# The Global Economic Crisis: How to Stop Sustaining Unsustainability

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**Prepare yourself for the coming global financial meltdown! Soon the U.S. dollar will no longer be the world's reserve currency! Buy gold before it is too late! Open an offshore bank account, get a second passport, and move your retirement fund overseas! Such are the typical injunctions in a growing number of blogs and newsletters by individuals such as Simon Black, Porter Stansberry, Peter McFarlane and others. There is no "recovery"; the United States is headed for another recession, warn financial managers like Pacific Investment Management (PIMCO) founder Bill Gross and NYU economics professor Nouriel Roubini. Others, such as Ed Rapp, a chief financial officer at the construction firm Caterpillar, believes the "prospects for growth in the U.S. economy are improving." While the U.S. economy will probably not grow by more than 2% or 2.5% annually for the next few years, Rapp and other financial advisors are not planning for a complete "implosion," much less the collapse of the U.S. dollar and U.S. economy. Who is right?**

**This article will examine five recently published books in order to answer several questions. How serious is the global economic crisis? Why does debt**

**matter? What caused the 2008 recession? What have been the effects of economic globalization? Is the United States in absolute decline? How should the country deal with a rising China? While John Mauldin's *Endgame* and David Hale's *What's Next?* focus primarily on the fallout of the 2008 recession, future of the U.S. dollar, and economic health of key countries and regions around the world since 2008, Michael D. Swaine's book *Engaging a Rising China* assesses US policies toward China in economic, as well as political, military, and environmental aspects. Political scientists Joseph Nye (*The Future of Power*) and John Ikenberry (*Liberal Leviathan*) explore the changing dimensions of power, the question of the United States' decline, and shifts in the liberal international order. Although all of the authors are cautious optimists about the future of the United States, the economists (Mauldin, Hale, *et al*.) are arguably less sanguine than the political scientists (Swaine, Nye, and Ikenberry).**

**As his book title suggests, Mauldin views the burgeoning U.S. government debt with alarm. As of September 2012, the total U.S. public debt was $16 trillion, or 103% of gross domestic product (GDP). Interest payments on the debt in 2012 amount to $340 billion at an interest rate of 2.13%. Why does debt matter? It "crowds out savings and investments," Mauldin explains (148). "Common sense dictates that your debt cannot grow faster than your income forever" (20). Recently, the U.S. economy has only been growing between 1.7 and 2.5 percent annually and will probably continue at this rate for several years. Full employment in the United States is not possible at such low growth rates (113). By contrast, as several authors note, China's economy has been growing between**

**seven and nine percent per year since Deng Xiaoping's market reforms in the early 1980s (Nye 179; Hale, 10, Congdon in Hale, 245). The IMF predicted that by 2016, China's economy will surpass the U.S. as the world's largest. The three other "BRICs" (Brazil, Russia, India, China), as well as Indonesia grew at rates above 5 percent between 2000 and 2010 (Nye, 167). All of the fifty U.S. states are in debt, and ten U.S. cities have declared bankruptcy since 2008. All states must depend on federal money, since – like the individual Eurozone countries – they cannot print money on their own (189).**

**Meanwhile, the government debt is growing at an increasing tempo. As Mauldin avers, Washington is not paying down the debt, but simply printing more dollars and "rolling" the debt -- issuing new debt to pay off the old in classic Ponzi scheme fashion (198). Given the current entitlement programs (Social Security, Medicare, Medicaid), the U.S. government cannot reduce debt levels meaningfully. Linked to inflation rates, such programs cannot be inflated away. The baby boomers in the U.S. (about 79 million people) have begun to retire and will rely heavily on such programs. Studies show that older people are also the most consistent voters. "Touching Social Security, Medicare, and health care is the political third rail," Mauldin notes. "You will get elected only if you do not touch them" (188). Indeed, the Social Security fund is already bankrupt; it merely consists of IOUs from the federal government (the so-called "intragovernmental debt").**

**Although Mauldin is vague on this point, "endgame" is presumably when bond buyers, including foreign investors, lose faith in the United States' ability to**

