strategic self-sufficiency; Two, it had enhanced the prospects and means to import and collaborative manufacture of weapon systems under licensed production that aimed at strategic optimality and efficacy; and, Three, it had paved the way for new initiatives of joint ventures in technology development that spans from concept and design planning to technology evolution to full production assemblies

The fifth systemic response has been India's strategic engagement and interoperability with the great powers. It had significantly augmented the interoperability through the following avenues of i) *increasing quest for proactive roles and missions*; ii) *Quest for Bilateral Strategic partnerships*; iii) *Quest for increased international engagement*; iv) *Quest for interoperability in platforms and processes*; v) *Quest in accrual of technological and operational competence in new generation technologies*. India's strategic engagement has been with the United States, Russia, France, United Kingdom, Japan, Australia and Israel. Strategic

engagement and interoperability have enhanced strategic gains for India in terms of Partnership for Interoperability and Technological Enrichment with the United States; Partnership for Reliability and Resilience with Russia; Partnership for Diversification and Synergy with France, United Kingdom and Japan and Partnership for Technological Synergy and Hybridisation with Israel. The twenty-first century thus presents to India, its significant opportunities and challenges with the growing economic and technological profiles that have enhanced its capabilities with value additions in its profile of strategic autonomy.

Promises and Pitfalls in India's Strategic Rise in the Twenty-First Century

While the narrative on India's strategic rise in the twenty-first century has been well espoused, it is imperative to assess the promises and pitfalls that are quite evident in its rise. Several challenges and questions remain persistent:

- a) What are the substantial issues of India's growth and how has this growth addressed its human security predicaments of development, poverty and the challenge to sustain economic growth with a social equitable purpose?
- b) What has been India's record of human development, governance and human rights? Has it been at the cost of rapid economic growth with lopsided mal-development efforts? Does India intend to replicate the China model at the cost of human development of rapid economic growth or are their other domestic factors constraining its economic growth?
- c) Could a purposeful economic growth on sustainable terms provide the leverage to address India's poverty or would the merely lopsided perspective of growth and development be India's preference?
- d) How has India addressed its internal security challenges of insurgency, religious fundamentalist violence for political ends, naxalism and terrorism; Has India addressed the systemic roots of the malaise or has it used political and physical coercion to contain its manifestations?
- e) How would India address its emergent and future challenges in Food security, energy security, environmental security, and demographic challenges and how would they impinge on Human security that is the cornerstone of a stable democratic polity?

The abovementioned challenges and pressure constitute the real pitfalls of India's strategic rise. India's Grand Strategy would be a "hollow edifice" if the

aberrations of its domestic situation and internal security are not addressed. The means to address these issues lie in the quintessence of how India articulates its comprehensive national power and security. The pitfalls of India's rise and the effectiveness to articulate a viable Grand Strategy is fraught with complications by the following challenges:

- a) India's failure to address the Human Security paradigm evident in human development and human rights—The imperative for human security and sustainable development;
- b) India's growing insecurity in the internal security domain owing primarily to the haste in lopsided economic priorities and mal-governance—The imperative to shun the perils of ultra-nationalism that alienates its minorities;
- c) India's imperative for a second Green Revolution and the achievement of self-sufficiency and equitable distribution of food grains—The imperative to physical self-sufficiency;
- d) India's imperatives for the sustenance of its Knowledge-Information economy/capital that is key to its prowess in science & technology and industrial strength;
- e) India's imperative is to enhance its efficiencies in distribution, conservation and develop alternate non-lethal energy sources and strategies that would conserve its energy and secure its future.

India's 'Rising Power' stands at the threshold of transformation. It has, however, been in transformative in scope in the following sectors that constitute its promising potential:

- a) *Stable political and social order* has been India's greatest endowment of strength that has weathered the pangs of development and stands poised to achieve national greatness even as India's huge population turns into a vibrant social and political critical mass for development. It is true that vast pockets of poverty coexists with the neo-rich; but the optimism is that the democratic process and the resilience of democratic governance; the free media; the rule of law; the credo of secularism and pluralism would be the catalytic forces that would transform the prevalent lopsided inequities into an evolving stable order.
- b) *Superior Human Resources and Resilience* has been India's growing and permanent asset that has replaced the negative image of over-population and the brain drain of India's talent. In an age of globalisation, India's human resources provide the diversified, highly talented, resilient human resources that would be the primary echelons of development,

growth and sustaining the premier economies of the United States, EU and even Japan.

India's superior human resources provide the qualitative edge in emerging high technologies in the globalised world economy. They provide the templates for transformation that are based on achievement criteria of merit and efficiency. India's human resources provide the basis of the evolving profile of research and development of the premier industries that are now gaining strength in India's technopolis.' *But the sustainability of this industrial edifice would be possible only when the large masses of India's demographic base are socially and economically empowered in a stable secular civic polity* (emphasis added).

- c) *Sustained economic growth* has been the hallmark of India's transformation as a 'Rising Power' in the twenty-first century. The economic boom in the past decade has been phenomenal with new benchmarks being set for economic growth in the country. Buoyed by investor confidence and the robustness of the economy had been quite healthy in all the macro-economic indicators of performance. Economic growth, however, has to be balanced by a unique formula of social equity. Without the balancing social equity, the sinews of Indian economic growth would have serious social and, therefore, political systemic consequences that would induce instability. The imperative of the transforming India is to focus on the balance between economic growth, structural reform and a viable social equity paradigm that ensures equitable social economic development—globalisation and economic growth with a human face.
- d) *Substantive Scientific-technological capabilities* have been India's innate strengths even as it transforms into a major power in the twenty-first century. India's scientific and technological capabilities have been robust in its basic sciences; civilian-scientific and military technological capacities. India's established lead in the "knowledge economy" and its evolving capacities in the other frontier areas of scientific and technological growth are propelling its momentum in its transformative energies.

India's scientific and technological capabilities have been unique and resilient. In the face of several technology denial regimes, there has been a significant nurture of indigenous technology development that has emerged with some time lag yet has been achieved with resolve.

India's scientific and technological capabilities have yet another salience; the ability to assimilate advanced technology and develop indigenous variants of the same. India's primary skills in technology development, research design, prototype development and serial production are well-known niches of its resilience. The imperative is to sustain the knowledge revolution in India to sustain its industrial technological competence. India's future lies in the knowledge industry and viable knowledge-industry foundations.

- e) *Robust Indian Diaspora and its Global Impact* has been India's international visage and profile. India's Diaspora constitutes its renewing resource in terms of the scientific, technical capacities and contribution to host societies and economies and more so to the international economy.

Indian Diaspora has been well-known for their profile of excellence and innovation as their adaptation and contribution to the United States and the West is quite prominent. India's Diaspora has provided a multi-tiered work force that has established its own niches of excellence and productivity. In the long-run they have emerged as India's brain trust of the knowledge capital and source for innovation and flows of investment into India. The immense contribution of the Indian Diaspora to the economic capacity and monetary strength of India has been unequivocal.

- f) *Emerging India Inc* is thus the new synergy of India's economic-technological and human capital viability that defines the concourse of Rising India in the twenty-first century. India's sustained growth with the average growth of 7-8 per cent provides the perspective for its "peaceful rise." India's Rise to power would be peaceful as it had always nurtured a defensive-defense security policy. *India Inc.* would thus emerge as the viable and vibrant paradigm to the peaceful rise of India predicated on the planks of economic renewal and resilience and its innate scientific-technological strengths premised on a social contract of equity and development.
- g) *Synergies in India's Strategic Defence Enterprise* have emerged significantly with India's evolving scientific technological prowess and its assimilative capabilities in the defence-industrialisation process. The Revolution in Military Affairs, the process of net centric warfare capabilities; the defence transformation process; technological and operational advances in its Command, Control, Communication, Computation, Intelligence, Information, Surveillance, Reconnaissance (C4I2SR) capabilities have enhanced defence effectiveness in its combat capabilities and strike efficiency.

There has been a quiet revolution of its nuclear capabilities that have grown since the nuclear weaponisation tests of 1998. Defence technological synergies provide India with the new capabilities of military interoperability of its armed forces with the super league military forces of the United States, Russia, Japan, United Kingdom, France, Germany and other major powers. Defence technological prowess has in turn tuned the Indian armed forces to evolve new doctrinal formulations like the recent Indian Army Doctrine, Indian Maritime Doctrine and the new aerospace expeditionary vision and operational capabilities of the Indian Air Force. These have enabled them to fine tune to both coercive compellent missions as well as non-offensive missions in the Benign, Constabulary and humanitarian mission as well. The role of Indian Armed Forces in the humanitarian rescue and rehabilitation missions in the aftermath of the Tsunami 2004 is a notable achievement.

The Future Pathways

The future pathways of India's 'Rise' are significant even as the sinews of globalisation and international interdependence weave India into the international system. India's pathways of its peaceful 'Rise' would have the following stabilising characteristics on the international system:

- a) India would be a power of robust economic strength and it viably manages its social economic transition within the country predicated on democratic consensus and equity- globalisation with a human face
- b) India's peaceful 'Rise' would be enduring as long as it is able to be assertive in terms of its strategic autonomy with the relentless pursuit of its strategic objectives based on considerations of its enlightened national interest based on consensus;
- c) India's future pathways for its peaceful 'Rise' could be better harmonised with an ambient human capital and social capital policy that constitutes the primary plank of transformation;
- d) India's peaceful 'Rise' would be enduring if the forces of communalism and parochial fundamentalism within the country are marginalised for the sake of social stability and secular identity. The pathos of communal violence and predatory assaults of the majoritarian fundamentalism has evoked much harm to India than good—that was realised by Prime Minister Atal Bihari Vajpayee in the aftermath of the gory of the Gujarat communal violence shamelessly perpetuated by the communal forces; the reassertion of communal chauvinism would be the cancerous attack on India's rise;

- e) India's 'Rising' power in the twenty-first century would be enduring by the fine balance of its domestic imperatives and external challenges. If the optimality is achieved then India's future as an emerging and major power is rest assured.

In summation, the prospects of India as an emerging power in the new century would be premised on how India addresses the domestic situation. While it has been synchronising its external diplomatic-strategic synergies quite well, the internal security order and the challenge to create and sustain equitable social-economic development that is laced with good governance is the most vital task.

While India is "poised for power" (Mohan 2007) the daunting challenges to sustain its growth and maintain course would depend on the stability of its political order that is today increasingly fragmented; an economic reform that is neither wholehearted nor equitable and a defensive strategic culture that does not possess the comprehensive capability and vision to address the issues and challenges in its strategic milieu.

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Reinventing Public Sphere: Habermas's 'Sluice' Model under Neoliberal 'Siege'

K.M.Seethi

In the realm of International Relations (IR) theory, the writings of Jürgen Habermas offer critical insights into various categories such as state, nation, civil society, community, class, power, etc. His readings of positivism, empiricism and historical materialism have already brought forth both opponents and adherents in a wide range of areas in social theory, philosophy, literary criticism, political science and IR. Perhaps the Critical Theory tradition of IR has drawn heavily from the writings and perspectives of the Frankfurt School with which Habermas has long been associated. This article does not delve into the whole spectrum of theoretical concerns developed by Habermas and his colleagues in the Critical Theory tradition of the Frankfurt School. It primarily deals with the notions of 'deliberative politics' and 'procedural democracy' advanced by Habermas in the background of his re-articulation of 'public sphere' in the 1990s. Here the focus is on the 'sluice model' which Habermas advanced to cope with the contemporary crisis of socialism and democracy.

Perhaps the relevance of the current discussion on 'deliberative politics' for the Third World, in general, and South Asia, in particular, could be discernible against the backdrop of the neoliberal-induced participatory development/democratic decentralisation experiments underway in countries such as India, Bangladesh and Sri Lanka. Though Habermas's notions of 'deliberative politics' and 'procedural democracy' do not necessarily have any direct bearing on such experiments in a wide variety of countries, the implications of his model need to be addressed in a wider context of the containment strategies of global capitalism. Before unravelling the critical issues he has taken up, it would be appropriate to offer a résumé of how Habermas's perspectives had already got into the realm of IR theory.

Critical Theory¹ entered the domain of IR in the 1980s, partly in response to Kenneth Waltz's neo-realist readings (Waltz 1970). Scholars belonging to this tradition such as Robert Cox, Richard Ashley, Mark Hoffman, Andrew

Linklater and Mark Neufeld differed with the ahistorical positions on state and state-system advanced by realism and neo-realism which tended to ignore the potentials and possibilities of change in the structure of international system. Critical Theorists, however, sought to develop a tradition that would not only acknowledge the implications of developments in the realm of 'class,' 'production' etc. but sustain normative concerns with the possibilities of the transformation of global politics.² Their primary concern seems to be how to engage with critical issues such as systematic violence, inequalities of wealth and power, deteriorating conditions of human existence etc. Critical Theorists have claimed to offer perspectives to comprehend the existing global order, thereby providing a normative critique of it. Most of them also sustain an interest in emancipation, in expanding the domain of human freedom (Shapcott 2001: 81). They, however, argue that full realisation of 'freedom' and 'equality' is out of question in a world dominated by sovereign states, but could be possible in a world based on cosmopolitan principles. It is through these principles that human emancipation could be conceived and a cosmopolitan community be constituted. According to Andrew Linklater, emancipation implies that the cosmopolitan community be constituted discursively as one in which all humans enjoy the opportunity for equal participation in a conversation, and thereby of determining their own lives (Linklater 1997).

