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That End-Of-Empire Feeling

David Corn

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David Corn writes The Loyal Opposition twice a month for TomPaine.com. Corn is also the Washington editor of [The Nation](#) and is the author of [The Lies of George W. Bush: Mastering the Politics of Deception](#) (Crown Publishers). Read his blog at <http://www.davidcorn.com>.

Is the United States in the last throes of empire? That sounds like an ideologically loaded, fatalistic and defeatist question. But it's what I've been wondering about at the start of this holiday season. Might future historians look back at the Bush II days and ask if this was the point when the country started slipping? Might the war in Iraq be regarded as a desperate act of a superpower that had already peaked? Will economists of the latter 21st century examine our economic decisions and say, "What were they thinking?" Or has the Grinch gotten to me?

Treasury Secretary John Snow says 'tis the season to be merry because the malls are crowded and the American economy, under the watchful gaze of George W. Bush, is on the move. But perhaps a touch of foreboding is merited. The White House and its conservative pals, trying to take advantage of the cheery season, have recently started a new campaign that claims Bush has been denied the credit for an economy that is expanding at a decent clip and that produced 215,000 jobs last month. In fact, polls show that most Americans—whether they're happy in the malls or not—have a downbeat view of the economy. And there are solid reasons why Americans should not put aside concerns about the country's long-term economic prospects and why Bush should not be pronounced the savior of the American economy.

First, the correlation between presidential action (especially tax cuts) and economic performance is iffy. How many conservatives credited Bill Clinton, who raised taxes on the wealthy and balanced the budget, for the explosive economic boom that occurred in the 1990s? By contrast, the results—and costs—of a military invasion are easier to tie directly to a commander in chief than economic developments. If most of the public believes Bush deliberately misled the nation into a bad war—which is what most do think at the present time—then Americans can be excused for not hailing Bush for the uptick in economic numbers for which he might or might not bear responsibility.

Perhaps Americans also know—or feel—that wage growth has lagged behind GDP growth. Or that the growing economy is a hot-money economy fueled by reckless borrowing (which could be read as a sign of national fading glory). Nervous Nellies like Alan Greenspan warn that, despite the recent economic growth, Bush is driving the federal budget off a cliff by creating trillions of dollars of debt that will have to be paid off after he leaves office. The current fiscal policy and the ballooning federal deficits, Greenspan claims, are "unsustainable." The outgoing Federal Reserve chairman is mostly fretting about a budget crunch that will be provoked by Medicare and Social Security obligations. But he also has noted that the growing trade deficit—and the spiraling cost of servicing it—poses a serious threat. A friend who is building a private equity fund for emerging markets summed up the macro situation for me this way: "What a great system. The Chinese lend us money to buy their goods. Then we have to pay back the loans with interest. They make money off us on both ends." Who are the better capitalists?

If the American economy is being hollowed out in age of globalization, do the traditional numbers—jobs produced, the unemployment rate—have the same meaning as they did in days of greater stability? Job creation may be up for the moment. But long-term job security and right-now health care security are less certain. Middle-class Americans can no longer expect to remain in a well-

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paying job for decades, as many American workers once assumed they would. Consider this: GM recently announced it will be dumping 30,000 jobs and closing several plants. Shortly after that, I heard CNN anchor Miles O'Brien gushing about a Toyota truck plant being built in San Antonio, Texas, that will create up to 2000 jobs paying \$9 to \$11 an hour. That's about \$20,000 a year—much less than what unionized autoworkers have made. Despite O'Brien's enthusiasm, this is hardly a tit for GM's tat.

Sure, some job creation is better than none. But considering the United States needs to create about 160,000 jobs a month to keep even with population growth, 215,000 is not a remarkable number. (Bush last week claimed credit for 4.5 million new jobs created in the past two and a half years. That's just about the keep-even number of 4.8 million of jobs.) Given all the legitimate concerns an American can (and should) have about the country's future economic well-being, the recent job spurt is not enough to warrant cries of "Thank you, George Bush." You don't have to be a worrywart to wonder if Bush is ignoring—or exacerbating—trends that will undermine America's traditional economic dominance. Many economists—[Morgan Stanley's Stephen Roach](#) and [Max Sawicky](#), to name a few—are sounding the alarm that if America doesn't change its borrowing ways, the nation is in for a hard landing.