**pay back the money and either stop buying bonds or demand higher yields (interest rates on their loans). Mauldin writes, "The point of no return for countries is when interest rates rise faster than their growth rates. At that stage, there is no hope of stabilizing the deficit." (111). For the first time in history, the U.S. lost its top-tier AAA credit rating from Standard and Poor's on August 5, 2011, which will make it more expensive to borrow money in the future.**

**Mauldin's book consists of fifteen chapters and is divided into two parts. The first part analyzes the "end of the debt supercycle." Mauldin explains the causes of the 2008 recession in simple terms. After the "dot-com" bubble burst in 2000, the Federal Reserve lowered interest rates to historical lows. With Alan Greenspan as the Chairman of the Federal Reserve, a lax atmosphere prevailed (22). Since there was so much money ("liquidity") available, financial institutions offered more loans and mortgages to borrowers who would otherwise have been denied credit. These "sub-prime mortgages," because riskier, yielded higher interest payments for the banks. As long as the economy grew and the real estate market expanded, housing values rose. Borrowers could easily tap into the equity in their home, summed up in the saying "My home is an ATM machine," (Kaletsky in Hale, 80). Investment bankers devised ways to "securitize" mortgages (pool them together) so they could be sold off to other financial institutions and investors in a secondary market around the world. Debt became just another consumer product. However, when interest rates began to rise in 2004, eventually to 5.25% in January of 2007, fewer people could afford to buy houses, thus the real estate market slowed, borrowers could not make house payments and lenders**

**(banks) repossessed their houses (foreclosure). The "shadow banking system" ended on August 9, 2007, when Bank Paribas "could not value the mortgage assets in three of its off-balance sheet vehicles" and "liability holders were frozen." This "kicked off a run on the shadow banking system," culminating in the largest bankruptcy in U.S. history ($600 billion) - that of the New York investment bank Lehman Brothers on September 15, 2008. (Mauldin, 23)**

**The second part of the book assesses the economic health of other countries, posing the question "who will face endgame first?" Other than the U.S., the countries hit the hardest after the 2008 recession were Great Britain, Japan, the Eurozone and other European countries, and the Baltic states. Australia, Canada, much of Latin America and Africa were less affected and recovered more quickly.**

**David and Lyric Hales' edited book *What's Next?* consists of 23 essays written by prominent independent analysts. Like Mauldin, the authors examine the future of the U.S. dollar and compare the economies of several countries and regions, but they also ponder the effects of globalization, the energy market, Iranian politics, policy issues such as financial regulation, climate change, and the "diminishing returns of information technology." While the fearmongers mentioned in the beginning of this review routinely lambast Federal Reserve Chairman Ben Bernanke's policy of money printing ("quantitative easing") as an inflationary trigger, analysts like Anatole Kaletsky praise the policy as "pragmatic." Since 2008 "monetary policy in Europe by contrast has been much tighter and less pragmatic"…. thus Europe's recovery will be slower than in the**

U.S. (Kaletsky in Hale, 72). Mauldin, too, points out the benefits of monetizing the debt. Strict fiscal policies can lead to deflation. Citing American neoclassical economist Irving Fischer, Mauldin writes: "The definition of debt deflation is when everyone in a market tries to reduce debt, which results in distress selling. This leads to a contraction of the money supply as bank loans are paid off. This in turn leads to a fall in the level of asset prices and a still greater fall in the net worth of businesses, precipitating bankruptcies, a fall in profits, and a reduction in output, trade, and employment. This then leads to a loss of confidence, hoarding of money, and a fall in nominal interest rates" (139). Central banks would rather have inflation than deflation, Mauldin observes (162, 230). In fact, there are very "few examples of deflation after 1948 or 1971." Mauldin believes that the Great Depression (1928-1936) could have been avoided had the U.S. not adhered to the gold standard and instead simply increased the money supply (217). If Bernanke had not increased the money supply significantly in 2008, the U.S. economy would have plunged into a much deeper recession, he posits (146).

