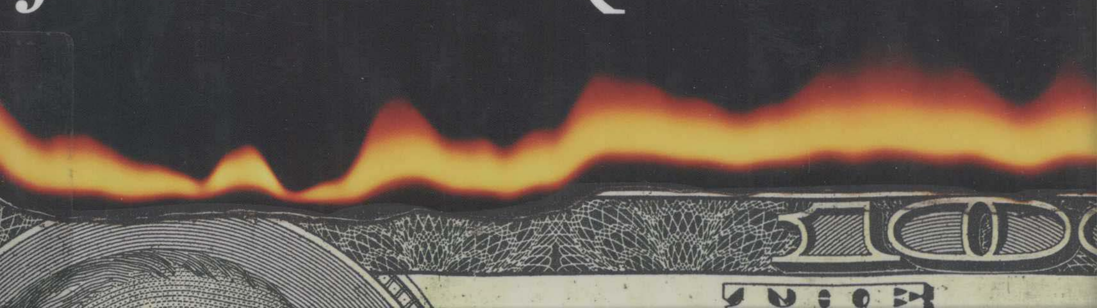
THE LAST ECONOMIC SUPERPOWER

The Retreat of Globalization, the End of American Dominance, and What We Can Do about It

JOSEPH P. QUINLAN



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The Beginning of the End

The last economic superpower went bust in September 2008. The financial tsunami that swept over Wall Street that month not only laid waste to venerable institutions like Lehman Brothers and battered the reputations of Goldman Sachs, Morgan Stanley, and other financial stalwarts, but the "Made in America" crisis also undermined the capacity and credibility of the world's last economic superpower—the United States. After years of living beyond its means and after amassing mountains of debt, the music finally stopped for a country that had long set the tune for the global economy and grown accustomed to standing at the pinnacle of the global economic order.

The epic U.S. housing boom and bust—and all the sordid auxiliary details associated with subprime mortgages and toxic derivatives—culminated in one of the worst financial crises in U.S. history. As fear and panic spread in September 2008, the world watched in stunned horror as U.S. banks folded, shotgun corporate marriages were hastily arranged on Wall Street, and the free-market-touting U.S. government was forced to bail out or take control of one financial institution after another. More worrisome, the pain was not contained to the United States. Given the financial hardwiring of the global economy, the aftershocks of Wall Street's financial meltdown spread far and wide, inflicting pain on tiny villages in Norway, German banks, Spanish homeowners, South Korean utilities, and many other parties. In the ensuing months, global economic activity collapsed. World trade and investment plunged, while the rate of global unemployment soared, triggering a mad scramble among governments "to do something" to stave off another Great Depression.

It was a humbling and humiliating moment for the United States—the chief architect of the global economy and long-time champion of globalization. In the quarter century leading up to the financial crisis, most of the world had few qualms with a global economy largely groomed and managed by the West, principally the United States. Most of the world also had little resistance to the central tenets of globalization—namely industry deregulation, unfettered global capital flows, trade and investment liberalization, and the primacy of the private sector. This acceptance was underwritten by superior results. From the early 1980s forward, the global economy experienced a blessed period of muted inflation, low unemployment, and infrequent and shallow recessions. Global trade and investment rose sharply over this period. The integration of China, India, and Russia into a world economic order structured and headed by the United States helped lift millions out of poverty. There were periodic financial crises during this period, but they were never at the core of the global economy—or the United States.

As the last decade rolled on, the U.S. economy seemed to be indestructible, quickly rebounding from the dot-com bust early in the decade and then the shocking events of 9/11. Against this backdrop, the world became more and more dependent on the

U.S. consumer in particular and the U.S. economy in general for growth. Early in the 2000s, the United States, with just 4.5 percent of the global population, accounted for nearly one-fifth of total world imports. Such was the outsized influence of the U.S. consumer on the rest of the world. Meanwhile, with the world's largest and deepest capital markets, Wall Street was at the epicenter of global finance and set the tune for the global capital markets. Concurrently, Japan's economic might continued to fade in the first decade of this century, while Europe struggled to generate sustained growth. China was emerging but had yet to arrive. America was the world's sole economic superpower as the new century commenced.

