The Spectacular, Sudden Crash of the Global Economy

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> The worldwide economic meltdown has sent the wheels spinning off the project of building a single, business-friendly global economy.

Worldwide, industrial production has ground to a halt. Goods are stacking up, but nobody's buying; the *Washington Post* reports that "the world is suddenly awash in almost everything: flat-panel televisions, bulldozers, Barbie dolls, strip malls, Burberry stores." A Hong Kong-based shipping broker told *The Telegraph* that his firm had "seen trade activity fall off a cliff. Asia-Europe is an unmitigated disaster." *The Economist* noted that one can now ship a container from China to Europe for free -- you only need to pick up the fuel and handling costs -- but half-empty freighters are the norm along the world's busiest shipping routes. Global airfreight dropped by almost a quarter in December alone; Giovanni Bisignani, who heads a shipping industry trade group, called the "free fall" in global cargo "unprecedented and shocking."

And while Americans have every reason to be terrified about their own econopocalypse, the *New York Times* noted that everything is relative:

> In the fourth quarter of last year, the American economy shrank at a 3.8 percent annual rate, the worst such performance in a quarter-century. They are envious in Japan, where this week the comparable figure came in at negative 12.7 percent — three times as bad.
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> Industrial production in the United States is falling at the fastest rate in three decades. But the 10 percent year-over-year plunge reported this week for January looks good in comparison to the declines in countries like Germany, off almost 13 percent in its most recently reported month, and South Korea, down about 21 percent.

Chinese manufacturing declined in each of the last five months; according to the *Financial Times*, "More than 20 [million] rural migrant workers in China have lost their jobs and returned to their home villages or towns as a result of the global economic crisis." The UN estimates that the downturn could claim 50 million jobs worldwide, prompting Dennis Blair, the U.S. National Intelligence Director, to warn Congress that, "instability caused by the global economic crisis had become the biggest security threat facing the United States, outpacing terrorism."

Riots, strikes and other forms of civil unrest have become widespread the world over; governments have fallen. In Europe, parties of the far right and left have seen their fortunes rise.

The model of economic globalization that's dominated during the past 40 years is, if not dead, at least in critical condition. Few progressives will mourn its demise -- it was both a proximate cause of the economic meltdown in which we find ourselves today, and one of its victims. But if we are reaching the end of an era, questions arise about not only what will replace it, but also how we'll finance the government spending that most economists agree will be required to stave off a long, painful depression.

Always a Flawed Model

For almost 40 years, smooth-talking snake-oil salesmen in well-tailored suits have pitched the wonders of a globalized economy. Politicians and pundits alike insisted that the wealthy states at the core of that worldwide economy could shift labor-intensive production to the poorer countries at the edges, in search of a cheaper pair of hands and less nettlesome regulations, and that ordinary working people would benefit. Whatever pain Americans might feel as a result of the project was merely temporary "displacement," they argued, and anyway those cheap toys at Wal-Mart more than offset any problems that might come along with the decimation of America's middle class. After all, a little lead never hurt anyone.

The same hucksters sold a similar bill of goods to the developing world. Look outward, they said, build export economies and turn those peasants into factory line workers. Sign treaties forcing governments to let multinationals move goods and capital freely, keep their regulators out of the way of Big Business's profits and prosperity will surely follow. Most governments adhered to this pro-corporate orthodoxy, slashing taxes on foreign companies and scrapping various controls on foreign investment. Largely unregulated "free trade" zones proliferated along the world's significant shipping routes.

The result was an explosion in international trade *and* a distinct increase in economic inequality in both poorer and richer countries.

Among the wealthy countries, nowhere was this truer than in the United States, with its fealty to a mythic "free market" and its elites' scorn for a robust safety net. After union-busting, global trade deals have done the most damage to workers' bargaining power. Whereas companies used to negotiate with their employees in relatively good faith, those negotiations are now overshadowed by the threat -- ubiquitous in labor disputes today -- to simply move the whole plant to Mexico or China.

The result was an *illusion* of prosperity. Corporate profits rose (in 2004, corporate profits took the largest share of national income since they started tracking the data in 1929 and wages took the smallest), and high earners did very well too. When the oil shock hit in 1973, those in the top one percent of the income ladder took in just over 9 percent of the nation's income; by 2006, they grabbed almost 23 percent. In the intervening years, their average incomes more than tripled (Excel file).

The rest of us didn't do as well. In 1973, the bottom 90 percent of the economic pile -- most of us -- shared two-thirds of the nation's income; by 2006, we got half. If you take off the top ten percent of the income ladder, the rest of the country in 2006 earned, on average, 2 percent *less* than they did 30 plus years earlier, despite the fact that the economy as a whole had grown by 160 percent over that time.