What is the link between economic globalization and the current global sovereign debt crisis? Globalization, explains Louis-Vincent Gave in chapter six, ushered in a period of "unprecedented stability in inflation, unemployment, and economic cycles" (Gave in Hale, 79). Three critical harbingers were the breakup of the USSR, China's membership in the World Trade Organization (WTO) in 2001, and the end of proxy wars between communism and capitalism in the developing world. Considering the current fury of many Americans at what they term China's "mercantilist policies," it is ironic to recall how arduously both the

Clinton and George W. Bush Administrations worked to get China to join the WTO, hoping U.S. corporations could profit from trade and investment in China's vast market (Swaine, 371). As Kaletsky explains, the "entire world economy moved toward a NAFTA-style free trade area." The process of globalization "transferred many manufacturing industries from the advanced economies to the developing world where labor was cheaper" (Kaletsky in Hale, 79). The greater stability created by globalization, according to Louis-Vincent Gave, gave businesses and consumers the confidence to borrow more than ever before, and banks were more willing to lend (Gave in Hale, 79). The good news for American workers is that the paradigm is now shifting in Asia, as Chinese labor costs slowly rise. Manufacturing will gradually return to the U.S. as corporations find it less cost-effective to operate in China (Gave in Hale, 85).

The contributors to *What's Next?* go into more detail about why countries like Australia, Canada, and most Latin American and African countries did not suffer in 2008-2009 as much as did the U.K., Japan, the Baltic States, and the Eurozone countries. In chapter eleven, for example, Saul Eslake explains that Australia's housing market was more "resilient." The Australian economy contracted "only in the fourth quarter" of 2008, but it "did not experience a recession in the sense of consecutive quarters of negative real GDP growth" (Eslake in Hale, 141). Factors in Australia's favor for avoiding a recession include the lessons learned from the Asian crisis of the early 1990s; its banks' minimal exposure to the "toxic assets" in U.S. and European banks; its export of mostly commodities; and its strong trade partnership with China. Moreover, as in

**Canada, Australian citizens are motivated to pay off their mortgages quickly, since they cannot deduct mortgage interest payments on their annual tax returns as Americans can (Eslake, 144-5). Mauldin, by contrast, warns that Australia may suffer from a slowdown in the Chinese economy and that its "housing bubble" may soon burst (281).**

**The reason the United States has been able to print massive quantities of dollars is because the U.S. dollar is currently the world's reserve currency. There is a strong demand for the dollar around the world, because other countries must buy dollars first in order to buy commodities like oil. While Mauldin and Ikenberry ignore this issue, John Greenwood, Nye, and Swaine (in passing) address it. Greenwood, chief economist at the Invesco financial services firm, argues that the dollar will remain the world's reserve currency for "many years," simply because there is no other pragmatic alternative. An international reserve currency must meet certain criteria. It must be circulated in a well-developed financial system and be fully convertible, widely available outside the host country, and supported by a large economy that is preferably in a creditor nation (Greenwood in Hale, 155-7). While the Chinese *renminbi*-based economy is certainly large, the *renminbi* – also called by its basic unit, the yuan - is still not wholly convertible and its capital markets are underdeveloped (xxiv, 163-4). Nye writes that China "is not willing to take the risks of making its currency fully convertible because of domestic political reasons" (57). Keeping the yuan artificially low also makes Chinese exported goods cheaper for foreign customers.**

**The euro, on the other hand, is still not fully competitive, because there is no market for European government debt at large; one must choose the debt of individual Eurozone members. Given the low yields on Japanese yen-denominated bonds and growing concern about Japan's creditworthiness, the yen is also not viable. The synthetic basket of currencies - "special drawing rights" (SDRs) - issued by the IMF are also not practical, given fluctuating interest rates and the fact that most traders prefer to deal in a single, easily convertible, currency. Like Greenwood, Nye believes that the U.S. dollar will remain the world's reserve currency for the "next decade or longer" (i.e. until 2020).**

**These authors may be overconfident. One should not ignore the fact that states like China, Russia, Iran, Brazil, and India have already begun to trade among each other in their own currencies. During their first summit meeting in June 2009, foreign ministers from the BRIC countries met in Yekaterinburg, in the Urals region of Russia, to discuss *inter alia* ways to reduce dependency on the U.S. dollar (Nye, 167). As Swaine notes, China's successful weathering of the global financial crisis has led to more resolve in some areas - for example, in bold calls for a move away from the dollar standard (39). Later, in February 2010, irate Chinese military officers proposed selling off U.S. government bonds later after the Obama Administration sold weapons worth $6 billion to Taiwan (Nye, 57). Beijing also abhors the U.S. Federal Reserve's money printing since it lowers the value of the U.S. dollar, hence diminishing the total value of the dollar reserves held by the Chinese.**