Those days have passed, however. The events of September 2008 not only decimated the portfolios of investors all over the world but the "Made in the U.S." financial debacle also demolished America's ability and authority to lead the global economy. As details have emerged of lax U.S. financial regulations, bogus credit ratings, sloppy risk management, excess risk taking by U.S. households and Wall Street firms, these unflattering truths, juxtaposed against the crumbling finances of the U.S. government, have converged to jeopardize the long-term growth of the U.S. economy and undermine the global attractiveness of the U.S.-led capitalist model. The world no longer dances to the tune of the United States. The U.S.-centric global economy of the past three decades is being reshaped. New economic powers are on the ascent—led by nations like China, India, Brazil, and Turkey, for instance—with these emerging players less inclined to follow the global rules laid out by the United States and the West. The developing nations, or "the Rest," have their own ideas about how the global economy should be managed.

The financial crisis of 2008 was a circuit breaker—the global financial meltdown broke the supposed inexorable advance of free-market capitalism, throttled the primacy and influence of global finance, and undermined the economic superpower status of the United States. In another sense the crisis accelerated a number of key long-range trends that were already in motion before the crisis struck. The relative economic decline of the developed nations and the rising influence of the emerging markets in general and China in particular were fast-forwarded by the crisis and have, in turn, accelerated the move toward a less U.S.-centric, more multipolar world.

This new world will be more complex, fluid, and disruptive, notably for the architects and standard bearers of the postwar economic system: the United States, Europe, and to a lesser extent Japan. In the years ahead, global power and influence will be more diffused among nations and regions, making it more challenging to coordinate and craft solutions to pressing global problems. The era in which a handful of nations could meet for a weekend and set the global economic agenda for the rest of the world is over. The new era will require far-reaching adjustments for those nations in decline and for those on the ascent. Becoming more acclimated to a new multipolar world will challenge not only nations but also key postwar multilateral institutions like the United Nations Security Council, International Monetary Fund, World Bank, and other Western-dominated institutions that have long held sway over global economic governance. Invariably, these institutions will have to yield more to the aspirations of the developing nations and their strategic interests in order to remain relevant.

In the end, as the following pages discuss, the financial crisis of 2008 was a tipping point. A messy multipolar world is upon us, one that will further erode the economic superpower status of the United States and one if improperly handled that will result in an economic cold war between the developed and developing nations. The latter represents the worst-case scenario. A more benign and favorable outcome could still emerge from the crisis if the United States, Europe, China, India, Brazil, and others can foster a climate of cooperation and agreement. Globalization is in retreat but need not cease to exist if the main economic players in a multipolar world can forge commonalities and subsume national interests for the global good. That is a tall order but not an impossible outcome.

PLAN OF THE BOOK

Chapter 1 discusses the rise of globalization since the collapse of the Bretton Woods system and highlights how globalization was kick-started by the liberalization of global capital markets. Money makes the world go round, and as capital flows became less constrained and more liberated over the past quarter century, the globalization of the real economy took hold. Cross-border trade and investment soared as the world economy, lead by the United States, was stitched closer together.

Well before the great financial meltdown of 2008, however, multiple warning signs suggested that all was not well with the uber-charged U.S. economy. The key metrics that were flashing red are examined in Chapter 2, while the financial meltdown and its aftershocks are the main topics of Chapter 3.

The messy, multipolar world of today is examined in Chapter 4. This chapter discusses five seismic trends that will test America's ability to adapt and thrive in the world of tomorrow: the advent of the G-20 as the world's new steering committee; the shift in the "commanding heights," or the rise of the state at the expense of the private sector; the rise and accelerating pace of regionalism; the arrival of Brazil on the global stage; and

China's economic emergence and the implications for the mainland and the world economy.