It is here that Linklater draws heavily on the 'discourse ethics'³ of Habermas. The influence of Habermas on Linklater's cosmopolitan project could be discernible in the context of his endeavour to help articulate and differentiate the purpose and constitution of a Critical Theory; to contribute to the philosophical defence of moral universalism; and to articulate a conception of cosmopolitan community informed by discourse ethics. To Linklater, discourse ethics offers two things: a philosophical account of why community should be understood as discursive community and a model of dialogue or conversation. It "defends the ideal that every human being has an equal right to participate in dialogue" (Linklater 1997: 107). The implications of discourse ethics for politics and IR could be perceptible against the backdrop of postmodern critical readings of Western universalistic reasoning. Linklater says: "Foucault and Habermas were agreed that the politics of speech was preferable to the politics of force. The gulf between Habermas and Foucault's thought is not as great as it is sometimes thought to be" (Linklater 1996: 290). Linklater points to Cohen's (1990:83-105) argument that discourse ethics is critical of "forms of life based on domination, violence and systematic inequality" which tend to obstruct full participation and therefore supportive of moves to equalise power. Linklater further suggests that discourse ethics "can be institutionalised in structures of participation the precise character of which varies from place to place" (Linklater

1996: 294). He, however, acknowledges: “discourse ethics cannot be completed by a number of separate experiments in democratic participation within independent sovereign states.” It inevitably “clashes with the idea of sovereignty which restricts the capacity of outsiders to participate in discourse to consider issues which concern them.” Linklater’s position raises several questions about the role and character of ‘moral agents’ who are supposed to problematise all “boundaries and bounded communities.” It also generates a lot of apprehension about the very process of agenda-setting (if not about the agenda itself) for discourses, and the capability of participants for such a dialogue in an imagined terrain of discourses. It would be interesting to consider how Habermas (to whom Linklater and other Critical Theorists have pronounced their intellectual adherence) has gone further and reinvented the ‘public sphere’ in what he himself called a ‘postmetaphysical’ construct, that too at a time when all available ‘spheres’ of the world-system are immeasurably tainted/corrupted by agents of global capital, including oligopolistic corporations.

Habermas on Radical Democracy and the Public Sphere

Since the early 1960s, Habermas has been concerned in different ways and contexts to develop theories of democratisation and political participation. His contributions have often been marked by their particular emphasis on ‘radical democracy.’ His *The Structural Transformation of the Public Sphere* (1989), which appeared first in 1962, dealt with the historical origins of the ‘bourgeois public sphere,’ followed by an analysis of its structural transformation in the twentieth century with the rise of state (welfare) capitalism, the culture industries, and the increasingly powerful role and influence of big corporations/industries in public life. He had argued that since big economic and governmental organisations began to hold sway over the public sphere, people were destined to become passive consumers of goods, services, political administration, and so on. Drawing the experiences of Britain, France, and Germany in the late eighteenth and nineteenth century, Habermas initially imagined a ‘bourgeois public sphere’ and then investigated the causative factors for its degeneration in the twentieth century. In the Preface to *The Structural Transformation of the Public Sphere*, he wrote: “Our investigation presents a stylized picture of the liberal elements of the bourgeois public sphere and of their transformation in the social-welfare state” (Habermas 1989a: xix).

According to Habermas, the public sphere, which had its genesis way back in 1700, began to mediate between the private concerns of individuals in their familial, economic, and social life in the context of the demands and concerns of social and public life. Newspapers and journals, as well as political clubs,

literary salons, public assemblies, pubs and coffee houses, meeting halls, and other public spaces constituted the main realms of the public sphere which he believed helped generate room for opposition to state power and other interests that were emerging to shape bourgeois society. However, as the democratic upsurges and revolutions were under way, the bourgeois public sphere began to lose its vitality and influence, particularly when it was institutionalised in constitutional systems which accommodated a wide range of political rights, legitimised through an adjudication system that mediated between claims between various individuals or groups, or between individuals and groups and the state. The focus of *The Structural Transformation of the Public Sphere* was primarily on the metamorphosis of the public sphere from a realm of rational discussion/debate and consensus to a terrain of mass cultural consumption and administration by big corporations and dominant elites. The transformation was seen as the consequence of the transition from market capitalism and liberal democracy in the nineteenth century to the stage of state and monopoly capitalism evident in the welfare state liberalism of the twentieth century.

Habermas argued that a “refeudalization” of the public sphere was inevitable since the late nineteenth century when private interests began to assume direct political functions and powerful corporations began to control and manipulate the media and state. Meanwhile, the state took upon a more crucial role in society, particularly in the private realm of everyday life, thereby undermining the space between state and civil society, between the public and private sphere. Alongside this decline of the public sphere, citizens became passive consumers without contributing anything to issues of the common good and democratic participation (Habermas 1989a: 206). Habermas’s formulations on the public sphere had already raised many problems. One wonders whether democratic politics anywhere in the world, any time in history, has been propelled by norms of rationality or public opinion discursively formed as ‘stylized’ by Habermas. Though embedded in a liberal/populist mode and characterised by diversity, tolerance, debate and consensus, Habermas’s public sphere was criticised for its dominance by white, property-owning male, thereby providing room for many exclusions. Some of his critics like Oskar Negt and Alexander Kluge(1993) had already pointed out how working-class, plebeian and women’s public spheres coexisted with the “bourgeois public sphere.”

However, towards the end of 1980s, Habermas sought to revitalise the public sphere, championing “a *critical* process of public communication through the very organizations that mediatize it”(Habermas 1989a: 232). He sustained some optimism that “a critical publicity brought to life within intraorganizational public spheres” would eventually lead to democratisation of the major institutions of civil society, notwithstanding the fact that he did

not have sufficient evidence to show that an ‘oppositional’ or ‘post-bourgeois public sphere’ would be forthcoming.

In the Preface to *Between Facts and Norms* (1997), which is often acclaimed as his monumental work, Habermas expresses his discontent with the emerging scenario of politics:

In contemporary Western societies governed by the rule of law, politics has lost its orientation and self-confidence before a terrifying background:... the conspicuous challenges posed by ecological limits on economic growth... by increasing disparities in the living conditions...; the historically unique task of converting state socialism over to the mechanisms of differentiated economic system...;the pressure of immigration from the impoverished southern regions...;the risks of renewed ethnic, national and religious wars, nuclear blackmail, and international conflicts over the distribution of global resources.... I suspect, however, that the unrest has a still deeper source, namely, the sense that in the age of a completely secularized politics, the rule of law cannot be had or maintained without radical democracy (Habermas 1997: xiii).

Obviously, Habermas uses his astute intellectual faculty to capture the stuff of contemporary politics. How he converts his “hunch into an insight” is a curious thing to study. In fact, much of his writings in the 1980s and 1990s focus on the public sphere and the indispensable setting for a genuine ‘radical democracy,’ which certainly call for critical scrutiny.

Habermas has always detested the classical Marxist strategy of political mobilisation - towards alternative arrangements of workers’ and popular power. His primary concern seems to be whether the public sphere can sustain itself in the face of working-class advancement. He would tell us:

The occupation of the political public sphere by the unpropertied masses led to an interlocking of state and society which removed from the public sphere its former basis without supplying a new one. For the integration of the public and private realms entailed a corresponding disorganisation of the public sphere that once was the go-between linking state and society (Habermas 1989a: 177).

In his early writings, Habermas not only talks about the failure of working-class struggle, but points to the “grave danger that mass movements - especially when successful - pose to the separation between civil society and the state” (Stolze 2000: 147; Habermas 1989a: 122-29, 139-40). In the 1980s, Habermas wrote about “exhaustion of utopian energies” in respect of a “shift of paradigm from a society based on social labor to a society based on communication” (Habermas 1989b: 68).

Calling upon the Left to abandon its “methodological illusions,” Habermas sought to bring in the necessary but general conditions for the communicative practice of enjoying life and for a procedure of discursive will-formation that would put participants *themselves* in a position to realise concrete possibilities for a better and less threatened life, on *their own* initiatives and in accordance with *their own* needs and insights (Habermas 1989b).

This calls for a significant re-articulation and refinement of socialist project - of course, with “a highly innovative combination of power and intelligent self-restraint,” which “can longer be entrusted to the state’s planning capacity” but rather emerge from the activity of “autonomous, self-organised public spheres” (Habermas 1989b:63-64). Against the backdrop of the developments in East Europe, he wrote that the socialist Left could “generate the ferment that produces the continuing process of political communication that prevents the institutional framework of a constitutional democracy from becoming desiccated” (Habermas 1990b:21). Almost during this time, Habermas characterised the changes taking place in Central and East Europe as “a triumph of civil society and the public sphere” (Hill and Montag 2000:1). Meanwhile, Habermas began to talk about “radically reformist self-criticism of a capitalist society, which, in the form of a constitutional democracy with universal suffrage and a welfare state, has developed not only weaknesses but also strengths” (Hill and Montag 2000). Henceforth, his major concern has been how to offer a postmetaphysical rationale for the public sphere. In the Preface to *Between Facts and Norms* he writes:

After the collapse of the state socialism and the end of the “global war,” the theoretical error of the defeated party is there for all to see: it mistook the socialist project for the design – and violent implementation – of a concrete form of life. If, however, one conceives “socialism” as the set of necessary conditions for emancipated forms of life about which the participants *themselves* must first reach an understanding, then one will recognize that the democratic self-organization of a legal community constitutes the normative core of this project as well (Habermas 1997:xii).

For Habermas the idea of radical democracy as a “form of self-administering socialism” had already become popular:

Only a democracy that is understood in terms of communication theory is feasible under the conditions of complex societies. In this instance, the relationship of center and periphery must be reversed: in my model the forms of communication in a civil society, which grow out of an intact private sphere, along with the communicative stream of a vital public sphere embedded in a

liberal political culture, are what chiefly bear the burden of normative expectations (Habermas 1977a: 133).

Though Habermas frequently referred to “the failures of advanced capitalist societies, he has equally insisted that capitalism itself cannot be superseded.” He saw the capitalist market and capitalist state as “the unsurpassable horizons of political theory and practice” (Stolze 2000: 149). Given the increasing complexity and functional differentiation of modern capitalist societies, he conceives of transformation “not in the sense of superseding the capitalist mode of production but merely of striving to counteract the worst effects ... of market misdistribution and state bureaucratization” (Stolze 2000: 150). While talking of “radical democratisation” in advanced capitalist countries, Habermas brought forth two models. The first one - a siege model - visualises how people can criticise and influence the state without actually trying to supersede the state power. It is here that the idea of “popular sovereignty” is “desubstantialized.”

... sovereignty is found in those subjectless forms of communication that regulate the flow of discursive opinion and will-formation in such a way that their fallible outcomes have the presumption of practical reason on their side. Subjectless and anonymous, and intersubjectively dissolved popular sovereignty withdraws into democratic procedures and the demanding communicative presuppositions of their implementation. It is sublimated into the elusive interactions between culturally mobilized public sphere and a will-formation institutionalized according to the rule of law. Set communicatively aflow, sovereignty makes itself felt in the power of public discourses. Although such power originates in autonomous public spheres, it must take shape in the decisions of democratic institutions of opinion-and will-formation, inasmuch as the responsibility for momentous decisions demands clear institutional accountability. Communicative power is exercised in the manner of a siege. It influences the premises of judgement and decision making in the political system without intending to conquer the system itself. It thus aims to assert its imperatives in the only language the besieged fortress understand: it takes responsibility for the pool of reasons that administrative power can handle instrumentally but cannot ignore, given its juridical structure (Habermas 1997: 486-87).

The message is palpable enough; yet he hardly says anything about “the means by which these autonomous public spheres are supposed to hold state power in check and redirect its activities to serve the common good” (Stolze 2000: 150). Apparently, the siege model turns out to be a symbolic one. In *The Structural Transformation of the Public Sphere* too, Habermas places the siege model as a “democratic dam.” According to him,

state apparatus and economy had become systematically integrated action fields that can no longer be transformed democratically from within, that is, switched over to a political mode of integration, without damage to their proper systemic logic and therewith their ability to function. The abysmal collapse of state socialism has only confirmed this. Instead, radical democratization now aims for a shifting of forces “within a separation of powers” that itself is to be maintained in principle. The new equilibrium to be attained is not one between state powers but between different sources for social integration. The goal is no longer to supersede an economic system having a capitalist life of its own but to erect a democratic dam against the colonializing *encroachment* of system imperatives on areas of the lifeworld. Therewith we have bid farewell to the notion of alienation and appropriation of objectified essentialist powers, whose place is in a philosophy of praxis. A radical democratic change in the process of legitimation aims at a new balance between the forces of societal integration so that the social-integrative power of solidarity – the “communicative force of production” – can prevail over the powers of the other two control resources, i.e., money and administrative power, and therewith successfully assert the practically oriented demands of the lifeworld (Habermas 1992:421-61).

It is in *Between Facts and Norms* (referring specifically to his earlier article “Popular Sovereignty as Procedure” appeared in the same volume) that Habermas acknowledges that “the image of the democratically besieged fortress of the state apparatus was misleading.” He has inhibitions whether a ‘democratisation’ “of the administration that, going beyond special obligations to provide information, would supplement parliamentary and judicial controls on administration from within.” He goes on to say:

But whether the participation of clients, the use of ombudspersons, quasi-judicial procedures, hearings, and the like are appropriate for such a democratization, or whether other arrangements must be found for a domain so prone to interference and dependent on efficiency, is as always with such innovations, a question of the interplay of institutional imagination and cautious experimentation. Of course, participatory administrative practices must not be considered simply as surrogates for legal protection but as procedures that are *ex ante* effective in legitimating decisions that, from a normative point of view, substitute for acts of legislation or adjudication (Habermas 1997: 440-41).