**However, as noted, economic globalization has made nation-states highly interdependent. While China can threaten to sell all or parts of its U.S. dollar-denominated debt holdings and call for a new global currency, its finance ministers know that if they did so, U.S. interest rates would rise, slowing U.S economic growth even more drastically, and greatly reducing Americans' demand for Chinese goods. Nye has likened this "balance of financial terror" to the Cold War nuclear balance of terror between the U.S. and USSR, but the analogy is not entirely correct (56-7). China can – and is – gradually reducing its dependence on the American consumer market by developing new markets in Latin America, Africa, Asia, and the Middle East (Swaine, 73, 189).**

**How should the United States deal with a rising China? According to Swaine, economic globalization is one of "three sets of variables" (along with China's growing power and nontraditional security threats) that are "reshaping the assumptions that have previously shaped Washington's policy toward Beijing" (xiv). In ten chapters, Swaine covers all key areas of U.S. relations with China. His research is based on interviews with over fifty policymakers conducted between 2008 and 2010, including Harvard professor Joseph Nye, who served as chairman of the National Intelligence Council and later assistant secretary of defense for international security affairs (1993-1995). Readers may find it difficult to discern Swaine's own opinions, due to his circumspect and verbose writing style. The book is largely a collection of different viewpoints, peppered with numerous qualifying expressions. If this reader understands correctly, Swaine argues that, given the new realities – the U.S. as the largest debtor nation in the world and China**

**conversely as the largest creditor nation – the U.S. "might not have the economic capacity" to "maintain military predominance in the Western Pacific and especially along China's periphery." Moreover, "China might not continue to accept this predominance" (342-3). Washington should downplay its emphasis on human rights and "democracy promotion", which the Chinese view as interference in their internal affairs, and focus on the two countries' largely common goals. The Chinese claim to strive toward a "mutually beneficial, win-win cooperative pattern" [*huli shuangying de hezuo geju*] (32).**

**Taiwan is arguably the most contentious issue in U.S.-Chinese relations (85). Here, too, Beijing would prefer to move gradually toward a negotiated reunification rather than to employ force (37). Ever since the negotiations in 1972 between Nixon and Mao Zedong, the U.S. has officially endorsed the "One-China" policy, stating that there is only one China and that Taiwan is a part of China. In 1979 President Carter formally recognized Beijing as the sole government of China and closed the U.S. embassy in Taiwan. In 1980 the US-Taiwan Mutual Defense Treaty of 1954 was abrogated. The U.S. nevertheless maintains unofficial relations with Taiwan and has pledged – in the 1979 Taiwan Relations Act - to assist Taiwan in maintaining its defensive capability. This act does not, however, require the U.S. to intervene militarily if Beijing attacks or invades Taiwan. Swaine argues that China's growing military leverage vis-à-vis Taiwan makes this current "hands-off stance toward the Beijing-Taipei relationship" unsustainable (15, 360). According to polls, Americans view the Taiwan issue as the least critical to U.S. national interests and would not support the use of American troops to**

**defend Taiwan (361). China is the largest foreign holder of U.S. debt (about $1.1 trillion) and thus holds great leverage over the U.S. It seems irrational for the U.S. to use that borrowed money to vex China further by arming Taiwan. The counterargument is that if Washington "abandoned" Taiwan, other traditional Asian allies of the U.S., such as Japan and South Korea, would lose faith in the U.S. to protect them militarily. However, China is now by far both Japan's and South Korea's largest trading partner, and Taiwan's largest export partner. Do they really need to be "protected" against China? Unfortunately, Swaine ignores the influential role of U.S. defense industry lobbyists (e.g. Boeing, Honeywell, Northrop Grumman, and others) on U.S. policy toward Taiwan.**

**Swaine warns against the "dangerous zero-sum mindset" he sees "growing in the defense communities" in both countries, leading some U.S. analysts to "assert the need for the U.S. to maintain clear predominance over Beijing at whatever cost" (16). Given America's worsening economic plight, this approach could be "self-defeating" and "even spur Chinese efforts to challenge US military capabilities on issues such as Taiwan" (16). Washington policymakers should eschew such zero-sum thinking, Swaine writes, and instead try to incorporate China further into bilateral and multilateral organizations (16). In contrast to the George W. Bush Administration, which called China a "strategic competitor," Washington should encourage China to behave as a "responsible stakeholder."**