Then, there's the war. Bush depicts it as an action crucial for the survival of the nation. Yet the nation—or much of it—does not buy that, and most Americans are alienated from an endeavor that is fundamentally redefining the country's relationship with the rest of the globe. They are not paying for the war. Nor are they rushing to join this grand effort. Recruitment has become a problem for the military. And the party that most supports the war—the Republicans—refuses to ask well-heeled American citizens to finance this project, which war-backers liken to World War II and the Cold War. In fact, the GOPers push for more tax cuts for the wealthy, while seeking to reduce public funds for health care for the poor, food stamps, school lunches and other programs that benefit low-income people. Think about it. The elites of America—the people who enjoy the benefits of this nation more than anyone—are generally content to sit back, pocket the Bush tax cuts and do nothing to encourage their children to sign up for this noble crusade. Is there not a whiff of end-of-empire decadence to this? But let's not blame only the top-dwellers. This society across the board (certainly, much of the media) pays more attention to the new Xbox 360 than daily developments in Iraq.

One cynical TV show host recently grouched to me: "Nobody cares about the war. I don't do shows on the war. It's all about getting through the holidays. Shopping—that's what people care about." A shop-til-we-drop economy and a war that is sold on the cheap. Are these signs of increasing national greatness? Or—bah, humbug—perhaps something else? Let's ask the folks at the mall.

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Why China Must Change

Thomas I. Palley

November 28, 2005



Dr. Thomas Palley was chief economist of the US–China Economic and Security Review Commission. Prior to joining the Commission, he was director of the Open Society Institute's Globalization Reform Project. He has written for The Atlantic Monthly, American Prospect and The Nation magazines. He can be reached at www.thomaspalley.com.

For the past five years, the global economy has been flying on one engine. That engine is the U. S. consumer who has been on a consumption binge financed by borrowing—in turn backed by a housing price bubble. This situation poses the threat of a serious hard landing when that engine eventually stalls, as it must. Ever-inflating house prices and rising debt-to-income levels are not sustainable. And as the late Herbert Stein, chairman of President Nixon's Council of Economic Advisers, wryly observed: "If something cannot go on forever, it will stop."

This view, regarding the global economy's excessive dependence on the United States and the financial fragility of the U.S. economy, is not just held by progressive economists. It is also shared by Wall Street. Thus, Stephen Roach, chief economist for Morgan Stanley, recently wrote in the *Financial Times* (Nov. 4, 2005): "there is now about a forty percent probability of a hard landing in the next twelve months." And in a research brief, Roach singles out China as being particularly dependent on the U.S.: "China's export prowess is balanced on the head of a pin—a pin made in America. Fully thirty-five percent of Chinese exports go to the United States."

Roach's Wall Street warnings are sobering. But they miss a more profound point, which is that the global economy has been heading in the wrong direction, hollowing out the middle class in America while failing to create a big enough middle class in the developing world. That hollowing-out process has long been visible in U.S. statistics on wages and family income distribution, and it has been rendered keenly concrete by Delphi Corp.'s recent bankruptcy filing. It is only because of successive stock market and housing price bubbles, combined with a massive increase in consumer access to credit, that the hollowing-out has not been worse.

The cause of these dangerous trends is the flawed structure of the global economy. Spurred by our own policy makers, the International Monetary Fund and the World Bank, developing countries have adopted an export-led approach to manufacturing growth and development. This approach has two critical features. First, countries rely on selling in foreign markets rather than their own domestic markets. Second, countries use undervalued exchange rates to subsidize their products, thereby making them hypercompetitive. China exemplifies this model, exporting more than half of its manufacturing output and having an exchange rate that is up to 40 percent undervalued.