Elsewhere, Habermas wrote that his objective

in proposing the image of a “siege” of the bureaucratic power of public administrations by citizens making use of communicative power was to oppose the classic idea of revolution – the conquest and destruction of state power. The unfettered communicative freedoms of citizens are supposed to become effective through – as Rawls says with Kant – the “public use of reason.” But the

“influence” of the opinions that compete in the public sphere, and communicative power formed by means of democratic procedures on the horizon of the public sphere, can become effective only if they affect administrative power – so as to program and control it – without intending to take it over (Habermas 1977a 135-36).

Habermas found this model too insufficient as he had doubts whether the citizens would really form continuous public spheres of this type that could address and contain abuses of the administrative power of the state. Habermas himself admitted that the siege model was “too defeatist.” He says:

Today, the matters that need regulation are often such that the political legislator is in no position sufficiently to regulate them in advance. In such cases, it is up to administrative and judicial authorities to give them concrete form and to continue their legal development, and these require discourses that have to do with grounding rather than with application. However, to be legitimate, this implicit subsidiary legislation...also requires different forms of participation – a part of the democratic will-formation must make its way into the administration itself. And the judiciary that creates subsidiary laws must justify itself in the wider forum of a critique of law. In this respect the sluice model counts on a more far-reaching democratization than the siege model does (Habermas 1977a 135-36).

Between Facts and Norms unravels his sluice model in detail. In order “to give a more precise form to, and seek a tentative answer to, the question of whether and how a constitutionally regulated circulation of power might be established,” Habermas draws on Bernard Peters’ proposal:

...processes of communication and decision making in constitutional systems display the following features: they lie along a center-periphery axis, they are structured by a system of “sluices,” and they involve two modes of problem solving. The core area of the political system is formed by the familiar institutional complexes of administration (including the incumbent Government), judicial system, and democratic opinion-and will-formation (which includes parliamentary bodies, political elections, and party competition). Hence this center, distinguished from the periphery in virtue of formal decision-making powers and actual prerogatives, is internally organized as a “polyarchy.” Within the core area, to be sure, the “capacity to act” varies with the “density” of organisational complexity. The parliamentary complex is the most open for perceiving and thematizing social problems, but it pays for this sensitivity with a lesser capacity to deal with problems in comparison to the administrative complex. At the edges of the administration, a kind of *inner* periphery develops out of various institutions equipped with rights of self-governance or with other kinds of oversight and lawmaking functions delegated

by the state (universities, public insurance systems, professional agencies and associations, charitable organizations, foundations, etc.). The core area as a whole has an *outer* periphery that, roughly speaking, branches into “customers” and “suppliers” (Habermas 1997: 354-55).

Here “customers” imply those “complex networks” that “have arisen among public agencies and private organizations, business associations, labor unions, interest groups, and so on” which “fulfil certain coordination functions in more or less opaque social sectors.” On the other side, “suppliers” are those “groups, associations, and organizations that, before parliaments and through the courts, give voice to social problems, make broad demands, articulate public interests or needs, and thus attempt to influence the political process more from the standpoint of particular interests” (Habermas 1997: 355).

According to him,

These opinion-forming associations, which specialize in issues and contributions and are generally designed to generate public influence, belong to the civil-social infrastructure of a public sphere dominated by the mass media. With its informal, highly differentiated and cross-linked channels of communication, this public sphere forms the real periphery. Naturally, as the debate over corporate bargaining shows, the distinction between output-oriented “customers” and input-oriented “suppliers” is not a sharp one. But the actually observable fusion between influencing the implementation of policies that have already been adopted, on the one hand, and influencing the formulation and adoption of policies, on the other, is not in agreement with constitutional principles (Habermas 1997).

Habermas further presents Peters’ sluice model and the two modes of problem solving. He says: “If binding decisions are to be carried out with authority, they must pass through the narrow channels of the core area.” Habermas quotes:

However, the legitimacy of decisions depends on processes of opinion-and-will-formation at the periphery. The center is a system of sluices through which many processes in the sphere of the political-legal system must pass, but the center controls the direction and the dynamics of these processes only to a limited degree. Changes can start just as much at the periphery as at the center...The idea of democracy is ultimately based on the fact that political processes of will-formation, which in the schema here sketched have a peripheral or intermediary status, are supposed to be decisive for political development. This is not preceded by the present schema (Habermas 1997: 356).

The implication of this model of “discourse theory of democracy” is that “binding decisions, to be legitimate,”

must be steered by communication flows that start at the periphery and pass through the sluices of democratic and constitutional procedures situated at the entrance to the parliamentary complex or the courts (and, if necessary, at the exit of the implementing administration as well). That is the only way to exclude the possibility that the power of the administrative complex, on the one side, or the social power of the intermediate structures affecting the core area, on the other side, become independent vis-à-vis a communicative power that develops in the parliamentary complex (Habermas 1997: 356).

Habermas admits that “the normal business of politics, at least as it is routinely conducted in Western democracies, cannot satisfy such strong conditions.” He continues:

In cases in which perceptions of problems and problem situations have taken a conflictual turn, the attention span of the citizenry enlarges, indeed in such a way that controversies in the broader public sphere primarily ignite around the normative aspects of the problems most at issue. The pressure of public opinion then necessitates an extraordinary mode of problem solving, which favors the constitutional channels for the circulation of power and thus actuates sensibilities for the constitutional allocation of *political responsibilities* (Habermas 1997: 357).

Thus, the sluice model is supposed to provide a better framework for understanding the “distinction between normal and extraordinary modes of posing and solving problems...” Habermas says that the “illegitimate independence of social and administrative power vis-à-vis democratically generated communicative power” could be “averted to the extent that the periphery has both (a) a specific set of capabilities and (b) sufficient occasion to exercise them.” The first refers to “the capabilities to ferret out, identify and effectively thematize latent problems of social integration.” Besides, “an activated periphery must then introduce them via parliamentary (or judicial) sluices into the political system in a way that *disrupts* the latter’s routines.” His first assumption (a) “places a good part of the normative expectations connected with deliberative politics in the peripheral networks of opinion-formation. He says: “The expectations are directed at the capacity to perceive, interpret, and present society-wide problems in a way that is both attention-catching and innovative.” Habermas further suggests that the periphery could satisfy these strong expectations “only insofar as the networks of non-institutionalised public communication makes possible more or less spontaneous process of opinion-formation.” In a typical neoliberal logic of contemporary politics, Habermas moves on to say:

Resonant and autonomous public spheres of this sort must in turn be anchored in the voluntary associations of civil society and embedded in liberal patterns of political culture and socialization; in a word, they depend on a rationalised lifeworld that meets them halfway (Habermas 1997: 358).

After dealing with the public sphere as a “communication structure rooted in the lifeworld,” Habermas describes “the political public sphere as a sounding board for problems that must be processed by the political system because they cannot be solved elsewhere.” He continues:

To this extent, the public sphere is a warning system with sensors that, though unspecialized, are sensitive throughout society. From the perspective of democratic theory, the public sphere must, in addition, amplify the pressure of problems, that is, not only detect and identify problems but also convincingly and *influentially thematize* them, furnish them with possible solutions, dramatize them in such a way that they are taken up and dealt with by parliamentary complexes. Besides the “signal” function, there must be an effective problematization. The capacity of the public sphere to solve problems *on its own* is limited. But this capacity must be utilized to oversee the further treatment of problems that takes place inside the political system (Habermas 1997: 359).

In fact, the current neoliberal strategies of “participatory democracy,” “citizens’ initiatives,” “local level planning” and “micro-politics,”⁴ which many Third World countries like India have been experimenting with, move along these lines. Habermas believes that the spatial structure of “simple and episodic encounters can be expanded and rendered more permanent,” but, strangely, “in an abstract form for a larger public of present persons.” Yet, these public spheres “still cling to the concrete locales where an audience is physically gathered” who “possess final authority, because it is *constitutive* for the internal structure and reproduction of the public sphere, the *only* place where actors can appear” (Habermas 1997: 361 and 364).

Habermas seems to have landed himself in an uncomfortable ‘sphere’ when he says that “civil society” today, in contrast to its usage in the Marxist tradition, no longer includes the economy as constituted by private law and steered through markets in labor, capital, and commodities.” Only naïve would believe this. In the neoliberal-induced development scenario, all social and political institutions, including global financial institutions, are vying with each other to appropriate “civil society,” to the extent to which it can play a ‘substitutive role’ in the development process and fill the vacuum created on account of the retreat of the welfare/social security state. However, in an unassuming manner, Habermas observes that the civil society’s “institutional

core comprises those nongovernmental and noneconomic connections and voluntary associations that anchor the communication structures of the public sphere in the society component of the lifeworld.” It is precisely these NGOs and voluntary agencies that have been deployed by neoliberal institutions like the World Bank for a smooth capital accumulation on a global scale.⁵ Echoing the neoliberal notions, Habermas says that the civil society comprises of “those more or less spontaneously emergent associations, organizations, and movements that, attuned to how societal problems resonate in the private life sphere, distill and transmit such reactions in amplified form to the public sphere.” Its core “comprises of a network of associations that institutionalizes problem-solving discourses on questions of general interest inside the framework of organized public spheres” (Habermas 1997: 367). However, Habermas believes that “the interplay of a public sphere based in civil society with the opinion-and will-formation institutionalized in parliamentary bodies and courts offers a good starting point for translating the concept of deliberative politics into sociological terms” (Habermas 1997: 371).

But he knew that “the actors who are more firmly anchored in civil society and participate in the reproduction of the public sphere also depend on the support of ‘sponsors’ who supply the necessary resources of money, organization, knowledge, and social capital.” Yet, he feels that these ‘sponsors’ “do not necessarily reduce the authenticity of the public actors they support” (Habermas 1997: 375).

When he comes to the end of *Between Facts and Norms*, Habermas seems to have settled himself within a ‘proceduralist paradigm’ which would sustain “autonomous public spheres, an expanded citizen participation, curbs on the power of the media, and the mediating function of political parties that are not simply arms of the state...” He says:

The well-known proposals to insert plebiscitary elements into the constitution (direct popular vote, petitions for a referendum, etc.) as well as the proposals to introduce democratic procedures at a grassroots level... are meant to counteract the subversion of the *political public sphere* (Habermas 1997: 442).

The intellectual transformation of Habermas speaks for itself in the following ‘lines’ (of) *Between Facts and Norms*:

Under the conditions of postmetaphysical thinking – for which no plausible alternatives exist, despite fundamentalist reactions against the losses incurred by modernisation – the state has lost its sacred substance. This secularisation of the spiritual bases of governmental authority, by now long under way, suffers from a deficit in implementation that is overdue. If this deficit is not met by more extensive democratization, the constitutional state itself will be

endangered. We could gather further evidence for this thesis if we were to go beyond our limited focus on national societies and, as an epoch of decolonisation draws to a close, broaden our view to take in the international order of the world society. The legitimations enlisted by the allies for the Gulf War provide evidence of a progressive denationalisation of international law. This example reflects the trends toward the dissolution of the sovereignty of the nation-state. Against the horizon of an emerging global public sphere, such trends could signal the beginning of a new universalist order (Habermas 1997: 443-44).

Since Habermas wrote this almost a decade ago, the world society has experienced not a “progressive denationalisation of international law” towards a “new universalist order” but a variety of retrogressive practices legitimising hegemonic designs/master plan of the US-led capitalist world. In fact, neoliberal globalisation warrants not only the ‘dissolution’ of the sovereignty of nation-state but new strategies of “extensive democratization” in the form of participatory politics and ‘governance.’ For a large number of countries in the Third World, the ‘successful’ culmination of decolonisation meant the beginning of neocolonialism in a variety of forms. Ironically, while Habermas’s earlier notion of public sphere was ‘national’ in many respects, he acknowledges, at least since 1990s, the existence and rationale of an ‘international public sphere.’ Surprisingly, even globalisation, notwithstanding all its problems, becomes the “bearer of genuine universalism” (Hill and Montag 2000: 4). As Hill and Montag (2000: 3) rightly point out, Habermas is apparently providing “‘modernity’ with its most theoretically sophisticated defense.” Interestingly, the public sphere, as it has been revitalised by Habermas in the 1990s, is no longer ‘bourgeois.’ Habermas seems to have come around the view that there is not only a “plurality of spheres” but there is a “sphere of all spheres.”

Drawing on Habermas’s renewed interest in the public sphere, Douglas Kellner argues that there exists an ‘international public sphere’ in the realm of information and communication (most notably in cyberspace) which expands the scope of “democratic participation and debate and creates new public spaces for political intervention” (Kellner 1995a; Kellner 1995b: 201-217). But this grossly underestimates those critical factors which act upon the very sphere of communication in all its functional and organisational contexts. These include the burgeoning digital divide, accessibility, capability of potential participants and so on. More importantly, like Habermas, Kellner is also unconcerned about the fact that all critical realms of communication the world over have been penetrated by global capital and big business so much so that its ‘autonomy’ and ‘objectivity’ is a matter of privilege and convenience. For a large number of

corporations, it is just another 'sphere' of investment and capital accumulation. When ideas and information are increasingly commodified in the era of globalisation, the discursive realm of the world society becomes much narrower and privileged.