**Not surprisingly, considering that he was one of Swaine's interviewees, Swaine's views about coopting China into the existing liberal world order are also reflected in Nye's book, *The Future of Power,* as well as in Ikenberry's *Liberal***

***Leviathan*. Nye organizes his study into three parts: types of power (military, economic, and "soft"); power shifts: diffusion and transition; and policy ("smart power"). He devotes chapter six to the question of American decline. After probing the possibility of both "imperial overstretch" and "domestic underreach," he nevertheless comes to an optimistic conclusion. The rise of China should not scare us. The U.S. is not in absolute decline. "Nations are not like humans with predictable life spans." (xii). "Power is like calories in a diet; more is not always better" (207). "War between a state with preponderant resources and a rising power" is not "inevitable" (154). Indeed, Great Britain managed the rise of American power peacefully a century ago. Americans have gone through moods of "declinism" in the past. After Sputnik in 1957, they feared the Soviets; during the oil shocks in the 1970s they feared the Iranians; in the 1980s it was the Japanese, and today it is the Chinese. He states confidently: "The U.S. is unlikely to decay like ancient Rome or even to be surpassed by another state, including China." And, "even if Chinese GDP surpasses that of the U.S. around 2030, the two economies would be equivalent in size but not in composition" (234, 180). The country has a vastly underdeveloped countryside and will have limited "international influence" as long as it "fails to evolve an attractive political system" (183). There are two kinds of decline, absolute and relative. The U.S. still has "soft power," which Nye defines as the ability to get what we want by attracting others, rather than by threatening or paying them. The U.S. has some of the best universities, spends more on research and development, participates in numerous international NGOs and leads in information technology,**

**biotechnology, and nanotechnology (192). Hence, it is not in absolute decline, Nye explains.**

**This discussion of American soft power, although persuasive, is largely abstract. Nye does not cite any international opinion polls, other than the BBC poll conducted in 2010. He mentions this poll to demonstrate the neutral or negative view of China, but omits to mention that, according to that poll, the U.S. is also not among the most favorably viewed nations in the world. Germany got the highest rating (an average of 59 percent positive), followed by Japan (53 percent), Great Britain (52 percent), Canada (51 percent), and France (49 percent). An average of 46 per cent viewed the U.S. as having a mostly positive influence in the world, while an average of 41 per cent believed China has a mostly positive influence in the world.**

**Moreover, the discussion of soft power – the power of persuasion – to some extent sounds like a rationalization. There are many forms of power, so it does not matter if U.S. *economic* power is declining, because we have *soft* power. As he rightly points out in his conclusion – citing Eisenhower's famous warning – the "strength of the American economy undergirds military strength" (229). However, we should remember that economic power also undergirds soft power and all technological innovations. Without adequate funding, the U.S. sooner or later will lose its competitive edge in the abovementioned technologies.**

**Like Nye, Ikenberry in his book *Liberal Leviathan* decries the errors of the Bush Administration's unilateralism. "The Bush experience shows that the**

**world's leading state can break out of institutional and normative constraints - even those that it itself has helped create - but that there is a price to be paid for it." (30). "[U]nder Bush's watch, the US turned itself into an empire. The US coerced more than it led" (xii). Ikenberry takes a more historical and theoretical approach than do the other four books. In part one he examines power and the varieties of order, including unipolarity and its consequences. Part two traces the rise of the "American system." One of the "great dramas" of world politics over the past two hundred years has been the "rise of liberal democratic states to global domination" (1).**

**Ikenberry also reaches an upbeat conclusion. The Westphalian liberal international order itself is not threatened, only America's leading role in it. We are experiencing a "crisis of authority." New centers of power have emerged, led by countries like China and India, but since they do not challenge the "deeper logic of open and loosely rule-based international order" – as, for example, Hitler, Mussolini, Lenin and Stalin did in the 1930s and 1940s – they are not security threats. The U.S. must simply "renegotiate" and share authority with the other key stakeholders (6). The liberal international order has overcome crises in the past and evolved as a result; it can do so again. Washington should respond to the rise of China by "strengthening the rules and institutions of the liberal international order" (356) Ikenberry calls for a new "grand strategy" and lays out general priorities. His primary focus is on political principles and values, not economic realities.**

