

The Economic Crisis and Deglobalization

Johnson is right on the money - the United States is a Banana Republic

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Abstract: This essay will explore Johnson's claim in his article "The Quiet Coup" that, in light of the recent financial crisis, the United States is becoming a 'Banana Republic'. Johnson presents an interesting argument about the connections between past crises in emerging markets and the US crisis. It will investigate the implications of this claim, specifically what it means for the future of globalization, world trade, and protectionism. Some major aspects of globalization, including Foreign Direct Investment and job loss, will be further explored as they relate to declining globalization (or deglobalization).

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The end of globalization as we know it could be catastrophic for the future of both the developing and the developed worlds. The trends of globalization can best be explored through careful examination of Simon Johnson's article, the "The Quiet Coup". Johnson essentially argues that the United States crisis is similar to crises typical in emerging markets; the finance industry has effectively captured the United States government. In this respect, our economic crisis is almost identical to many past crises in emerging market nations. Johnson continues to explain that the similarity in these crises could mean that the United States is becoming a 'Banana Republic'. This paper will explore that claim and the possible implications of the US as a Banana Republic for globalization in the future.

Johnson discusses Russia's economic issues and compares them to those currently occurring in the United States. He explains that the root of Russia's economic problems lies in its assumption that the country's energy sector could support a permanent increase in consumption and excessive borrowing. Foreign investors prefer to lend money to people who have the implicit backing of their national governments, in this situation, the powerful oligarchs. Because of the ease with which these oligarchs can borrow, they soon begin to over borrow and credit conditions become tighter. At this point, foreign investors are not as keen to invest. The governments of these emerging markets now typically must eliminate some of the largest companies and restructure the banking structure. This is where the inconsistency of the comparison between the US and emerging markets would generally appear; unlike most emerging market economies, including Russia, the United States is so powerful that it can almost indefinitely continue to find foreign investors. In light of the global crisis however, this stark difference is not quite as clear.

The South Korean crisis of 1997, often called the IMF crisis, provides another interesting comparison with the United States situation. In this case, South Korea's economy was fundamentally sound, however its banking sector was burdened with some problems similar to those currently in the United States. South Korea, just like the US, had problems with non-performing loans; however these loans were to businesses, attempting to fund aggressive expansions to compete on the world stage, which ultimately failed to ensure returns and profitability. Eventually, as in Russia's case, excessive debt led to major failures in the private sector and takeovers by the government. Samsung Motors was dissolved, Daewoo Motors was sold to General Motors, and Hyundai Motors took over Kia Motors. In South Korea's case, excessive debt forced the emerging market government to stage takeovers of failing companies, which ultimately allowed South Korea to continue to grow and resume its role as the world's fastest-growing economy. Again, as in Russia's case, the comparison with the United

States can only reach a certain point. The implications if the United States were to dissolve some of its major companies and institutions could be enormous for the US as well as for the rest of the world.

Malaysia, in 1998, offers one more example of an emerging market crisis to compare to the US crisis. Malaysia was a popular investment destination, which was reflected in its stock exchange, the most active stock exchange in the world. As in Russia, expectations of continued growth gave Malaysia confidence. Malaysia's government even articulated a policy expecting Malaysia to be propelled to developed nation status by 2020. The Malaysian ringgit (currency) was attacked by speculators, which led to a domino effect destroying Malaysia's prominent stock exchange. The crisis led to rating downgrades and widespread sell offs on the stock and currency markets of Malaysia. To overcome the crisis, the Malaysian government announced various measures. One major measure was to buy bad loans from banks and to help other banks by replacing debt with stock. This type of solution has been discussed in the context of the United States crisis, however major opposition to this plan exists because it does not prevent this type of crisis from occurring again. In the case of Malaysia, asset values have still not returned to their pre-crisis highs.

The striking similarities between crises in emerging markets and the crisis in the United States are clear after examination of the circumstances surrounding each economic downfall. The recent economic crisis not only placed the United States on the same playing field as many emerging market economies in terms of problems, but also in terms of solutions. One incident that succinctly describes this phenomenon occurred last December. Lou Jiwei, the head of China's sovereign wealth fund, called on the World Bank recently to guarantee investments in the US and Europe, just as he does in developing nations, because investing in those places was no longer safe¹.

It has generally been agreed upon that the United States cannot be compared to emerging markets in terms of wealth, world power, or options for foreign investment. This is true, however, in light of the worldwide economic crisis, opinion is shifting. It now appears that the solution to this problem, as the IMF points out, is the same or very similar for many nations, whether emerging market or developed nation. As Jonathan Ford writes in an article for "Prospect" magazine entitled "Crisis Watch: we are all emerging markets now", the US needs to shrink the financial sector, as did the emerging market nations in their crises. At a G7 meeting in February 2009, US Treasury Secretary Timothy Geithner said that the powerful nations needed to "build a strong foundation for economic growth and recovery" and to begin a "process of comprehensive reform of [our] financial system"². This advice is almost the exact same advice that the IMF gave to emerging markets in economic crises as a stipulation for aid from the IMF.