Ted Stolze has succinctly remarked that the principal function of Habermas's public sphere "is to mediate between social and administrative power." Though his public sphere permits citizens to form opinions, these opinions "remain mere opinions." And eventually,

citizens must be content either symbolically to storm an administrative fortress (the siege model) or else generate certain messages from the periphery that at best will eventually filter across to be interpreted, and legitimated, by the administrative center (the sluice model). Either way, their ability to carry out genuinely collective *action* has been seriously undercut (Stolze 2000: 155; Sitton 2003: 121-158; Scheurman 1999:153-177).

Habermas's 'post-bourgeois public sphere' is a problematic that raises critical (but uncomfortable) questions about its real 'normative' character, its propensity for sustaining/and rationalising the apparently 'reformist' Western political systems in universalist terms, and its task of 'popularising' new strategies of social containment through 'participatory discourses.' This certainly calls for greater vigilance on the part of IR Critical Theorists who are blissfully engaged in redrawing the 'boundary' of the 'discursive' map of the world. The South Asian IR scholars need to address such issues of development and democracy with sufficient caution and theoretical insights.

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Notes

- 1 Andrew Linklater distinguishes Critical Theory of Marxian tradition from the postmodern Critical Theory. Unlike the latter, Critical Theory of Marxian tradition sustains its faith in the Enlightenment project and defends universalism in its ideal of open dialogue between all members of the human race. Postmodern Critical Theory, however, remains sceptical about the emancipatory project of both liberalism and Marxism. According to Linklater, Critical Theory's contributions are four-fold. First, it contests the claims of positivism by arguing "knowledge does not arise from the subject's neutral engagement with an objective reality but reflects pre-existing social purposes and interest." Second, it contests the claims of empiricists about the social world which assume that existing structures are immutable. Critical Theory keeps alive the possibilities of new forms of community in which individuals and groups can attain higher

- levels of freedom. Third, it contests the claims of Marxism with respect to 'class power' as the fundamental form of social exclusion and 'production' the key determinant of society and history. Habermas's critical reading of historical materialism is a case in point. Fourth, it contests the ahistorical position of realists and neo-realists by arguing that social arrangements/rearrangements could be possible through "open dialogue and support for post-sovereign communities in which new levels of universality and difference become possible." For a succinct analysis of the contributions of Critical Theory see Linklater (1996: 279-98).
- 2 For details see Cox (1986); Linklater (1990); Hoffman (1987); Ashley (1981: 204-36); Neufeld (1994).
 - 3 Discourse ethics "provides the procedures and conditions under which divergent agents engage in conversation to establish the validity of their moral claims. The aim of conversation is both to achieve substantive agreement and to regulate, adjudicate and assess these competing moral claims. Discourse ethics itself does not claim to provide substantive resolutions of moral problems, only the means by which they may be resolved." See Shapcott (2001); also see Jürgen Habermas (1990a).
 - 4 For a perspective on the theme, see Seethi (2001).
 - 5 For perspectives on this theme see World Bank (1996); World Bank (2000); Ashman, (2001:1097-1113); Baviskar (2001: 3-15). For a more forthright defence of neoliberal strategies, see Fukuyama (2001: 7-20). For an insightful survey of various theoretical positions on civil society see Chandhoke (1995 and 2003).

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Identity and Authenticity

A Critical Exploration into the Political Theory of Charles Taylor

Chandran Komath

The idea of authenticity has been playing a critical role in the contemporary discourses on identity politics and the social construction of epistemic authority. The desire for authenticity has been nostalgically present not only in social and political theories but also in the lives of people and nations. The idea of authenticity represents the recognition of unique difference. Authenticity is basically the desire for an unaffected, original, and innocent way of life. It has been conceptualised as a theory of autonomous agency, self-actualisation of personal and social identities and, importantly, as one of the sources of the self. The historical and philosophical accounts of authenticity can be seen in the writings of thinkers like Rousseau, Herder, Karl Marx et al. However, the contemporary discussions on authenticity are dominated by the ‘Herderian idea.’¹ For Charles Taylor, the modern understanding of authenticity is very close to the “notions of difference, originality and the acceptance of diversity” (Taylor 1991b: 37).

This article will try to examine Charles Taylor’s conception of an authentic identity against the background of recent the poststructuralist claims of fragmentation and contingency in identity theorisation. For the poststructuralists, the claim for recognition/authenticity is a false problem, and, moreover, it tries to reduce identity into sameness and totalisation. At the same time an attempt has been made to understand Taylor’s conception of recognition of authenticity and its philosophical roots in the modern (romantic) idea of an expressivist self. Even though Taylor recognises the constructionist thesis on identity, he has been very keen on distancing his ideas from a neo-Nietzschean perspective which understands all the foundational claims of truth, knowledge, morality, identity etc. as based on the interplay of a will to power. However, Taylor understands the dialectics of modern recognition of identity from a Hegelian intersubjective perspective and his conception of an authentic identity tries to transcend the Hegelian system itself. In the concluding

part, we will try to explain the spatial/temporal and political limitations of the Taylorian conception of an authentic self in the era of neoliberal capitalism. Before examining the notion of an authentic identity as conceptualised by Taylor, it is necessary to comprehend his philosophical anthropology.

Taylor's Political Theory

The questioning of ontological individualism rooted in the liberal philosophy is an important development in the contemporary discussions on identity. Ontological individualism argues about the existence of the selves outside the social domain. Therefore it emphasises the presociality of the self. However, the social identity thesis in various colours rejects this idea and argues that identities are socially constituted (Kymlicka 2002). Philosophical roots of social identity thesis can be seen in the major philosophical writings of Hegel, Marx, Freud, Mead et al. However, their theorisation on identity has always been interpreted within the framework of modernity. The contemporary discussion on identity has tried to interpret what sociality is in a distinctive manner. By critiquing the philosophical assumptions of modernity, the poststructuralists, postmodernists and communitarians have radically questioned the rationalities of modernist conceptualisation of identity in the name of totalisation, essentialism, universalism, ethnocentrism and so on. On the other hand, many thinkers have expressed a strong contempt for the very "limits of moral philosophy as traditionally conceived, the antinomies of Kantian (formalist) ethics" and alternatively emphasised "the need for an approach that would take more account of the contingent, historical, or situated character of real world ethical issues" (Norris 1994: 160).

Charles Taylor has developed a powerful critique of the contemporary theories of freedom and rights. He has also challenged some of the basic assumptions rooted in political theory as well as social and political practices in the modern liberal democracies. Taylor revived the ancient idea that political community is not a mere instrument of individual interest, but rather a common good. Distinct from liberal political theory, Taylor viewed human knowledge as the product of engaged and embodied agency and also as the outcome of experience and existence. For him, human beings are self-interpreting animals and the meanings of their actions and interpretations are structured in their language and culture (Taylor 1986: 16-44). This notion is clearly visible in his critique of liberal atomism (Taylor 1988b: 187-210), study of modernity, and of the politics of recognition/authenticity. Distancing himself from those who viewed foundations of knowledge, truth, identity etc. in the individual experience (liberal-empiricist tradition) and those who viewed foundations of political, moral, cultural, epistemological judgments are grounded in the

interplay of the “will to power” (Nietzschean tradition), Taylor alternatively introduced a dialogical framework to understand and analyse these categories (Kerr 2004: 84-104). This gives some distinctiveness to the Taylorian perspective in the contemporary political discourses on identity, culture, recognition, freedom and so on. For Taylor, human life is fundamentally *dialogical* in character and the “sense of self” emerges out of social interactions (Taylor 1994: 32). Nicholas H. Smith observes that “If there is a single core idea around which Taylor’s hermeneutics is organized, it is that a person is being for whom things matter. This is what makes the identity of a person a self identity different to the identity of other kinds of being” (Smith 1996: 107).

According to Taylor, identity and self are the results of some constitutive relations. Taylor calls this as the “dialogic structure of identity” and “webs of interlocution.” He says that, “one cannot be a self on one’s own. I am a self only in relation to certain interlocutors: in one way in relation to those conversation partners who are essential to my achieving self-definition; in another in relation to those who are now crucial to my continuing grasp of languages of self understanding. A self exists only within “webs of interlocution”² (Taylor 1989: 36). In Taylor’s view, human identity is always bounded in space and time. This bondedness has been playing an important role in the shaping and constituting the fields of ethical and political possibilities. Traditionally, liberal philosophy emphasises the idea of autonomy and tries to associate it with self-sufficiency of the individual. However, Taylor argues that autonomy has a social nature, it develops only through sociality or socialisation and we need sociality to its exercise. In Taylor’s language, “I am self only in relation to certain interlocutors.” Autonomous person can separate himself from social context with which he was earlier identified. No person is born autonomous by birth but one becomes autonomous through social distancing and for that, even an autonomous person requires a social context. “We cannot attain autonomy from the notion of self as social atoms” (Crittenden 1993: 36-65).

The central question in Taylor’s identity thinking is the bondedness of human agent and the community. Communitarians, particularly Taylor, have been critical of the liberal understanding of the relationship between an individual and the community. The distinctiveness of Taylor’s contribution lies in the fact that he brought these critiques to both ontological and normative levels. For Taylor, the traditional liberal ontology viewed self as ahistorical, asocial, detached and radically autonomous and therefore was seen as incoherent. Moreover, many of the normative prescriptions that stem from this framework of the self are undesirable because it neglects or undermines the importance of community or the idea of belonging. According to Taylor, the purpose of political society is not just the protection of individual rights and

freedom. It is not a mere instrument. To the fullest development of ideals like freedom and justice we need a political society, because in Taylor's view the self-determination (and autonomy) of the individual is only possible in political society. Therefore he invokes the idea of civic republicanism. What is important here is 'we' identities, and he does not view 'we' identities as a mere convergence of 'I' identities (Taylor 2003a: 195-212).

It could be argued that Taylor's ideas of community and self can provide an adequate explanation of methodological individualism grounded in the theories of modern procedural liberalism. Procedural liberalism is of the view that community/society can only be supplemented to individual (Gutman 2003: 190). This very notion is embedded in the contemporary liberal theories of freedom, justice and human identity at the level of its ontology. The very logic of the methodological individualism is essentially based on this kind of a dualistic understanding. Methodological individualism describes the nature of reality and explanations in a reductionist manner. It asserts the compositional unit of the whole and therefore, individuals are the basic unit of analysis. However, Taylor's distinctiveness lies not in the assertion of social over the individual but in his attempts to explain the ways in which the formation of an 'I' identity is influenced by the cultural and moral community. In this way, Taylor has made a persuasive attempt to reconcile this individual/social dichotomy. Taylor has also been concerned about the nature of the 'culture of modernity' by which he means the constitution of the idea of selfhood. He points out: "It is a culture in the three senses... it prizes autonomy; it gives an important place to self exploration; and its vision of good life involves personal commitment" (Taylor 1989: 305). The individualisation process in modernity has inherited this aspect remarkably. However, he also points out the inescapable nature of these questions under conditions of modernity. Taylor's main focus is on the constitutive nature of sociality in the making of human identity. In Taylor's view, the contemporary identity crisis arises from the dissolution of the power of the 'disengaged reason' which was hegemonic in the modern man's attempt to master over nature.

Traditionally, liberalism construes a hierarchical relationship between individual rights and common good. Taylor describes various kinds of liberalism as 'procedural' such as Rawl's liberal egalitarianism, Nozick's libertarianism and so on. According to Taylor, procedural liberalism's fundamental assumptions on individual liberty and rights are based on the idea of negative liberty (Taylor 1988b: 211-21). It also emphasises the idea of state neutrality among various conceptions of good. Taylor calls it as 'atomism' because of its ontological inadequacy to define a common good. Instead of this ontology of procedural liberalism, Taylor put forward the ideas of liberal holism and

situated freedom. In Taylor's view, it can only reconcile the emerging tensions between holistic and pluralistic conceptions of freedom. It was a shift from morality (dignity) to an ethics (good). For Taylor, this can be considered as the appropriate form of framework to an increasingly multicultural world. Liberalism ascribes the right of individual without any conditions and denying any kind of possibility to obligation what Taylor calls "obligation to belong" (Ibid.: 185-208). For liberals this belonging is a derivative of individual freedom and autonomy. In such a manner, the whole trajectory of modern liberalism, from Locke to Nozick, presupposes a kind of ontology privileged by right thesis. According to Taylor, human agent's efficient capacity for exercising rights or free choice requires some backgrounds or background conditions. By this background conditions what he means is that the "agent has to belong to society or context." This is Taylor's social thesis on freedom and rights, which argues that without it, no one can develop a sense of freedom, and helps his/her for exercising rights and freedom. According to this principle, there is no distinction between right to freedom and obligation to belong. The central goods in liberalism, freedom and autonomy, cannot be developed in an individual without some socio-cultural context.

The Idea of Modern Identity

Taylor's *Sources of the Self* is basically an examination of the sources and history of the modern self. According to Taylor, our search for identity is an "inextricably intertwined themes" of "selfhood and good" (Taylor 1989: 3). His main quest is to understand the possibility of the existence of 'selves' in various moral spaces. He says that the idea of 'neutral' self is impossible and also a myth (Ibid.: 49-50). Taylor's conception of a modern identity is based on these aspects of identity. First is the "idea of modern inwardness, the sense of ourselves as beings with inner depths, and the connected notion that we are 'selves'; second is the affirmation of ordinary life which develops from early modern period; third, the expressivist notion of nature as an inner moral source" (Ibid.: 10). In his search for the moral sources of the modern identity, Taylor historically examines the genesis of various aspects. Taylor's historical examination of the sources of the selfhood begins from the ancient and medieval conception of morality. He points out that during these times the idea of moral sources stemmed from a larger cosmic order. The source of the selfhood is closely identified with external reality. However, modernity inaugurated a new science (Baconian science based on observation and experiment as central to knowledge, instead of the a priori thinking of the medieval theology) and a new religion (Protestantism) which helped to affirm the values and issues of ordinary life. In such a situation "the fullness of Christian existence was to be found within the ordinary activities

of this life, in ones calling and in marriage and the family” (Ibid.: 218). This idea of ordinary life has been playing a central role throughout Taylor’s philosophy.