The focus on export-led growth has distorted the global economy. First, it has created the global financial imbalances that Wall Street is so apprehensive about, as manifested in the record U.S. trade deficit. Second, U.S. manufacturing has been undermined by unfair competition subsidized by under-valued currencies. This, in turn, has accelerated the hollowing of America's middle. Third, export-led growth promotes the global race-to-the-bottom since countries look for international competitive advantage however possible. Consequently, workplace standards, wages and the environment are all subject to persistent retrograde pressures, impeding the development of a middle class in developing countries.

The implication is that the global economy must shift from export-led development to domestic

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market-led development. In an export-led world, higher wages undermine employment. In a domestic market-led world, higher wages can promote employment. This is where labor standards and unions enter. The challenge is to establish a system that has wages rising with productivity so that workers can buy what they produce, rather than dumping it on world markets. Setting wages by government edict does not work, as evidenced by the former socialist economies. Instead, labor standards and unions are the way forward, since they provide a decentralized mechanism that links wages and productivity through bargaining. History supports this. Every country that has ever made the transition to developed industrialized status has traveled this route.

China is the poster child for export-led manufacturing growth. It has the most undervalued exchange rate, the worst labor repression, and is by far the largest developing country exporter. As such, China is the gravitational attractor for the race to the bottom. Other countries must change too, but they can only do so if China changes so that none lose relative competitive advantage. If China revalues its exchange rate, other East Asian countries can also do so. Likewise, if China raises wages, so too can others.

One area where China is showing leadership is its stated commitment to increase social spending. This will be good for China's citizenry, and it will also contribute to incomes and domestic demand in China, which will be good for the global economy. However, there is also a problem that is unique to China. Labor standards and trade unions are key to domestic market-led development, but China's political system prevents them. That creates an additional political roadblock that must be solved. Democratic reform in China is not a nicety. It is a necessity for the global economy to work.

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Bad Moon Arising

Max B. Sawicky**August 25, 2005**

Max B. Sawicky is an economist at the [Economic Policy Institute](#). He can be reached at his blog, [MaxSpeak, You Listen!](#)

While last week we were distracted by some euphoric fluff about this year's budget deficit, serious problems are brewing. The U.S. economy is facing two giant imbalances: the projected gap between tax revenues and federal spending, and the current, growing gap between what the U.S. buys and what it sells to the rest of the world. The measure of our political system's vacuity, fed by a brainless commercial media, is the inability or unwillingness to put these issues on the table. Consequently, when forced to deal with a crisis, the remedies are likely to be short-sighted, panicky and stupid.

In light of the interesting times that lie ahead, whatever happens to the 2005 or 2006 deficit is not even a sideshow; it's a flea circus.

There is some good news to be found. We're finally getting a glimpse of the [long-promised job growth](#), and unemployment is a respectable 5.0 percent, but there is evidence of [slack](#) remaining in the labor market. Some who have left the labor force—and are therefore no longer counted as unemployed—would prefer to be working. Is there really a sudden rash of yearning for higher education or for the pleasures of hearth and home? Possible, but not likely. Such changes in behavior patterns typically take time to unfold, and the shifts since the 2001 recession seem relatively sharp.

Yet even that recent progress on jobs belies the overall [awful record](#) since the end of the recession in 2001. This recovery compares very badly to the 1993 recovery, which was no great shakes in its own right. One of the federal government's most important tasks is to alleviate employment slumps, and the Bush administration's neglect of this task has been its greatest domestic policy debacle.

The most important indicator that workers are chasing jobs, rather than the converse, is the dismal progress of wages. The Labor Department's [most recent monthly report](#) shows an increase in hourly pay of 0.4 percent. The annual equivalent, 4.9 percent, ain't bad. Except, unfortunately, the Consumer Price Index increased 0.5 percent in the same month, so inflation-adjusted wages decreased. Falling wages do not signal a robust job market.