Chapter 5 examines the exhausted finances of the United States. A creditor nation in the mid-1980s, America is now the world's largest debtor nation, a situation that will greatly handicap the U.S. economy and its global influence for a long time to come. How did we get here? What caused America's finances to implode during the first decade of this century? America looks more and more like a financial cripple owing to the untimely convergence of two wars, the financial crisis of 2008, and soaring entitlement liabilities. The bill from each one of these factors, according to various estimates, is at least $1 trillion, and counting.

The fading appeal of Europe and Japan, and the implications for the United States, is the subject of Chapter 6. The twilight of Europe and Japan and their diminished capacity to affect the global agenda is just as important as the much told story of the rise of China and India. Their decline coupled with America's increasingly exhausted resources means that the most important forces that had been driving globalization forward for the past three decades have been crippled, leaving the fate of globalization much in doubt. America's ability to shape the global agenda in economics, foreign affairs, and other key multilateral issues has been increasingly compromised by politically weak and economically stagnant allies who have in turn lost faith in America's ability to lead.

Chapter 7 highlights and discusses the new power brokers in action—or how states like China, Brazil, and others are reconfiguring and reshaping the global economy. The chapter analyzes how the world's most critical inputs—natural resources, capital, and labor—are under the increasing control of the developing nations, and the mounting tensions that are expected to arise as a result of these circumstances. In particular, the chapter examines the new mindset and goals of corporations from the developing nations, many of which are determined to increase their market presence in the United States and Europe. Global mergers and acquisitions are no longer the exclusive domain of the developed nations; new corporate players from Brazil, Turkey, and India, for instance, are spreading their corporate wings, creating a great deal of angst and anxiety in the West. Simultaneously, at the precise moment that many Western firms need access to the markets and resources of China, Brazil, India, and other emerging markets, the latter have become a great deal pickier and choosier about foreign direct investment from the West. In the end, consumers, natural resources, capital, talent—most of the critical inputs to economic growth now lie outside the control of the United States, an unfavorable turn that has helped undermine America's economic superpower status. There is nothing "super" about an economy that is overly dependent on other people's oil and natural resources, deep in debt to the rest of the world, and increasingly reliant on emerging market consumers in the face of stagnant and mature markets at home.

Chapters 8 and 9 peer into the future and discuss the two paths before the United States and the world economy. Given the dramatic changes that have overcome the economies of the West and the Rest, we face two potential scenarios: the first scenario centers on an economic cold war between rich, developed nations and poor, developing nations.

In this first scenario, the subject of Chapter 8, the United States and the developed nations, rather than adjust to a new global landscape and accept their diminished relative role in the world economy, deny reality and cling to the old order. The policies and structures of the past, however, are unacceptable to the developing nations who feel that the time has long passed for the rich to lead and the poor to follow. As a result, tensions rise between a U.S.-led developed nations bloc and a China-led developing nations cohort. Growing worker discontent and rising nationalism and xenophobia in both the developed and developing nations trigger various forms of protectionism, entangling the global economy in a web of regulations and cross-border barriers that inhibit the unfettered flow of people, goods, and capital.

Economic nationalism becomes rampant around the world. Defending globalization becomes the best way to lose political legitimacy and power at home. Tensions reach a breaking point, and an economic cold war breaks out, fragmenting the global economy and all but ending the current phase of globalization. In this world, global reregulation replaces deregulation. The private sector takes its cue from the public sector—politicians—rather than the market. Banks effectively become utilities, or risk-averse institutions whose principal mandate is to support the local and national economy. Cross-border capital flows are restricted; capital is again "caged," hindering growth in world trade and investment. Multinationals are politically browbeaten to become more local, less global at home, while given the cold shoulder overseas, impairing their global reach and their global earnings. This, along with a rise in tit-for-tat trade and investment protectionism, leads to a reduction in global trade and investment. Consumers are big losers, with rising trade barriers and the hoarding of resources resulting in higher prices for food, energy, and other staples. Global capital markets swoon as investors take cover. All told, the global economy sputters to a halt and enters a prolonged period of slow or no growth.