Taylor interestingly narrates two dominant ways of identity thinking or conceptions of identity in the culture of modernity. One is based on the Enlightenment notion of a rational, secular, universal identity and the other is the romantic understanding of an expressivist self. The genesis of this development begins from the Renaissance humanism which emphasised the faith in human rationality and secularisation of knowledge through various scientific methods and finally, visualised a self-sufficient free individual. The two important representatives of the mainstream Enlightenment identity thinking were Rene Descartes and John Locke. On the one hand, Descartes, the father of modern philosophy, inaugurated a paradigm shift in the human understanding of an agent. The central ideas of this new philosophy were based on the notion of ‘disengaged reason’ which conceptualised nature as a big machine. Descartes has had a hope that through the application of mathematical formulis it is possible to capture the whole picture of the universe. The fundamental aim of the Cartesian project was the secularisation of knowledge and freedom. Taylor calls this as a “self mastery through reason therefore *cogito* became central to his whole project” (Ibid.: 143). This is clearly revealed through his statement, “I think therefore I exist” (*cogito ergo sum*). Descartes separation of mind from body created an understanding that subject and object are two distinctive spheres. On the other side, John Locke was the chief proponent of empiricism which claimed that all knowledge is derived from observation. He rejected the traditional idea of a *priori* reasoning. Locke conceptualised human mind as a *tabula rasa* (empty plate). For Locke the creation of identity was basically a process of accumulation of knowledge and experience. At the same time, Locke’s empiricist method emphasised the idea of reflexive capacity of the mind. This was “the growing ideal of a human agent who is able to remake himself by methodical and disciplined action” (Ibid.: 159). This constitutes the very basis of a Lockean “punctual self.” As Linda Alcoff observed, these two traditions had a strong distrust with social and cultural attachments. Alcoff points out that “the distrust of cultural and social identity is justified by its conflict with reason: if a strong attachment to identity disallows disengagement or the objectification of one’s culture and one’s people, even an imaginative disengagement, for the purpose of reflective critique, then one cannot gain critical distance, and thus one’s allegiance to it cannot be rational” (Alcoff 2000: 326). For Taylor, this was the one crucial development in the modern identity thinking which has become hegemonic in the intellectual world generally and the culture of modernity in particular.

Another way of thinking of the self/identity begins from the emergence of modern romantic thought. Romantic thinking was a counter movement against some of the cold rationalities of the Enlightenment. It deeply quarrelled with the two hegemonic principles of Enlightenment—rationalism and universalism—and alternatively proposed the idea of sensibility and feeling in human affairs. In Taylor's view, it was a recantation against the "reification of the disengaged first-person-singular self of the modern epistemological tradition" (Taylor 2004: 33). At the same time, the romantic tradition emphasised an anti empirical, and expressivist individualism (Taylor 1989: 243). Instead of cognition it placed sensibility and feeling as central to human identity and viewed identity as the expression of an innate feeling. The distinctiveness of this shift lies in the fact that it attempted to connect an intimate relationship between self-expression and nature. It was fundamentally concerned with the harmony between nature and self. In Taylor's words, the "inner voice or impulse, the idea that we find the truth within us, and in particular in our feeling" became its first principle (Ibid.: 368-69). Herder was a philosopher of the modern expressivist understanding of identity. According to Taylor Herder's theorisation of culture inaugurated an "expressivist theory of language and meaning in the philosophical thinking" (Taylor 1995: 79). For Herder language was central to the making of human identity (Ibid.: 86). According to Taylor, the counter perspective of Herder's expressivism had been based on two crucial understandings. "The first consists in articulating a part of the background, in such a form that our reliance on it in our thought, or perception, or experience, or understanding language, becomes clear and undeniable. The second main direction of argument, in the counter-thrust to Cartesian-empiricism has been the attempt to place our thinking in the context of our form of life" (Ibid.: 90-1). Therefore, Herder's criticism of disengaged reason of mainstream Enlightenment had introduced the idea of a situated thinking and background in human life. However, like in the Enlightenment conception of self-mastery through reason, conception of true and authentic self was also part of the romantic expressivist project. Taylor's central contribution lies in his attempt to reinvoke this marginal tradition of modern moral sources and to give an alternative understanding of human identity, from a hermeneutic-dialogic fashion.

The Modern Politics of Recognition and Difference

The contemporary theory of recognition is a Hegelian theory. Two important Hegelian theorists of recognition, Taylor and Axel Honneth have developed a remarkable stand in this regard. Hermeneutic Hegelianism is the driving force of Taylor's concept of recognition (Yar 2001a: 288-303; Taylor 1977). Hermeneutics can loosely be defined as the theory or philosophy of the

interpretation of meaning (Bleicher 1990: 1). It is the science of interpretation and it rejects that “there was a truth out there. It questions the rationalities of Enlightenment universalism as prejudiced, the prejudices against culture, community, diversity, values, religion and so on. Gadamer argues that “there is one prejudice of the Enlightenment that defines its essence: the fundamental prejudice of the Enlightenment is the prejudice against prejudice itself, which defines tradition its power” (Gadamer 2005: 272-73). Gadamer further argues that Enlightenment has always viewed prejudices in a negative manner, most often upholding neutrality and scientificity in judgments. It stands for culture-neutral understanding and viewed tradition, belief, community etc. as prejudiced entities which ultimately block rational engagements.

Taylor’s conception of identity and its links between recognition, difference, and authenticity have been hotly debated in the contemporary social and political theories. For Taylor, the modern notion of an authentic identity is constituted by these facets which are incorporated into it at different stages of the philosophy of history. Politics of recognition reflects Taylor’s central theses on political and social philosophy. As Seyla Benhabib observes, Taylor’s politics of recognition is “the development of an intersubjective conception of identity based on a dialogical model of “webs of interlocution” and his reconstruction of modern subjectivity in the light of demands for equal dignity and authenticity” (Benhabib 2002: 51).

Notion of the Self and Recognition

Taylor says, “Our modern notion of the self is related to, one might say constituted by, a certain sense of inwardness” (Taylor 1989: 111). For Taylor the idea of recognition is a pure modern product (Parekh 2004: 199-213). In the politics of recognition, Taylor historically and philosophically narrates the development of modern idea of subjectivity. The first crucial moment in the course of recognition was the emergence of modernity which inaugurated a new idea of subject/subjectivity. Modernity has led to the replacement of the aristocratic notion of ‘honour’ to a more democratic notion of ‘dignity’. The emergence of universal ideas and humanist concepts were part of this crucial change. The leading principle at this stage was the idea of an equal human worth due to all human beings. The philosophies of Rousseau and Kant have been given enough justification for this kind of an understanding. The second paradigm change is the emergence of the modern notion of identity. According to Taylor the modern notion of identity gives rise to the politics of difference. For Taylor, “[T]he politics of difference grows organically out of the politics of dignity through one of those shifts with which we are long familiar, where a new understanding of human social condition imparts a radically new meaning

to an old principle” (Taylor 1994: 39). The politics of recognition was a turn to Aristotle and Hegel and also a retreat from Kant and utilitarianism. The guiding principle of this political process is ‘ethical’ rather than ‘moral,’ and emphasis on “good rather than only the ‘just’ life and rooting it in communal rather than abstract organisation, concrete rather than universal normative criteria, and substantive rather than procedural values which highlights difference and uniqueness and over generality and similarity” (Alexander and Pia Lara 1996: 127).

According to Taylor “our identity is partly shaped by the recognition or its absence, often by *misrecognition* of others” (Taylor 1994: 25). For him, “Nonrecognition or misrecognition can inflict harm, can be a form of oppression, imprisoning someone in a false, distorted reduced model of being. Misrecognition shows not just lack of due respect, it can inflict a grievous wound, saddling its victim with a crippling self-hatred. Due recognition is not a courtesy we owe people. It is a vital human need” (Ibid: 25-26). The concept of humiliation has been playing an important role in the politics of recognition (Lukes 1997: 36-51; Margalit 1996). The moral importance of decency and the injuries of humiliation are important as far as the politics of recognition is concerned.

The identities whose recognition Taylor is talking about are collective social identities, such as religion, language, gender, ethnicity, race, sexuality. Taylor conceives identity as a primary good and he builds his argument upon the premise that “dominant groups tend to entrench their hegemony by inculcating an image of inferiority in the subjugated” (Ibid.: 66). For Taylor identity is a sense of “selfhood” that has to be respected. Taylor says “I can define my identity only against the background of things that matter. But to bracket out history, nature, society, the demands of solidarity, everything but what I find in myself, would be to eliminate all candidates for what matters” (Taylor 1991b: 40). The language of identity reminds us to what extent we are, “dialogically” constituted. For Taylor, identity is basically “who we are,” “where we are coming from” (Ibid.: 34). For Taylor, *language* covers “not only the words we speak, but also other modes of expression whereby we define ourselves, including the “languages” of art, of gesture, of love and the like” (Taylor 1994: 32). In Taylor’s view, “we become full human agents, capable of understanding ourselves, and hence for defining an identity, through our acquisition of languages of expression” (Taylor 1991b: 32-3). This statement clearly reveals that self is not a pre social thing, but, rather, a product of our dialogues, in multiple levels. Taylor argues that “free individuals can flourish only to the extent that (they) are recognised. Each consciousness seeks recognition in another, and that is not a sign of a lack of virtue” (Taylor 1994: 50).

Dignity and Authenticity

In Taylor's view, our sources of the modern self or identity have two important poles. The "politics of equal dignity" and the "politics of difference" associated with ideals of autonomy and authenticity respectively (Coke 1997: 258-88). The Enlightenment universalism and the politics of dignity have systematically marginalised the other side of the modern identity. The language of the equal human worth epitomised the marginalisation of an authentic pole. However, Taylor through his politics of recognition attempts to revitalise or retheorise this marginalised source of the self, which is often subjugated in the culture of modernity. The eighteenth century romantic thinkers were very much concerned about the singularity of the individual and the particularity of human culture. The Herderian ideal of authenticity has its root in this thinking. Its central premise was based on 'the inwardness' of human beings, the very right to be different and unique. On the other side, the language of dignity hegemonised the modern culture. Taylor finds out some ruptures in the philosophy of Rousseau, a tendency to move towards the ideal of authenticity. Rousseau had raised some serious criticisms against the rationalities of Enlightenment, especially in his conception of a 'noble savage'. According to Taylor, "Rousseau frequently presents the issue of morality that of our following a voice of nature within us.... Our moral salvation comes from receiving authentic moral contact with ourselves" (Taylor 1991b: 27). However, the real inheritor of this stream of thinking was Herder, who claimed that "we have an *original* way of being human. Each person has his or her own 'measure' in his way of putting it." Taylor says that this idea has deeply penetrated into modern consciousnesses (Ibid.: 28). Herder emphasises the need for an authentic sense of the self and articulated the desire for authenticity, to develop their own authentic selves. For him "each human being has his own measure, as it were an accord peculiar to him of all his feelings to each other" (Taylor 1989: 375). He also points out that our sense of the self is very close to culture and language. Herder redefined both the site of authenticity and its language, totally distinct from the language of Enlightenment rationalism. He viewed authenticity as a private matter and the idea of 'mineness' of culture or nation became important. Taylor observes that, "[t]here is certain way of being human that is *my* way. I am called upon to live my life in this way, and not in imitation of anyone else's. But this gives new importance to being true to myself. If I am not, I miss the point of my life, I miss what being human is for *me*" (Ibid.: 28-29). Taylor puts it "no one thought that the differences between human beings had this kind of moral significance." In such a manner he recognises the value of this ideal as a counter perspective against the disengaged rationality of Enlightenment.

The politics of difference is based on the recognition of a unique identity. As Taylor observes “we give due acknowledgement to what is not universally present—everyone has an identity—through recognizing what is particular to each” (Taylor 1994: 39). The idea of difference means difference or the uniqueness of identity. Therefore, demand that is most commonly associated with the politics of recognition is a demand for the recognition of difference rather than toleration (Jones 2006: 123). This appeal to authenticity is the distinctive nature of Taylor’s politics of recognition. Authenticity is explained as “truly the agents own,” what is important is agents own desires and values. Thus, the ideal of dignity and authenticity was two facets in the trajectory of modern identity thinking.

The contemporary discussions on authenticity are centred on the Herderian ideal. For Taylor the “ethic of authenticity is particular to modern culture and also a child of the Romantic period, which was critical of disengaged rationality and of an atomism that didn’t recognize the ties of community” (Taylor 1991b: 25). From this perspective, “human activity and life are seen as an expression.” Taylor argues that “it was Herder who launched the idea that each individual “has its own way of being human, which cannot exchange with that of any other except at the cost of distortion and self-mutilation” (Taylor 1977: 15). Taylor further argues that Herder introduced an alternative anthropology which was centred on the “categories of expression.” It was a critique of the “objectification of human nature, a critique of the analysis of the human mind into different faculties, of man to body and soul, calculative notion of reason, divorced from feeling and will” (Ibid.: 13). Taylor invokes Herder’s idea of culture as the expressive aspect of individuality for his politics of recognition. Expressivism is the idea that “man comes to know himself by expressing and hence clarifying what he is and recognizing himself in this expression” (Ibid.: 17). Culture and language are the two important achievements of humanity. According to Taylor, Herder “applied his conception of originality at two levels, not only to the individual person among other persons, but also to the culture-bearing people among other peoples. Just like individuals, a *Volk* should be true to itself, that is, its own culture” (Taylor 1994: 31; Fox 2003: 237-62; Linker 2000: 267-93).