But we continued to buy; it's become almost a cliché to say that American consumerism is the engine of the global economy.

How did we do it with incomes stagnating? First, women entered the workforce in huge numbers, transforming the "typical" single-breadwinner family into a two-earner household. (Between 1955 and 2002, the percentage of working-age women who had jobs outside the home almost doubled.)

After that, we started financing our lifestyles through debt -- mounds of it. Consumer debt blossomed; trade deficits (which are ultimately financed by debt) exploded and the government started running big budget deficits year in an year out. In the period after World War Two, while wages were rising along with the overall economy, Americans socked away over 10 percent of the nation's income in savings. But in the 1980s, that began to decline -- the savings rate fell from 11 percent in the 1960s and '70s, to 7 percent in the 1980s, and by 2005, it stood at just one percent (household savings that year were actually in negative territory).

After the collapse of the dot-com bubble and the recession that followed it, the economic "expansion" of the Bush era was the first on record in which median incomes never got back to where they were before the crash. Fortunately for Wal-Mart shoppers, a massive housing bubble was rising. Americans started financing their consumption by taking chunks of equity out of their homes. The result: in 2005, long before the housing bubble crashed, the average amount of equity Americans had in their homes was already the lowest it had ever been.

We hear a lot of chatter about a "credit crunch" being at the root of our economic woes -- that banks aren't lending to otherwise qualified individuals and businesses. The truth, however, is that before the housing (and stock) markets crashed, the average American household already had 20 percent more in debt than it earned in a year.

Already deeply in the hole, when the markets crashed, consumers stopped spending, and that's fueled millions of layoffs, led to a mountain of foreclosures, and left state budgets decimated. The connection between decades of false prosperity, the piles of household debt that resulted, and the degree to which that left American families vulnerable to the bubble's crash is not difficult to see.

Global Illusion of Prosperity

During the "era of globalization," massive increases in trade created a similar illusion of prosperity, masking a long-term decline in real economic growth worldwide.

Much of Asia has become a huge production platform for the West. It's been said, half-jokingly, that the modern global economy works something like this: the U.S. produces pieces of green paper, which it trades to China for the goods lining the shelves of Wal-Mart and Target, the Chinese trade those pieces of paper to the oil-producing states for energy, and the oil producers exchange them with Europe for Mercedes and *foie gras*.

Economist Robert Brenner described a "long downturn" in the world's wealthiest countries, noting that their economies grew by a steady rate of 5 percent or more each year from the end of World War II through the 1960s, but in the 1970s their growth fell to 3.6 percent, and it has averaged around 3 percent since 1980.

But as the social scientist Walden Bello pointed out, even those anemic numbers are misleading. "China's 8-10% annual growth rate has probably been the principal stimulus of growth in the world economy in the last decade," he wrote. Without China's (and to a lesser degree India's) consistent growth rates, global economic expansion has been all but nonexistent.

China became an export engine by keeping wages down through repressive union-busting and by drawing on an almost endless supply of poor rural peasants to work its production lines.

While global trade flows have exploded, much of that trade has been between multinationals based in the advanced economies and their own offshore units. They ship production overseas, but the goods produced end up back in domestic markets; it's a means of avoiding "first-world" wages, public interest regulations and environmental restrictions.

China and the U.S. have developed a precariously symbiotic relationship. As Walden Bello wrote, "With its reserve army of cheap labor unmatched by any country in the world, China became the ‘workshop of the world,’ drawing in $50 billion in foreign investment annually by the first half of this decade.” To survive, firms all over the world, "had no choice but to transfer their labor-intensive operations to China to take advantage of what came to be known as the ‘China price,’ provoking in the process a tremendous crisis in the advanced capitalist countries’ labor forces.”

It was always an unsustainable model; the United States’ annual trade deficit with China -- financed by debt -- was $6 billion as recently as the mid-1980s; by last year it had exploded to *$266 billion*.

Defenders of the global trade regime have long argued that China’s currency will rise in value against the dollar, the trade deficit will shrink, and there will be significant “decoupling” between the two economic powerhouses as a new generation of middle-class consumers in the East Asian countries begin demanding a greater share of all those manufactured goods.

On the surface, it appeared that at least the last part of that was indeed happening. As Bello noted, “To satisfy China's thirst for capital and technology-intensive goods, Japanese exports shot up by a record 44%, or $60 billion. Indeed, China became the main destination for Asia's exports, accounting for 31% while Japan's share dropped from 20% to 10%. China is now the overwhelming driver of export growth in Taiwan and the Philippines, and the majority buyer of products from Japan, South Korea, Malaysia, and Australia.”

