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Overview

The Global Economic Crisis and U.S. Power

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EXECUTIVE SUMMARY

This chapter examines both the effect of the global recession on the prospects of capitalism remaining the predominant mode of economic organization and the impact of the downturn on U.S. power and hegemony.

MAIN ARGUMENT:
Although the current capitalist system is acutely susceptible to crises, capitalism as a model of economic organization has been far from irreparably harmed by the current economic crisis. Instead, capitalism will continue to persist as it has for centuries, its capacity to evolve and ability to efficiently distribute resources being its greatest strengths. Though capitalism may not be at risk, its current form, fundamentally shaped by U.S. economic and political hegemony, could be challenged. These challenges will be greatest if China experiences a quick recovery while the U.S. economy languishes interminably. However, current projections of U.S. economic growth, combined with a Chinese stimulus package emphasizing increased production rather than consumption, make such disparate recoveries unlikely. In sum, the current crisis is not a watershed signaling the shift of hegemony from Washington to Beijing.

POLICY IMPLICATIONS:
• Sustaining U.S. hegemony over the long run will require engineering a controlled global adjustment of the international economic system that does not put the U.S. at an inordinate economic and geopolitical disadvantage.
• Overcoming structural disincentives to avoid reducing budget deficits and devising a non-inflationary exit from present deficit spending are key medium-term challenges to preserving hegemony for the U.S.
• Decreasing the current accounts and budget deficits through both lower spending and steady dollar depreciation is essential in protecting the dollar as the dominant international reserve currency. This exorbitant privilege of being the world’s banker is fundamental to the preservation of U.S. political hegemony.
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The current global recession is certainly the worst economic crisis that has afflicted the international system since the Great Depression. What began in the United States in 2007 as a financial crisis centered on failing subprime mortgages soon expanded into a larger recession that engulfed the real economy and thereafter was transmitted globally. The Business Cycle Dating Committee of the National Bureau of Economic Research has now concluded that the current recession in the United States began in December 2007 when payroll employment peaked before beginning the downward slope from which it has yet to recover.¹ By September 2008, when the shocking bankruptcy of Lehman Brothers publicly signaled the advent of the financial crisis, the recession in the United States had indeed become severe measured by either the contraction in national output or the aggregate hours worked in the national economy. At the time of this writing in June 2009, the current national downturn has already exceeded the longest previous contraction since the Great Depression—the 1981–82 recession, which lasted sixteen months.² Thanks to the consequences of globalization, this recent crisis has left a dramatic impact on the international economic system as a whole.


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The transmission of the deepening U.S. economic crisis to the global economy has occurred through multiple paths. For starters, weakening U.S. demand has depressed the imports of foreign goods and services, thereby affecting all of the United States’ major trading partners irrespective of how healthy their own economies might have been otherwise. The slowing of U.S. economic growth has also affected the major natural resource exporting states, including oil and energy producers, whose own economic prospects are tied substantially to the high resource prices that were the norm during periods of sustained growth.

Further, the failing financial markets in the United States and the falling stock prices in all U.S. bourses not only eroded the asset base of many multinational businesses but also undermined the ability of numerous foreign firms to raise capital in the United States. Declining securities prices in U.S. stock markets led to a dilution of the values of assets traded in other foreign stock exchanges as expectations of a contracting real economy both globally and within individual countries found quick reflection in falling stock prices, which are little other than indices reflecting investors’ anticipation of future income. The spiral of contracting credit triggered by the initial failures of U.S. financial institutions also resulted in reduced portfolio and direct foreign investments in foreign countries, a change that exacerbated macroeconomic balances and balance of payments problems in countries whose economic fundamentals were already precarious.

Finally, states that were afflicted by their own asset bubbles, manifested through the presence of non-performing loans in their financial systems, also experienced crashes. In many cases, the exposure of domestic financial institutions to troubled international partners and to problematic contracts, including derivatives, that have seen sharp reductions in value contributed to replicating the U.S. contraction with varying degrees of intensity and scale.

The cumulative effect of the U.S. economic crisis and its international spillover has been a global economic recession of significant magnitude. As the World Bank has noted, the current recession could result in the global economy contracting for the first time since World War II, with global trade also expected to fall for the first time in three decades. With both direct and portfolio-based foreign investment tightening, the bank estimates that sharply constrained credit and higher interest rates will become significant constraints in many developing countries, with GDP growth in 2009, for example, expected to fall to 1.6% from the relatively high level of 5.8% the previous year. Since any global growth of under 2% per annum is considered a recession, the bank calculates that this depressed economic performance
will likely trap some 90 million more people in poverty in 2009, with a billion or more people going chronically hungry.\(^3\)

Even as these tragedies unfold in the developing world, however, the situation in the developed market economies is barely recognizable. The extent of state intervention that the current crisis has engendered in countries that were long the example of successful capitalism is mind-boggling. While significant monetary easing generally occurs in any recessionary environment, the difficulty in stimulating economic growth despite the persistence of a zero nominal interest rate in the United States has once again breathed new life into the old fears that the U.S. economy might find itself in a Keynesian “liquidity trap” where even low interest rates cannot stimulate increases in investment and employment. In an effort to escape this snare, government spending in the United States and across much of Western Europe has ballooned dramatically, producing huge budget deficits of the kind not witnessed before. Sustaining these unprecedented budget deficits has been complemented by historically exceptional large-scale state acquisitions of troubled private sector assets—from banks to automobile makers—as governments struggle to keep major private employers afloat even as they attempt to resuscitate economic activity through loose monetary policies.

The continuance of such intervention has raised fears about the long-term impact of growing national deficits, which could precipitate inflation and rising interest rates leading to stagflation in the worst case. The United States has been able to sustain such massive government spending in the near term only because the dollar still remains the international reserve currency. Because international lenders appear willing to sustain U.S. deficit spending on a significant scale, policymakers in Washington enjoy the luxury of being able to sustain such expenditures without triggering inflationary pressures immediately. Whether the United States can continue to live beyond its means indefinitely, however, is a critical issue and one that in many ways remains the underappreciated cause of the current crisis. This problem raises important questions about whether the binary deficits—the budgetary deficit and the current account deficit—can be sustained without severely undermining U.S. hegemony and with it the current global system that ultimately serves U.S. interests.

The current economic crisis and the character of state responses to that crisis, then, bear upon two consequential matters: first, the future of capitalism as a mode of economic organization and, second, the future of U.S. power. Both these issues are undoubtedly interlinked. If capitalism as a mode of production has been irretrievably damaged by the current economic