If, as Johnson and others believe, the United States and other developed nations are becoming "Banana Republics", what does this mean for world trade and globalization? Many believe that the globalization of the early 21st century is giving way to a newly popularized phenomenon: deglobalization. Two nations stand out as examples for what other emerging market nations and developing nations might look like in the future if deglobalization is in fact the future of international economics: Chile and Pakistan.

Governor State Bank of Pakistan Syed Salim Raza said that compared to other Asian economies, which relied heavily on exports to the developed world, Pakistan is less affected by the economic crisis because of its limited exports and low exposure in the international financial markets. He said that in the near future Pakistan will probably be focusing on producing more for the domestic economy and taking the opportunity to "develop commerce and domestic brands". This quasi-protectionist plan for the Pakistani economy seems to be an increasing trend in terms of economic plans in the developing world.

¹ "Prospect" Magazine, 'Crisis Watch: we are all emerging markets now', May 14, 2009

² CNN.com/Europe, 'US: Financial crisis spread to emerging markets', February 14, 2009

Chile is another emerging market nation that is actually thriving amid the global economic downturn. A few years ago, Chilean Finance Minister - Andrés Velasco - insisted on saving a large chunk of profits from the huge boom in copper prices. Matt Moffett writes in *The Wall Street Journal* that because of Velasco's rainy-day fund, Chile is now in a position to fully fund its own recovery from the global economic crisis. Velasco's insistence that Chile should save the money from the enormous boom in copper prices is now paying off elegantly. The Chilean stimulus package is about the equivalent of 2.8% of gross domestic product, as opposed to 2% in the United States³. This relatively large stimulus package means that Chile's annual economic output will decline by only 0.5% compared to much more extreme declines in other nations.

In the *International Business Times*⁴, Dani Rodrik writes that growth in the developing world comes in three varieties: foreign borrowing, commodity booms, and economic restructuring and diversification into new products. As Rodrik discusses, the first two forms of growth are not reliable because of busts in commodity prices and too much reliance on foreign capital. The emerging market nations that have managed to produce long-term growth over the past few decades are those nations that rely on the third form of growth: economic restructuring and diversification into new products. These countries were able to increase their domestic employment opportunities in high-productivity activities. In the past, these countries tended to have trade surpluses or very small deficits. China, a nation that fueled its growth by transforming its economic structure to an increasingly sophisticated set of industrial goods, is an excellent example. Rodrik explains that the push of emerging market nations into tradable goods and services was usually accommodated by a willingness of developed nations (especially the United States) to run large trade deficits. Thus, deglobalization could potentially be extremely harmful to developing nations and especially emerging market economies, because of the implications for the economic policy in more developed nations such as the US.

One aspect of globalization that has been very beneficial is foreign direct investment (FDI). Most people in developing nations welcomed FDI as a way to get new factories and new jobs. FDI is also a common path by which skills and technology are transferred from rich to poor countries. FDI is almost universally agreed upon as a definite benefit of globalization. However, sadly, this beneficial aspect of globalization is facing some serious obstacles. The United Nations Conference on Trade and Development (UNCTAD) stated that worldwide FDI inflows shrank 21% in 2008 and the World Association of Investment Promotion Agencies says that FDI will contract by a further 12% to 15% this year⁵. This will inevitably harm the least developed nations of the world and will slow down the process of working toward the Millennium Development Goals.

Job loss is an important aspect of globalization that has been deeply affected by the economic crisis. The International Labour Organization forecasts that worldwide unemployment will rise by about 30 million above 2007's levels in 2009⁵. The impact on migrants is especially dire. In the past decade, more people than ever have been moving voluntarily, however fierce competition is forcing some migrants to move back to their home countries. This will inevitably lead to demographic shifts in many nations and possibly social and political fallout worldwide. Thus, the implications of deglobalization are not only economic, but also social and political.

The economic crisis certainly seems to have put the trend of expanding globalization of the early 21st century at risk. As Johnson points out, the United States has been turned into a Banana Republic after the recent economic crisis. This means that the United States and other developed nations might totally change their international economic policies in the future, putting into jeopardy the total global economic system. People in developing nations and some emerging market nations stand to lose the most from this process of deglobalization.

³ *The Wall Street Journal*, "Prudent Chile Thrives Amid Downturn"; May 27, 2009

⁴ *International Business Times*, "A De-Globalized World?"; May 27, 2009

⁵ *Economist.com*, "Turning their backs on the world"; Feb 19th, 2009