For Taylor the idea of recognition is culminated in the modern period and overrides the pre-modern notion of honour or status based social relations. Taylor visualises the idea of “self realization” through the politics of difference, for this purpose recognition is the main way. According to Lash and Featherstone, “For Taylor, Hegel’s dialectic of master-slave was primarily about dignity and less about authenticity. The assumption is that master and slave are deserving of equal recognition as rational agents: they deserve to be equally

respected and accorded equal dignity” (Lash and Featherstone 2001: 12). The philosophical development of the modern idea of identity from Rousseau, Kant and to Hegel all emphasised equal moral worth. By the notion of the recognition of authenticity, Taylor tries to break this Kantian moral order which is based on the premise that “a systematic union of rational beings through common objective laws” (Taylor 1988b: 326).

Identity formation and self-realisation are closely related processes. Taylor’s emphasis is on “the cultural constitution of the subject” which means “the way the individual forms his or her identity, sense of self, and intuitive system of values by inheriting and passing an unchosen legacy of collective orientations, shared meanings and standards, networks of kinship and pre-contractual forms of solidarity which are a prerequisite for, rather than the outcome of, the subject’s capacity for moral commitment” (Bowring 1997: 107). He also understands culture as “irreducible social good.” According to him, “reducible social good is a good whose value cannot be reduced to the satisfaction of a collection of individual desires” (Taylor 1995: 142). He explains two ways of defining irreducible common good; “(1) the goods of a culture that makes conceivable actions, feelings, valued ways of life and (2) goods that essentially incorporate common understanding of their value” (Ibid.: 140). He further argues that, “if we refer to the background of practices, institutions, and understandings which form the language-analogue for our action in a given society as our culture...., then it is clear that the culture can be the locus of goods” (Ibid.: 136).

The Taylorian conception of social identity is basically emphasising the value of perception. Taylor regards perception as an important element in the shaping of our knowledge and social identity. Merleau-Ponty and phenomenology are very much influential in this regard. Merleau-Ponty emphasised the bodily nature of perception and the ways in which our bodies are themselves constructed by history and culture. Taylor invokes this phenomenological insight and argues that “because we are in the world, we are condemned to meaning” (Smith 2002: 1). For Taylor perception is always influenced by social identities, because our attitudes, opinions, and beliefs are very much constituted by these identities.

Culture or Economy: Debates on Recognition and Redistribution

The politics of recognition has been a subject of serious discussions in contemporary times. Some scholars argue that Taylor’s recognition thesis is “one-sided which pays attention to recognition at the expense of redistribution.” Both Nancy Fraser and Iris Young agree with this point. They view that in Taylor’s recognition thesis “cultural values are primary questions of justice” (Young 1997: 148). Nancy Fraser criticises the identity model on two grounds.

On the one hand, it displaces redistribution, and on the other, it reifies identities. She further argues that, “it puts more pressure on individual members to conform to a given a group culture” (Fraser 2000: 112). According to Fraser, “The identity model thus lends itself all too easily to repressive forms of communitarianism, promoting conformism, intolerance and patriachalism.” She concludes that it tends to deny ‘its own Hegelian premise’ “by valorizing monologism—supposing that misrecognized people can and should construct their identity on their own” (Ibid). Therefore, for Fraser, the identity model of recognition is “deeply flawed.”

Fraser’s main attempt has been to reconcile the paradigms of recognition and redistribution for a transformative politics. The normative core of Fraser’s conception is the notion of *parity of participation* (Fraser 2001: 29). This norm is based on the idea that “justice requires social arrangements that permit all (adult) members of society to interact with one another as peers.” According to Fraser:

Demands for ‘recognition of difference’ fuels struggles of groups mobilized under the banner of nationality, ethnicity, ‘race’, gender, and sexuality. In these ‘post-socialist’ conflicts group identity supplants class interest as the chief medium of political mobilization. Cultural domination supplants exploitation as the fundamental injustice. And cultural recognition displaces socioeconomic redistribution as the remedy for injustice and the goal of political struggle (Fraser 1995: 68).

Instead of the one-sided approach of difference based ‘affirmative’ politics, Fraser suggests the necessity of a redistributive–transformative politics. In her analysis of recognition/ redistribution dilemma, on the one side, Fraser locates the ideas of Marx, Rawls, and Amartya Sen in the realm of redistribution, and on the other, the ideas of Taylor and Honneth in the realm of cultural or symbolic spheres. Fraser argues that the cultural injustices are mainly rooted in the “social patters of representation, interpretation, and communication” (Ibid.: 71). Here the central task of the social theorists in the ‘post- socialist’ politics is the reconciliation of these two paradigms of justice.

However, in an important essay on recognition, Majid Yar accuses Nancy Fraser of having introduced a “perspectival dualism” in the whole recognition debate (Yar 2001a: 288-303). The crux of Yar’s criticism is that Fraser’s culture based recognition and economy based redistribution claims fundamentally limit the possibility of the very idea of recognition. He argues that Fraser understands the idea of recognition as strictly limited to cultural or injustices in the spheres of language and representation (symbolic sphere). The main difficulty of Fraser’s conception of recognition arises from the absence of a clear theory of recognition,

especially to have distinction between various Hegelian models of recognition. Yar describes Taylor's recognition theory as a "hermeneutic Hegelianism and therefore he tries to understand the problems of morality as centred in the practice of linguistic-communicative understanding and representation." Elaborating Taylor's idea of recognition he says that the problem of recognition thus pertains to the problem of publicly affirming cultural particularity and collective identities. On the other side, Yar spells out the distinctive nature of Axel Honneth's conception of recognition and its philosophical differences very clearly. He understands the specificity of Honneth's theory of recognition in its "constitutive" character whereby "it sees recognition as a first-order genetic account of the process of human self-formation." He elucidates Honneth's attempt to connect his recognition as an exercise in "philosophical anthropology" and "in doing so makes recognition coextensive with a (social) theory of human nature." Reading the struggle for recognition as a philosophical anthropology, one that defines human self-formation and social formation as such, enables Honneth to claim that its logic permeates to all struggles for social justice, which are manifestations of a struggle for human self-realisation. In short, Yar tries to understand "different manifestations of injustice and struggles against them as different moments *within* the (meta) logic of recognition" (Ibid.: 302).

Axel Honneth argues Fraser's crucial mistake lies in the tendency to reduce "politics of recognition" as mere "social recognition of persons to the single aspect of cultural recognition or acceptance of their differing forms of life" (Honneth 2001: 52). He also points out the limitations of Fraser's argument on redistribution and her attempt to include Marx in the realm of distribution. Honneth also explains the mistakes of Taylor's theory of recognition saying it as "narrow paradigm" and a "misleading chronology." Taylor understands the question of juridical equality and cultural equality in the liberal capitalist societies as two separate stages, therefore "fails to consider all aspects of a legal nature within current struggle for recognition" (Honneth 2001: 52). Taylor's theory, un/consciously makes a twofold distinction that the old social movements were focused juridical equality, unfamiliar about social recognition and the new social movement's struggles for cultural difference. However, Honneth contests this sort of a divisive understanding and explains how historically, these two forms of struggles interrelated whether it is in the trade union movements or women's liberation movements and so on. In short, Honneth's theory of recognition treats different forms of struggles as various moments in the course of social esteem and self-realisation.

Poststructuralism and Taylor: Fragmentation or Authenticity

The culture of modernity is central to Taylor's whole project. He argues that modernity was "disenchantment" at the same time he rejects both dialectical and binary approaches to modernity. Taylor's conceptualisation of modernity talks about the possibility of 'alternative modernities.' Taylor views modernity as a multivalent process. He describes the three "malaises of modernity." The first is about "some fears, a loss of meaning or the fading of moral horizons, and the second the eclipse of ends, in the context of growing instrumental reason, and the third is a loss of freedom" (Taylor 1991b: 10).³ However, he understands the "subtle and complex nature of modern culture." Taylor argues: the deep crisis arises not in the context of domination of instrumental rationality per se but it arises from the consequences of moral and political culture of modernity. The common nature of this malaise is that "the important virtues of society are rational organization, distributive justice and the safeguarding of individual independence" (Taylor 1979: 137).

Taylor describes the poststructural/postmodern "negation of all horizons of significance" as nihilism. He finds out the expressions of nihilism in some traditions of modernism and the writings of postmodernists like Foucault and Derrida (Taylor 1991b: 60). Taylor writes: "The impact of these thinkers is paradoxical. They carry their Nietzschean challenge to our ordinary categories to the point even of 'deconstructing' the idea of authenticity, and the very notion of the self. But in fact, the Nietzschean critique of all 'values' as created cannot but exalt and entrench anthropocentrism. In the end, it leaves the agent, even with all his or her doubts about the category of the 'self,' with a sense of untrammelled power and freedom before a world that imposes no standards, ready to enjoy free 'play' or to indulge in an aesthetic sense of the self" (Ibid.: 61-2). According to him the contemporary popular culture celebrates this 'higher theory of culture' as authenticity. At the same time he traces the influence of expressivist elements of protest against modernity in later Foucault, especially his engagement with the question of "aesthetic creation of the self."

Taylor takes exception to the "reduction of debate between the discourses of difference and of universalism to mere question of power" as a dangerous play (Lash & Featherstone 2001: 5). Some scholars observe that "Foucault's concept of the self appears to have no intrinsic connection with the social world. It is solitary and isolated" (Dodd 1999: 101). Taylor also subscribes this view. He says: 'neo-Nietzschean theories of Foucault and Derrida "claim that all judgments of worth are based on standards that are ultimately imposed by and further entrench structures of power." Moreover, "The theories hope to escape

this whole nexus of hypocrisy by turning the entire issue into one of power and counter power. Then the question is no more one of respect, but taking sides, of solidarity. But this is hardly a satisfactory solution, because in taking sides they miss the driving force of this kind of politics, which is precisely the search for recognition and respect” (Taylor 1994: 70).

The poststructuralist approach to language and culture and the idea of subjectivity are fundamentally different from Taylor. For the poststructuralists, language is the crucial medium for the deconstruction of identities. For Taylor, language and culture are the different moments in the modern emergence of subjectivity and identity. Language and culture constitute authenticity of human life. Poststructuralist, especially Foucault sees, human beings or individuals as the product of various regimes of power. He explains the operations of power through the micro institutions and bodies of human society and the very subject is constituted by innumerable ways. As such culture itself is the product of various discursive formations. The episteme of man has been playing a crucial role in the very construction of humanist problems. For Foucault, the shifts of episteme will result to the erasure of the very concept of man and his authentic claims.

Taylor points out that Foucault tries to reject the ideas of freedom and truth. For Foucault “The idea of liberating truth is profound illusion. There is no truth which can be espoused, defended, rescued *against* systems of power. On the contrary, each such system defines its own variant of truth. And there is no escape from power into freedom, for such systems of power are co-extensive with human society. We can only step from one to another” (Taylor 1988b: 152-53). Taylor questions the value neutral position of Foucault. Taylor says, Foucault “adopts a Nietzschean derived stance of neutrality between the different historical systems of power, and thus seems to neutralize the evaluations which arise out of his analysis.” He also argues that Foucault “opposes the classical liturgical idea of punishment to the modern humanitarian one and refuses to value the second over the first. But this refusal is over-determined in a sense. It doesn’t seem to depend only on the bottom-line Nietzschean stance of neutrality, but also on his concrete reading of this ‘humanitarianism’ which is seen as a growing system of control” (Taylor 1988b: 163; 1985: 377-85). Taylor says that “Foucault espouses both the relativistic thesis... that one cannot judge between forms of life/thought/valuation, and also the notion that these different forms involve the imposition of power. The idea of ‘regimes of truth’, and of their close interaction with systems of dominance, is profoundly Nietzschean. In this relationship Foucault sees “truth as subordinated to power” (Taylor 1988b: 177; 1998: 110-16). However, Taylor

endorses the role of agency and the possibility of an authentic life in his theorisation. For him, social contexts have multiple natures by using reflective capacity. Individual and their agency can play an important role in constructing themselves as subjects. For Taylor, all regimes and disciplines are not totalitarian, there is also possibility for freedom and actions. According to him, “In the heart of struggle, behind the barricades, there is a real liberation of expression, a field for creative action, the breaking down of barriers, a real participatory democracy” (Taylor 1979: 155). For Taylor, “conception of freedom has not been a mere foot note, but one of the central ideas by which the modern notion of the subject has been defined, as is evident in the fact that the freedom is the one of the values most appealed to in modern times. At the very outset, the new identity as self-defining subject was won by breaking free from the larger matrix of cosmic order and its claim” (Ibid.: 156). However, there is no meaning in absolute freedom. The quest for absolute freedom “is a problem for all forms of modern expressivism, and in a sense also for the whole modern conception of subjectivity.” Taylor’s main concern is the situatedness of freedom, otherwise it is meaningless. This is one of the important criticisms against neo-Nietzscheans.

