

A Tale of Two Diverging Economic Worlds

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Increasingly a deep divide within the world of globalization is emerging which will have the most profound significance for the future of G7 nations' economic and political stability. The divide is between those nations which are still embedded within the dollar system, including countries in the Eurozone, versus those emerging economies—especially the BRIC—Brazil, Russia, India, China—where new economic markets and regions are rapidly replacing their over-dependence on the United States as prime export market and prime source for investment finance. The long-term consequences will be an aggravation of the trend of the United States as a political and economic superpower in terminal decline, while dynamic new economic zones, initially mainly of regional importance, will arise.

The one great asset which nations like China, Indonesia, India and Brazil bring to the emerging divide is the one greatest long-term economic deficit or liability of the older industrialized world, USA, UK, Germany and the EU generally. That is their demographic advantage.

With the exception of Russia, all the growth economies possess young, dynamic and growing populations. Interesting to recall is that the hidden story of the pre-1914 German 'economic miracle' was based on a similar 'secret'—rapid and dynamic young and growing population, while that of Great Britain and France was stagnant or in decline after the British Great Depression of 1873 which led to huge emigration of population to the USA.

It's no accident that the leading political elites of the G7 argue that the greatest threat globally is the rapid birth rate in developing countries. Translated from their euphemism, they really mean the greatest threat to their continued dominance of world affairs is population expansion in emerging economies, as new contenders inevitably rise.

New growth regions emerging

Almost naturally in the past eighteen months, once the initial shock of the worst financial and economic shock since the 1930's began to subside, China and its immediate trading partners along with the other high-growth emerging economies, began looking for new alternatives to the dying dollar system.

The present crisis is no short-term epiphenomenon as Ben Bernanke, Treasury Secretary Tim Geithner or Barack Obama would wish us to believe. It is the reflection of more than 65 years of defective US economic policy, a defect which reached epidemic proportions after the decision to abandon the gold exchange standard in 1971. Let's be clear, that gold standard as well as its predecessors was no magic economic panacea. But the break by Nixon in August 1971 allowed Washington to embark on a de facto financial imperialist policy which ruined much of the world economy in its ravages of the past thirty eight years.

Today the contrast between declining G7 economies and emerging dynamic high-population growth economies could not be clearer. The G7 nations from USA to Germany to Italy are choking in public debt, ranging from 80% of GDP in the United States to well over 100% in Italy and a staggering 199% in Japan. Only Zimbabwe with 218% debt to GDP tops that. Germany has a ratio of 77%.

By contrast, of the emerging dynamic high-growth countries, only India has significant public debt, a legacy of the British colonial era, of 58% GDP. Brazil, despite a severe debt crisis in the 1980's, today has a public debt to GDP level of a very manageable 45%, while Indonesia, one of the fast-growing newly emerging economies, has 34%. South Korea with a high domestic savings culture has a mere 28% debt ratio and China a mere 18% debt to GDP level. Russia, which used the recent boom in oil and gas revenues to pay down its foreign and IMF debts, while the country has severe demographic problems, has a public debt to GDP as of 2008 data of 6%. It has also slowly rebuilt foreign exchange reserves after the crisis last year to a level of \$404 billion this month, making its reserves the third largest in the world.

So, with the economies of the USA and EU caught in the jaws of a twin scissors-like crises between growing public debt and declining population growth rates to service that debt long-term, the emerging economies of Asia and Eurasia as well as Brazil in South America are booming, precisely because they enjoy the twin assets of low public debt to GDP ratios combined with dynamic growing populations.

In China, India, Indonesia, Brazil economic growth continues to advance significantly. Governments are not buried under a mountain of debt and citizens remain optimistic about their future. This divergence, between the once rich and the once poor, will mark a geopolitical shift in the pivot of world history when viewed retrospectively by future economic historians.

Caught in the blades of a twin crisis

The most notable aspect of the crisis is the thorough discrediting of western academic economists, including every single winner of the Economics Nobel Prize. Their grandiose theories justifying their laissez faire 'free market' economic model of globalization has been proven fatally wrong, in effect a transparent promotion gimmick to justify the process of one-sided globalization, little more. They have been exposed, to use the terms of one of my favourite children's stories by the Danish writer H.C. Andersen, like the Emperor with no clothes.

The dollar system their world had been based on since Bretton Woods in 1944, is undergoing a death agony. Every measure advocated to date by two US Administrations—Bush and now Obama—as well as the other G7 governments has amounted to giving heavy and even heavier doses of financial chemotherapy to a dying patient. The ever higher doses of taxpayer bailout to maintain a failed financial and banking model on artificial life support is merely worsening the underlying health of the US economy.

The record US financial bailouts since September 2008, a span of a mere ten months, have brought the US Federal debt from some 60% to a whopping 80% of GDP. Private US household debt is now above a record 100% of GDP, significantly worse than in the bad recession year 1974 when it was a mere 40%.

More alarming, for any prospect of growing out of the US economic downturn, the long-awaited phenomenon of demographics has slowly begun to impact. In the coming 1-3 years the impact of Baby Boom generation retirees in record numbers will hit. They will be forced to draw down their public Social Security retirement from the Government as well as selling their private 401k and similar stock and bond investments in order to live in retirement. In economic terms they will become a net drain on the US public finances whereas rising unemployment among younger workers whose taxed earnings are needed to pay into the Social Security fund, will aggravate the US public debt level rapidly to Italy or even Japan or Zimbabwe levels in coming years. Unemployed workers do not pay taxes. They draw on state benefits instead.

In April, India's car sales were 4.2 percent higher than they were a year prior. Retail sales rose 15 percent in China in the first quarter of 2009. China is likely to grow at 7 or 8 percent this year, India at 6 percent and Indonesia at 4 percent.

By contrast, even using badly flawed official data, the US economy contracted at an annual rate of 6.1 percent last quarter, Europe by 9.6 percent and Japan by a frightening 15 percent, something that rivals the 1930s.

In the West, plus G7 member Japan, banks are overleveraged and thus dysfunctional, governments paralyzed with debt, and consumers are rebuilding their huge debt burdens. America is having trouble selling its public debt at attractive prices. The last three Treasury auctions have gone badly. Its largest state, California, is veering toward total fiscal collapse. The current fiscal year US budget deficit is going to surpass 13 percent of GDP, a level last seen during World War II.

By contrast emerging-market banks are largely healthy and profitable. Every Indian bank, government and private, posted profits in the last quarter of 2008. The governments are in good fiscal shape. China has the world's largest foreign currency reserves, \$2 trillion in reserves, and a budget deficit less than 3 percent of GDP. Brazil is now posting a current account surplus. Indonesia has reduced its debt from 100 percent of GDP nine years ago to 34 percent today.

Unlike in the West – where governments have run out of money or creative new ideas and are now praying that their medicine will work – these countries still have options. Only a year ago, their chief concern was an overheated economy and inflation. Brazil has cut its interest rate substantially, but only to 10.25 percent, which means it can drop it further if things deteriorate even more.

The mood in many of these countries remains surprisingly upbeat. Their currencies are appreciating against the dollar because the markets see them as having better fiscal discipline as well as better long-term growth prospects than the United States. Their bonds are rising. This combination of indicators, all pointing in the same direction, is unprecedented.

The United States remains the richest and most powerful country in the world. Its military spans the globe. Even if its leaders prefer not to call it such it represents the most powerful informal empire in history to date. But just as previous global hegemony went into irreversible decline—the Spanish Empire of the 16th century to the British Empire in the 20th century—great global powers sink into terminal decline once they become overburdened with debt and stuck in slow growth.

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