But Bello went on to describe that this "decoupling" was also an illusion:

> Research by economists C.P. Chandrasekhar and Jayati Ghosh, underlined that China was indeed importing intermediate goods and parts from Japan, Korea, and ASEAN, but only to put them together mainly for export as finished goods to the United States and Europe, not for its domestic market. Thus, "if demand for Chinese exports from the United States and the EU slow down, as will be likely with a U.S. recession," they asserted, "this will not only affect Chinese manufacturing production, but also Chinese demand for imports from these Asian developing countries."

> The collapse of Asia's key market has banished all talk of decoupling. The image of decoupled locomotives — one coming to a halt, the other chugging along on a separate track — no longer applies, if it ever had. Rather, U.S.-East Asia economic relations today resemble a chain-gang linking not only China and the United States but a host of other satellite economies. They are all linked to debt-financed middle-class spending in the United States, which has collapsed.

We often hear that U.S. consumer spending accounts for 70 percent of the economic activity in the country. Do the math: with 20 percent of the world’s economic activity, U.S. consumers -- most weighed down with stagnant wages and maxed-out credit -- make up about 14 percent of the planet’s economic demand. Add the other affluent countries (which were also heavily invested in our real estate market and related securities), and it’s easy to see why the economic meltdown has grown to global proportions. The dominoes are tumbling.

What’s Next?

International trade existed long before the era of economic globalization, and will continue after its demise. The so-called “free trade” agreements championed by both Democratic and Republican lawmakers, liberals and conservatives alike, for the past few decades was always less about trade than constraining the policy options of governments through treaty.

The one likely bright spot in all this is that the cookie-cutter, one-size-fits-all economic orthodoxy lies in ruins. What will replace it is a question for the long-term.

The more immediate question is two-fold. First, in a global economic crisis such as the one we're experiencing today, where is the engine of rapid growth that might pull the world's economy out of the doldrums? Recessions of recent years -- in the early 1980s, the early 1990s and the early 2000s -- weren't global in nature; rapidly developing economies in Asia and Eastern Europe, and later the rise of the U.S. housing market, pulled the world out of the doldrums. It's difficult to see where that kind of growth might be found today.

And then there is the question of how long foreign investors will continue to run our tab. As Americans' demand for just about everything has tanked, economists from across the political spectrum have called on the government to take up the slack. So we got a big stimulus package -- probably the first in a series -- which will be tacked onto a budget that was already deeply in the red. The hole is cavernous, and we have little choice to dig deeper. In 2008, the official deficit was around $500 billion; the most optimistic projections are deficits averaging around $1.35 trillion in both 2009 and 2010.

In 2006, economist Barry Bosworth testified before Congress that "net foreign lending" had been almost $800 billion in the red -- a negative 7.2 percent of national income. "This degree of reliance on foreign financing is unprecedented," he explained, "but has been achieved with relatively few strains because foreigners perceive the United States as offering safe and attractive investment opportunities."

Right now, foreign investors are still snapping up American debt -- the dollar is seen as a safe haven in turbulent seas. But how long, and to what extent they will continue to do so are crucial questions.

China, with the world's largest foreign currency holdings -- about 70 percent of which is in U.S. treasury bills -- is still buying, at least for the moment. Luo Ping, director-general of the China Banking Regulatory Commission, recently asked, "Except for US Treasuries, what can you hold? Gold? You don't hold Japanese government bonds or UK bonds. US Treasuries are the safe haven," he explained. "For everyone, including China, it is the only option."

But the Chinese are concerned about the stability of their investments. If the U.S. government needs to raise the interest rates on its securities to attract enough foreign investment to cover our shortfall, the value of those T-bills China and other central governments are holding will drop.

Last week, Secretary of State Hillary Clinton acknowledged that the world economy is anything but decoupled, all but begging the Chinese to continue to buy our debt. According to *Agence France Presse*, "Clinton and Chinese Foreign Minister Yang Jiechi largely agreed to disagree on human rights," while "she focused on the need for China to help finance the massive 787-billion-dollar US economic stimulus plan by continuing to buy US Treasuries."

In a moment of clarity -- one that shone a light on the rot of the global economic system that has prevailed for the past 40 years, Clinton explained to the Chinese media, "We have to incur more debt … the US needs the investment in Treasury bonds to shore up its economy to continue to buy Chinese products."

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