Taylor sees a paradoxical nature in the poststructural claims, especially in Derrida’s claims on the end of subjectivity. Taylor says for all the talk of “end of subjectivity” one of the strong attraction of this kind of position is precisely the license it offers to subjectivity, unfettered by anything in the nature of a correct interpretation or irrecusable meaning of either life or text, to effects its own transformations, to invent meaning. Self-making is again primary” (Taylor 1995: 16). For Taylor “The Nietzschean position also stands and falls with a certain construal of knowledge: that it is relative to various ultimately imposed regimes of truth” (Ibid.: 17). According to Taylor, Foucault “rejected the concept of punctual self, which could take an instrumental stance towards its life and character—this is indeed what arises out of the practices and ‘truths’ of the disciplinary he painted in such repellent colors (whatever protestations of neutrality accompanied the depiction). But he could not accept the rival notion of a deep or authentic self that arise out of the critical traditions of Hegel and, in other way Heidegger and Merleau-Ponty. This seemed to him another prison. He rejected both in favour of a Nietzschean notion of the self as potentially self-making, the self as a work of art, a central conception of an “aesthetic of existence” (Ibid.: 16). As far as Taylor is concerned the idea of ‘background’ is important in human life. According to Taylor, it is not easy to “...just walk away from these deep pervasive, half-articulated, taken for granted pictures that are embedded in our culture and enframe our thought and action.... You can’t free yourself from them until you identify them and see

where they are wrong; and even it's not always easy" (Taylor 2003a: 158-59). For Taylor, the significance of Hegel lies in the fact that he insisted "to situate subjectivity by relating it to our life as embodied and social beings, without reducing it to a function of objectified nature.... In the sense, the modern search for situated subjectivity is the heir of that central aspiration of that Romantic period which Hegel thought to answer definitively—how to unite radical autonomy with fullness of expressive unity with nature" (Taylor 1977: 570). Taylor locates Marx in the tradition of radical Enlightenment with an expressivist theory. For Taylor Marx's theory was a combination of radical Enlightenment and expressivism. At the same time he criticises the division of scientific and young Hegelian expressivist Marx. Taylor points out that from the beginning "Marx's position was a synthesis between radical Enlightenment, which sees man as capable of objectifying nature and society in science in order to master it, and the expressivist aspiration to wholeness. This is what he meant in speaking of communism as the union of humanism and naturalism" (Ibid.: 551). And moreover, "the tremendous power of Marx's theory comes from his joining this thrust of radical Enlightenment expressivist tradition" (Ibid.: 548). Taylor also wants to highlight Marx's radical critique of the inhumanity of the enlightenment. Taylor argues that "the principal justifying myth which he denounces as the alibi for exploitation and oppression is not the old religion but the new atomistic, utilitarian Enlightenment philosophy itself, principally as reflected in the theories of the classical economists" (Ibid.: 548). However, Taylor argues that "Marxian synthesis between Enlightenment science and expressive fulfilment is in the end not viable." He argues that "if it is to be a more relevant theory it must say something extra about the "personal level of the individual" (Fraser 2003: 761). Another important contention is that "Marxism posits the unrealistic and 'unliveable' notion of 'generic man, harmoniously united in contest with nature.'" Moreover, "the situationless nature of freedom in Marxism results in a characterless self which has no defined purpose." Taylor also gives a hint on the future of Left politics; "a politics which stays close to the local, to lived experience, to the aspirations which groups spontaneously adopt" (Taylor 1979: 180).

Taylor's fundamental solution against the malaises of modernity is the revitalisation of romantic expressivism. However, Taylor's historical examination of the sources of our modern identity ends in the Judaeo-Christian God. Even in the time of "higher modernity" he is very much hopeful about the rich moral sources of Christianity. "There is a large element of hope. It is a hope that I see implicit in Judaeo-Christian theism (however terrible the record of its adherents in history), and in its central promise of a divine affirmation of the

human, more total than the human can ever attain unaided” (Taylor 1989: 521; 1999). However, Quentin Skinner argues that Taylor’s theistic thesis believes that “we cannot hope to realize our fullest potentialities in the absence of God” (Skinner 1991: 148). By following the philosophical tradition of Bertrand Russell, Skinner questions the irrationality of the theistic foundational claims and argues that “anyone who continues to affirm it must be suffering from serious psychological blockage or self-deceit” (Ibid.: 148). However in a reply to Skinner’s criticisms Taylor denies it as mere rhetoric and affirms the value of being a believer and a Christian (Taylor 1991a: 240-41). This affirmation clearly reflects his quest for a fundamental moral source and truth in theistic sources. At the same time, Taylor does not seek to the details of non-theist sources of the selfhood, in our culture.

Conclusion

The penetration of capitalist social relations in the entire areas of human relations has created a critical and panic situation throughout the world. The crisis generated by postmodernism and neoliberal social relations have compelled many thinkers to develop a new community oriented ethics and identity. Charles Taylor’s attempt formulates an authentic conception of identity based on recognition can be seen in this context. To pursue an authentic human and cultural identity, the contagious world situation addressing the questions of material inequalities and fundamental social transformations, would be part of nostalgia and not meaningful. In Taylor the philosophical project of authenticity is primarily attributed to the recognition of cultural communities. To conceptualise an authentic self/identity based on cultural/moral space is not a progressive political agenda, especially in a neoliberal world. “What exist in the era of globalization are scare-crow cultures and communities rather than the authentic ones who would be able to make strong evaluation” (Rodrigues 2002: 115-16). The question of the materiality of authenticity and the existing unequal social relations are not considered in this authenticity project. There are some serious difficulties in the conceptualisation of cultural and moral community as the prime site of authenticity and identity. The Taylorian communitarianism ultimately fails to understand the very formative nature of culture and its inseparable relationships with the wider socio-economic realm. The romantic conception of an expressivist self and protest is not enough to change the fate of oppressed and exploited people throughout the world. Taylor’s understanding on liberal democracy in the era of neoliberal capital is an impoverished one. Taylor says “Democracy, particularly liberal democracy is a great philosophy of inclusion.” He also describes liberal

democracy as “most inclusive politics of human history” (Taylor 1999b: 138-63). Taylor’s attempt is to create a liberal multicultural consensus in the era of neoliberal capitalism and exploitation and in reality it has a counterproductive effect. Thinking of culture without considering other dimensions of socio-economic processes is a mystification of reality. Therefore in the era of capitalist globalisation and culturalism “it is absolutely essential to reiterate that most things *are* a matter of class” instead of culture and moral community (Ahmad 2006: 104).

For all communitarians “inherited systems of affiliation are important.”⁴ (Shapiro 2004: 170-71). However, the authenticity claims of Taylorian communitarianism “denies the idea that there is hierarchy of determination in existing social relations which is inevitable result of historical formation quite beyond any valuation that any individual may attach them” (Ahmad 2006: 108). By hiding the historical and contemporary reasons of hierarchical social relations and exploitation, the claims for authenticity ultimately lead to the generalities of ‘ethnicities’, ‘difference’ and ‘multiculturalism’ as the permanent feature of societies (Zizek 1997: 28-51).

In the poststructural politics of contingency and the Taylorian authentic identity material production is not a central category in their theorisations. For Taylor, material production is not the site of authentic identity. The proponents of contingency also claim the decentered character of the social and the incapacity of capitalist social production in determining the nature of identities. The deconstructionism argues that the material production is a mere part of various discursive regimes which do not exist outside the domains of symbolic sphere. On the other hand, the proponents of authenticity are also not concerned with the question of material production and its role in determining human identity. The difference based recognition has a tendency to valorise culture and communities in the quest for an authentic self. It has only a limited potential to address the other important aspects of human identity. In a neoliberal capitalist world, culture itself has become a big industry and it has close interconnections with other realms of material productions.

In the Taylorian notion of an authentic identity, his critique is not modernity per se. Rather, it is directed towards the rationalist-empiricist tradition of Enlightenment. For Taylor, the mainstream of Enlightenment was atomistic in social philosophy and utilitarian in its ethical outlook. It looked at nature and society, as having only instrumental significance; they were seen as potential means to the satisfaction of human desire and nothing more. Therefore, his concern is to revitalise and retheorise the marginal tradition of the Enlightenment, the romantic expressivist thought. His politics of recognition

can therefore be seen as an attempt to incorporate the elements of expressivism into the lives of cultural and political communities. It is, however, worth noting to consider some problems of Taylor's attempt to trace out the fundamental nature of identity from a culturalist perspective. The constitutive elements of Taylor's authentic identity are culture, morality and community. For Taylor material realm is not a site of authentic production of identity. Even though he questions some of the rooted assumptions in liberal political theory, Taylor's communitarianism may not appear to be an effective alternative for an emancipatory politics. His conception of an authentic identity based on cultural community on the other hand hides the central problems in the contemporary world. It reduces the dimensions of identifications into one's own cultural community and the dimensions of class are totally missing. The revitalisation of romantic expressivism is not a viable solution in the context of growing neo-racism, ethnic separatisms, communal tensions and more importantly, economic violence. Therefore a real alternative is not to maintain the distinctiveness of cultural communities especially in a world where culture and capital have a close interconnection.

The ascendancy of neoliberal policies and the retreat of the state from social spheres have got some theoretical justifications in the same trajectory of the critiques of modernity. The anti-Enlightenment nature of poststructuralism and neoliberalism is clearly visible in its approach towards the very idea of society. The neoliberal political philosophy fundamentally argues against the social nature of labour and places market as the measure of everything. It also reduces the concept of freedom and well-being into the level of individual satisfaction. On the other side, poststructuralist politics is governed by the principles of contingency, fragmentation and heterogeneity. It also has a proclaimed enmity to any notion of totality, system, structure and the determinate nature of social relations. For poststructuralists, society is a mere discursive construction which cannot claim any analytical priority. Consequently, it has considerably failed to give any attention to the social nature of human labour and importance to collective actions, and therefore it helps to maintain the smooth operation of neo-capitalist exploitation and oppressive structures. In the postmodern vocabulary any talks about progress should be abandoned. The main weakness of poststructuralist version of identity thinking and authenticity claims of Taylorian communitarianism is that it overlooks the importance of dominant nature of social relations in the name of textualism and moral community. The most important difficulty with the claims of fragmentation and authenticity in identity thinking is the misrecognition of materiality and its constitutive nature. For poststructuralists, anti-essentialist difference provides the key for all engagements whether it is social or political.

For Taylor, the values of community/culture are central to political actions and an authentic identity. In Taylor's thesis on identity the 'question of who we are' is mainly determined by the cultural communities in which we live. It is a precondition of human agency and selfhood. However, his thesis conceptualises an authentic identity in a moral space which is unaffected by other socio-economic processes. 'Who we are' is not only a matter of culture and community, but also our pre positions in economy and society. In sum, the notions of authenticity and cultural survival invoke some nostalgic elements of the past and try to maintain an unaffected authentic identity in the era of neoliberal capitalism.

Notes

1. Johann Gottfried Herder, a German Romantic philosopher emphasised the irreducible diversity of human culture. His concept of *Volk* gave emphasis to the uniqueness of nations and cultures.
2. The idea of dialogism is originally propounded by Mikhail Bakhtin. A postcolonial theorist, Homi K. Bhabha, is one of the chief exponents of Bakhtin's ideas of dialogue and hybridity in the contemporary human sciences. See, Bhabha (1990).

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A Sociologist Critically Examines Paul Krugman's Economics

Kim Scipes

*The Return of Depression Economics and the Crisis
of 2008*

Paul Krugman is arguably the most-read economist in the world today. A Princeton University Professor of Economics and International Affairs, a Nobel Prize laureate in Economics, and a twice-weekly *New York Times* columnist, his reach extends far beyond academia, into government and public discourse. He obviously has very high-level contacts in government—Ben Bernanke, the Chairman of the US Federal Reserve is a former colleague, and the person who hired Krugman from MIT. Krugman's writing is accessible—at least his public writings—and he is even witty at times. And, he is not afraid to go after the right-wingers when necessary. In short, he brings an understanding of economics to a public that is largely considered economically ignorant, and makes “the dismal science” not.

As a long-time global labour activist turned sociology professor at a regional campus of Purdue University in Indiana, I turned to Krugman's new book, along with other resources, for help in preparing for a course on “The Sociology of the Current Financial Crisis” that I am teaching this summer. What I read in Krugman's book shocked me—and in more ways than might be immediately expected. Let me give an overview of Krugman's book, and then I'll comment.

Krugman seeks to share his understanding of the current financial crisis, and he takes things up to October 2008, making this an extremely up-to-date book (an earlier version of this book examined the 1997-98 “Asian Financial Crisis,” and he now extends his analysis to see what was learned from it that is guiding the responses to the current crisis.) His methodology is to report and discuss financial crises particularly since the Great Depression of the 1930s, but even some before that, in order to help pull out commonalities and differences. Importantly, his scope is global as well: he discusses financial

crises in Latin America in the 1980s, with a particular examination of Mexico and Argentina; Japan in the 1990s and on to 2003; the “Asian financial crisis” of 1997; and Argentina (again) in 2002. He examines these crises to try to learn what happened, and to see what the economic profession has learned from them.

From looking at these particular cases, he also looks at policy responses to these crises. He certainly is critical. However, he writes as a Keynesian, which obviously colours his perspective [quickly, Keynesians focus on creating demand to get an economy out of economic slowdowns, and take the position that macroeconomic intervention through cutting interest rates or increasing budget deficits, as needed, “could keep a free market economy more or less stable at more or less full employment” (102)]. Interestingly, he also writes from a particular Keynesian position, not common to all Keynesians—surprisingly, and I comment further below, he all-but-ignores the real economy of production and consumption.