The other dubious triumph of the moment is the federal budget deficit. The deficit for Fiscal Year 2005, in a victory over pessimistic expectations, turns out to be lower than previously expected, though still high compared to previous years. The difference was a surge in revenue that is attributed by you-know-who to supply-side effects of the tax cuts—greater investment, work effort and economic growth.

The bulk of the revenue surge was actually in the corporate income tax, and the bulk of that increase is due to the expiration of a [temporary tax cut](#) that had increased the deficit in previous fiscal years (2003 and 2004). It did not increase investment, it merely changed the timing of investment. This cut was part of the second Bush tax cut package enacted in 2002, which included a speed-up in depreciation deductions for business. By deducting sooner rather than later, you pay less taxes in '03 and '04, but more afterwards. Voila! Look how fast tax revenues went up! The

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Congressional Budget Office [does not expect this revenue surge to persist](#).

The budget outlook darkens as we look forward. Estimates of falling deficits depend on unprecedented discipline in discretionary spending growth, and completely implausible cancellation of the Bush tax cuts after 2010. There is also the matter of a couple of wars. If military expenses grow, that's another ding in the fiscal fender.

These facts notwithstanding, little political advantage is likely to be found in the budget situation. The deficit outlook is not healthy, but it is probably digestible in the short term. No negative impact of the run-up in federal debt since 2001 can be found in the economy. Interest rates remain low enough for investment to go forward, not to mention housing market mania. Thus far, the tax cuts have been a free lunch for politicians. The real trouble comes later: Our economic future hinges on the fate of the dollar in international currency markets.

Quarter after quarter, the United States racks up record trade deficits. As we buy more from foreigners than we sell to them, the difference is made up by growing foreign ownership of financial assets denominated in dollars, including federal government debt and dollars themselves. Without this support from foreigners, particularly from the central banks of Japan and the People's Republic of China, the U.S. economy would be in a very different place.

Most economists feel this situation cannot go on indefinitely. But it does go on, and as long as it does, there will be no negative economic repercussions in the United States and no grist for anybody's political mill. On the other hand, if and when foreigners become reluctant to buy as much U.S. federal debt, or to draw down their dollar holdings, there will be bloody hell to pay here at home. This could begin to happen most any time. Even if there is never any crisis, that debt will require repayment out of U.S. economic output, putting a drag on domestic consumption and investment.

The famous housing boom has helped to fuel consumer spending. People watch their homeowners' equity blossom. They borrow against that equity to finance spending that their annual incomes could not support. They take out "nothing down" or interest-only mortgages, leveraging themselves up the wazoo. When housing price inflation slows down or even reverses in "frothy" regional markets, consumer spending will take its lumps, and employment will suffer. At worst, people in over their heads will be unable to carry their mortgages. In the wake of legislation passed this year, bankruptcy won't be as easy a transaction as it used to be.

Further mucking up the picture are energy prices. Even though gas is still cheaper than it has been in some years past, [the longer, 80-year trend of falling gas prices may have reversed decisively](#). At any rate, [spikes in energy prices preceded each of the five previous recessions](#). Consumers spend more on fossil fuel, which benefits foreigners who sell us their oil, and less on other things that support domestic employment. Rising gas prices weaken consumer confidence, dampening purchases across the board.

Looming a bit further down the road is another problem: the chasm between projected increases in federal health care spending (on Medicare and Medicaid) and tax revenue. We are talking about a gap equivalent to [8 percent or more of the Gross Domestic Product](#). Current total Federal tax revenue is about 17 percent of GDP. Note that health care won't get any cheaper in the private sector either, where it now increases by double-digit rates annually. So we are looking at a choice between unprecedented tax increases and the gutting of health care benefits.

This should be a period of preparation for possible adversity and planning for future, inevitable contingencies. Neither is being done. We're stuck in a misconceived war. We neglect genuine terrorist threats and foreign policy challenges. We are embroiled in debates with antediluvian minds over issues of gender, science and culture. Our public debt rises faster than our GDP.

Meanwhile, we expect foreigners to hold our IOUs.