The second scenario, the subject of Chapter 9, is the reincarnation of globalization. Under this scenario, the West and the Rest come to recognize their mutual interdependence and move down the path of mutual cooperation, not competition, on a number of fronts. With an effective G-20 governing the global economy, with the United States and Europe accepting and adapting to their diminished role in the world, and with key developing nations becoming real global stakeholders, a new era of globalization is possible. Joint global stewardship will be required—not just between the United States and China, but also from Europe, Russia, Brazil, and key nations in Africa and the Middle East.

While the financial crisis of 2008 has thrown parts of globalization into reverse and undermined the economic superpower status of the United States, a more robust and inclusive global economy could still emerge in the years ahead. We have reached the end of globalization as determined and designed by the United States but not the end of globalization if America and the West can embrace a new configuration with different characteristics—Chinese, Indian, Brazilian, Egyptian, and many others. This represents a significant challenge to a country that likes to think of itself as "indispensible," and one that is long accustomed to sitting at the head of the table, giving orders, not taking them.

The challenges in front of China, India, Russia, and other key developing nations are no less daunting. Having arrived on the global stage, are these nations ready to assume the mantle of global leadership? Will they be willing to subordinate national self-interests for the good of the global common good when it comes to tackling weighty global issues like climate change, the proliferation of nuclear weapons, and aid and development for the world's poorest nations? The answers to these questions are unclear. What is clear is that the aftershocks of the global financial crisis present a golden opportunity for the world's leaders to recast, reinvent, and reenergize globalization.

Only time will tell whether or not the world economy is heading for an economic cold war or about to chart a new course toward greater globalization. *The Last Economic Superpower* lays bare the challenges in front of the United States. How the story ultimately ends remains to be discovered.

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Globalization's Comeback

The decamping of the state from the commanding heights marks a great divide between the twentieth and twenty-first centuries.

—Daniel Yergin and Joseph Stanislaw, *The Commanding Heights*

Disillusionment can be a great motivator. Make enough people miserable, drain their hopes for the future, sap their confidence, and the result is an ideal prelude for change. During the 1970s the United States suffered two oil shocks, soaring prices, two economic recessions, declining productivity, and the demoralizing effects of stagflation—high inflation-cum-high unemployment. Against this ugly backdrop, the political and economic scars the decade left on the United States were deep enough to set off a global revolution.

The seminal event that started the 1970s downturn came from halfway around the world. Up until the early 1970s, the United States had been the unchallenged leader of the free world, and times were so good after World War II that the 1950–1973 period is often referred to as the "golden era." As the label implies, the two decades following the war were a time of strong global growth and development thanks to U.S. economic aid and leadership (a.k.a., the Marshall Plan), and the successful rebuilding of war-torn Europe and Japan. By the time the 1970s rolled around, all the major economic players before the war had recovered from the ravages of conflict.

The good times ended when a group of developing nations decided to exert their collective might against the West. On October 16, 1973, the Organization of Petroleum Exporting Countries (OPEC) announced that it was raising the price of oil by 70 percent. This body blow from the Middle East suddenly upended a near quarter century of prosperity and growth for the United States and many other nations. Soaring oil prices stunned the fossil-fuel-dependent West and brought economic growth in the United States and beyond to a grinding halt.

In the ensuing months, prices soared, and the unemployment lines lengthened. Those weren't the only lines. Soon long lines of cars were winding into gasoline stations across the nation, an outcome of gasoline shortages. To make ends meet, many U.S. households that had grown comfortable with a single wage earner found they needed two incomes to keep up with the rising price of food, energy, and other staples. Relatively tame over the 1960s, the U.S. inflation rate surged from 3.4 percent in 1972 to more than 12 percent by 1974. Not surprisingly, investors took fright of the shifting economic landscape, and by the end of that year, the Dow Jones Industrial Average was down by roughly 40 percent from the levels at the end of 1972.

In such an environment, the misery index—a figure that simply combines the rate of inflation with the unemployment rate—gained national prominence. The index spiked to nearly 18 percent in 1975 as prices continued to soar and the number of idle workers increased. Jimmy Carter pounded the point over and over during the campaign of 1976, helping him win the presidency.

Popular discontent stoked skepticism over the government's role in the marketplace, undermining support for government