Krugman points out the economics profession—of which he is a full-fledged member—has basically claimed that they know enough to prevent any future repeats of the Great Depression. Yes, there are still recessions, but the response is simple: cut interest rates to restimulate the economy and, if necessary, cut taxes and raise spending. This approach has been used in the United States in 1975, 1982, and 1991.

However, in talking about the financial crisis that began in Asia in 1997, he observes “the policies those countries followed in response were almost exactly the reverse of what the United States has done in face of a slump” (102). Many of the affected Asian countries raised their interest rates and cut their budgets drastically. How to explain that? He notes that the Asian countries’ economic policies had been “largely dictated” by the US Treasury and the International Monetary Fund (103).

Here he turns to the issue of international currency speculation, arguing that the policies designed for East Asia were intended to thwart speculators—thus, he sees the crisis as a financial crisis only. Krugman points out that speculators seek situations where they can prey on weakened—or apparently weakened—currencies, benefiting from and sometimes even stimulating currency crises. Therefore, to keep the speculators at bay, the solutions proposed were designed to maintain market confidence at all costs, even though much of the problems that emerged were from the private sector and not the public sector. Hence, interest rate hikes and drastic budget cuts were proposed so as to discourage currency speculation. Obviously, this takes us into the realm of social psychology:

... because crises can be self-fulfilling, sound economic policy is not sufficient to gain market confidence—one must cater to the perceptions, the prejudices, the whims of the market. Or, rather, one must cater to what one hopes will be the perceptions of the market.

... international economic policy ended up having very little to do with economics. It became an exercise in amateur psychology, in which the IMF and the Treasury Department tried to persuade countries to do things they hoped would be perceived by the market as favorable (114).

And then, to his credit, Krugman asked if the IMF actually made things worse. He concluded it had done two things wrong—the IMF was wrong to demand fiscal austerity, and it was wrong to demand structural reform as a precondition to getting new money—and avoided one problem (demanding that these countries defend their currency values at all costs) by creating another (demanding that they raise their interest rates so as to try to persuade investors to keep their money in the country).

Nonetheless, Krugman continues onward to argue there simply were no good choices in this situation, concluding “And so it really was nobody’s fault that things turned out so badly” (118); i.e., “stuff happens.” I wonder if the millions of workers who lost their livelihoods, the children who were forced out of school because their families could no longer pay education expenses, and everyone else whose life was disrupted would agree with Krugman on that (and actually, Malaysia rejected IMF prescriptions and emerged much less damaged than the countries that accepted them.)

Krugman stays on the tracks of the speculators, seeking “bad guys” cause obviously it could not be the economic system itself. He specifically focuses on George Soros and his efforts. He notes that Soros had created a financial crisis for Britain in 1990. He critiques Mahathir Mohamad, then prime minister of Malaysia, for blaming speculators and especially Soros for Malaysia’s financial crisis in 1997-98. But then Krugman talks about efforts by speculators—rumored to include Soros—to create a currency crisis in Hong Kong, but were turned back only by deft action by governmental officials. Hummm ... maybe Mahathir wasn’t as crazy as he first seemed....

Krugman continues this approach. He talks about Long Term Capital Management (LCTM), a hedge fund whose collapse in 1998 threatened to cause a full-scale global financial panic. And, helpfully, he explains to the reader the real idea of a hedge fund: instead of helping to make sure that market fluctuations do not affect one’s wealth, as is often suggested, Krugman points out that “What hedge funds do, by contrast, is precisely to try to make the most of market fluctuations” (120).

In other words, hedge funds try to profit off of small variations in valuation between different (usually) international markets, shifting money back and forth across the globe with computer keystrokes. And because they can often operate with large amounts of money, they can make immense profits off of small changes—or they can lose immense amounts of money if they guess wrong. LTCM guessed wrong—and a global financial system calamity was barely averted.

Here, though, Krugman says something very interesting. After the New York Federal Reserve intervened to get a group of investors to buy out the management of LTCM, and surmount the crisis, Krugman points out that, “even now, Fed officials are not quite sure how they pulled this rescue off” (138).

Speaking of the Fed, he shifts to discussing Alan Greenspan’s stewardship of the US Federal Reserve. Krugman is quite critical of Greenspan, and points out that on Greenspan’s watch, two economic bubbles were allowed to emerge—in stocks related to the dot-com world in the late 1990s and the housing crisis of the mid-2000s—and Greenspan basically did nothing about them.

Along with the two bubbles, however, Greenspan did nothing while a “shadow banking system” emerged, which basically functioned as a banking system only without the regulation with which the established banking system had to contend (albeit with little interest to regulate by the George W. Bushies). By June 2008, the combined balance sheets of the five major investment banks reached over \$4 trillion, while the total assets of the entire banking system was only \$10 trillion. It was the failure of this shadow banking system that Krugman claims caused the current financial crisis, which began in the summer of 2007. He calls this “The Mother of All Currency Crises” (176):

... in the short run the world is lurching from crisis to crisis, all of them critically involving the problem of generating sufficient demand. Japan from the early 1990s onward, Mexico in 1995, Mexico, Thailand, Malaysia, Indonesia, and Korea in 1997, Argentina in 2002, and just about everyone in 2008—one country after another has experienced a recession that at least temporarily undoes years of economic progress, and finds that the conventional policy responses don’t seem to have any affect (emphasis added) (184).

Krugman doesn’t present any “solutions” to the crisis. All he can come up with is the need “to approach the current crisis in the spirit that we’ll do whatever it takes to turn things around; if what has been done so far isn’t enough, do more and do something different, until credit starts to flow and the real economy starts to recover” (188).

This shocks me. Here is one of the most highly respected and well-trained economists in the world telling us to do “whatever it takes to turn things around.”

I'm sorry: a high school student could give this kind of advice. You don't need a Ph.D., etc., to come up with this.

And this comes after almost 190 pages of historical examples, and clear discussions of what happened and/or should have happened. And this is the best he can come up with...?

However, in his defense, he does suggest "vigorous monetary expansion" earlier in the book to end recessions, the tool which was used to end recessions of 1981-82, 1990-91, and 2001, as he notes (68). But Krugman does not differentiate between short-term financial stimulation—such as vigorous monetary expansion—and the long-term economic stimulation provided by plentiful, well-paying jobs that provide means for people to support themselves and their families. His concern only extends to the short-term response. And this illuminates a key weakness of the Keynesian approach: as long as sufficient demand can be generated—no matter how—then apparently any recession can be overcome. Krugman doesn't have to be concerned about jobs, because his particular type of Keynesian does not require this consideration, and thus, he doesn't.

Beyond this, there are two things in the book that caused my jaw to drop, at least metaphorically. First, Krugman shows that finance officials have seen the problems we're facing in the US and the world again and again—most certainly in 1997-98 as the "Asian financial crisis" spread around the world, almost taking down Russia, Brazil and the United States—and they have no understanding of the causes of these crises and, hence, no realistic solution.

He refers to this several times throughout the book: the problem is "deleveraging," "involving plunging prices and imploding balance sheets" (135). In other words, great amounts of money are invested—by "regular" investors such as investment banks as well as speculators—in the hopes of making great profits, and when things go bad—for whatever reason—this "herd" flees like a bat out of hell, destroying economic value and leaving economic and social devastation that affects millions of people in their wake. And it's on to the next "opportunity."

Yet Krugman cannot explain why investors pulled out of Asia the way they did in 1997. He focuses on Thailand, suggesting it was because an over-supply of credit (i.e., in this case, foreign investment): "Soaring investment, together with a surge of spending by newly affluent consumers, led to a surge of imports, while the booming economy pulled up wages, making Thai exports less competitive..." (81). So, supposedly export growth slowed down, creating a huge trade deficit. And the problem was "crony capitalism."

Krugman's got a problem here. He asserts—giving no evidence for the claim—that Thai wages were being pulled up by the expanding economy. Yes,

generally speaking, research has shown that workers make more money in multinational corporation's subsidiaries and/or subcontractors than they do in corporations run by Thai capitalists (i.e., "national" capital) or than they did in their former lives as peasants. However, once the jump has been made into the MNC-related factories, there is nothing to push up wages. Unlike Filipino workers in the 1980s, Thai workers never created a labour movement strong enough to force MNC-related factories to keep raising wages. And without that, and especially in the face of competition from countries like the Indonesia, Malaysia and the Philippines, it is all but certain Thai wages did not increase, and certainly nowhere near with the importance Krugman suggests.

The larger problem of Krugman's analysis here is that he leaves out the development strategy pushed by the International Monetary Fund (IMF) and the World Bank (WB): export-oriented industrialisation. In other words, recognising the low levels of consumption in these countries, along with the cheap cost of labour, the IMF/WB encouraged each of the "developing countries" in Asia to focus their economy toward providing imports for the developed countries, such as the US. And when each industrialising country in the region did this, ultimately there became an overproduction of goods, which forced prices downward, and investors were not prepared for the reduction of growth. And as overproduction forced prices down, governments devalued their currencies to try to maintain their respective economy's competitive positions. And the result was about \$105 billion dollars of investment withdrawn from East Asia in little more than a year. This economic problem then shifted to Russia, to Brazil and, finally, to the US.

As I wrote in an article in *Canadian Dimension* in mid-1999, "It became a crisis because investors around the world were making heavy bets that the economies in East Asia would continue to expand as they had been since the mid-1980s, and they were unprepared—intellectually or emotionally—to have the Asian 'economic miracle' collapse. After all, by the mid-1990s, Asia (including Japan) had been producing one-third of the manufacturing value in the world." In short, I showed it was an economic crisis—based on overproduction—and a financial crisis rather than just a financial crisis as Krugman alleges.

Along with this, however, is something even more shocking than his not understanding the cause of the "Asian financial crisis": I don't know about Krugman's academic writings, but in this book, he shows almost zero interest in or knowledge of what he calls "the real economy" in the United States, the economy of production and consumption, and the lives of working people. His total focus on this, in any concentrated form, is on pages 179-180.

Now maybe this is not uncommon among economists, but this utterly astounds me. In this book, he gives no idea of the changes that are going on in the real economy. However the global economy is getting more and more competitive, jobs are being destroyed by businesses through technological displacement and by off-shoring of production to respond to this increased global competition; companies are restructuring; corporate bankruptcies are throwing even more and more workers on the scrap heap, etc., which, in turn, reduces these displaced workers' ability to support their families, to consume products, to live (for details of this, see my recent "Neo-liberal Economic Policies in the United States: The Impact of Globalization on a 'Northern' Country" at <http://www.zmag.org/znet/viewArticle/21584>).

And while things are getting worse in the United States, the financial crisis has already wrecked untold misery on people in the "developing countries." In a global economic system dependent on selling to the "developed countries," the economic contraction in this country is an unmitigated disaster for hundreds of millions around the world.

In short, what Krugman doesn't understand—and more importantly, what the people who share Krugman's viewpoint and the people they advise don't understand—is that there is a difference between the economic system and the well-being of working people in this country and around the globe. Not understanding that difference is the reason, I believe, that we're gotten the particular response of the Obama Administration, pushing trillions of dollars to the banks, and much, much less to support the rest of us. The refusal of the government to bail out the State of California, to give an extreme case, only illustrates this difference much more clearly.

Krugman, who so smugly dismisses alternatives to capitalism in his first chapter, spends the rest of his book giving us considerable reasons for requiring an alternative. Capitalism has caused great misery around the globe over the past several centuries, and a small number of us (relative to the world's population) have done well over the past 100 years (give or take). Now, as this financial crisis continues, the benefits are becoming even more restricted.

Courtesy: *Z Net* and *Countercurrents*

About the Authors

Immanuel Wallerstein is Distinguished Professor Emeritus of Sociology, State University of New York at Binghamton. Among his numerous books are *The Modern World-System* (1974, 1980, 1989), *Unthinking Social Science* (1991), *After Liberalism* (1995), *The End of the World As We Know It* (1999), and *The Decline of American Power: The U.S. in a Chaotic World* (2003).

Kim Scipes is an Assistant Professor of Sociology at Purdue University North Central in Westville, IN. He has been episodically writing on changes in the global economy and how they have affected Americans over the past 25 years.

Helena Cobban is the author of *Re-engage!: America and the World After Bush* and the author and publisher of *JustWorldNews.org*.

C.P. Chandrasekhar is Professor, Centre for Economic Studies and Planning, School of Social Sciences, Jawaharlal Nehru University New Delhi.

Jayati Ghosh is Professor, Centre for Economic Studies and Planning, School of Social Sciences, Jawaharlal Nehru University New Delhi.

Arindam Banerjee is a member of Faculty, Centre for Development Studies, Thiruvananthapuram.

K.M.Seethi is Director, School of International Relations and Politics, Mahatma Gandhi University, Kottayam, Kerala.

W. Lawrence S. Prabhakar is Associate Professor, Department of Political Science Madras Christian College, Chennai.

A.M. Thomas is a member of Faculty and Chairman, Centre for Indian Diaspora Studies (CIDS), School of International Relations and Politics, Mahatma Gandhi University.

Happymon Jacob is Assistant professor in the Centre for International Politics and Organisation, School of International Studies, Jawaharlal Nehru University, New Delhi.

Chandran Komath is a PhD Scholar in the Centre for Political Studies, Jawaharlal Nehru University, New Delhi.

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Srinivasan, Grover, and Bhardwaj (2005) found

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