**Financial sector practitioners challenge this rosy thesis. The global financial crisis today is unprecedented and has shattered conventional wisdom about global governance. "The Westphalian system of national sovereignty and voluntary cooperation is cracking at the seams in this highly interconnected and interdependent world," claims Andrew Sheng, former chairman of the Hong Kong Securities and Futures Commission (Sheng in Hale, 252). "We have a global economy without a corresponding global monetary policy, global financial regulation, or global fiscal system." No country can tighten monetary policy alone "for fear of inviting hot money that negates the policy." Likewise, no country can "tighten financial regulation for fear that businesses will relocate to other financial centers." Global financial institutions are larger than sovereign nations, but ineffectively regulated at national levels, unchecked by any global laws. When the banks fail, nation-states have to pay for their mistakes. The "whole world suffers in the form of higher inflation, near zero interest rates, increased taxation, and lost jobs" (252). This disjointed regulatory environment, Sheng warns, has led to excess consumption that exacerbates global warming, as the recent increase in typhoons, floods, earthquakes, and droughts attest.**

**Persistent problems, which Ikenberry omits to mention, include the distorting role of lobbyists on U.S. policymaking through campaign donations and domestic political gridlock that prevents Republican and Democratic parties to work toward common national goals. Many defense analysts, for example, are calling for greater military spending to counter a rising China, as if no economic crisis existed. According to a survey of war veterans in July 2012, 72 percent cite**

**economic weakness (42 percent) and the national debt (30 percent) as the top threats to national security, *not* the rise of China. According to another analyst, China owns so much U.S. debt that the interest income alone that it receives from the U.S. Treasury Department is nearly enough to fund China's entire military budget.**

**What should we do? Both Nye and Ikenberry provide only normative templates for a possible grand strategy Washington should pursue. Some of the contributors in Hale's book suggest specific tactics. Sheng advocates a "turnover tax" (user-pay tax); Jack Mintz recommends more excise taxes and a VAT (general sales tax) for the U.S.; and Carole Basri provides a checklist for greater transparency and regulation in financial sectors (253, 262, 280). Tim Congdon argues that central banks should boost their quantity of money, since the biggest threat to recovery is not inflation but deflation (248). Mauldin offers a more comprehensive series of recommendations and practical ways to implement them: 1) target legal immigration; 2) reduce dependence on foreign oil; 3) increase taxes, but in a strategic way that does not penalize private businesses that create jobs; and 4) compete globally to attract foreign businesses (208-214). Mauldin proposes a "glide path option," whereby the U.S. government reduces the deficit by $150 billion a year over a period of five or more years, tolerating high unemployment, which would then persuade creditors to continue lending to the U.S. (206).**

**All five books are useful and well-researched. Evaluated for scope, timeliness, readable and cogent prose, and use of concrete examples to illustrate abstractions, the books by Nye and Mauldin rank the highest and would fit best in**

**undergraduate courses. Ikenberry's book is highly abstract and best suited for graduate students and academics. Hale's book sorely lacks a concluding chapter to unite the disparate essays, some of which are written for specialists (Bressand), too broad in scope (Jefferis), or lack a clear thesis and relevance to the book's central purpose (Safavi). Although thorough, Swaine's book reads like a dry policy report with many bulleted lists of variables and policy objectives. One half of the 671-page book consists of footnotes and the font is abnormally small.**

**In some respects, Simon Black and Porter Stansberry are correct: repeated money printing and rolling the debt is merely sustaining what is unsustainable. "Kicking the can down the road" will ultimately destroy the U.S. dollar and economy. However, fearmongering about the "end of America" or the rise of China is just as dangerous as complacency about American superiority is. "Belief in the inevitability of conflict can become one of its main causes," Thucydides warned (Nye, 179). Just as the persistent thoughts of an individual shape his or her reality, so the predominant thoughts of a nation's citizens shape the nation's destiny. Solutions to the crisis do exist if we will only unite as a global community to think constructively and creatively in a spirit of cooperation, not competition.**

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