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Message to World at the G-20 Summit: Don't Depend on a Strong U.S. Recovery to Bail You Out

What's Your Reaction?

This week's U.N. General Assembly and the countless, private discussions between presidents, premiers and prime ministers will range from climate change to terrorism, but most of the leaders are more preoccupied with the outlook for their economies. In this sense, the UN meeting is an opening act for the main attraction, the G-20 summit in Pittsburgh at the end of the week. There, the leaders will focus on new regulation for global capital flows and the institutions behind them, with some good doses of finger-pointing at the United States. (Christina Kirchner of Argentina, the world's largest debt defaulter, couldn't wait: She led yesterday with America-bashing at the UN.) But the blame game is really a plea that the United States help pull the rest of the world out of its ditch.

America, with 23.5 percent of worldwide GDP -- Japan is second at 8.1 percent, followed by China with 7.3 percent -- is the only country with the economic heft to move other nations. Much of our impact comes from our annual imports of $2.5 trillion, which help keep employment up in most other large economies. If we could get our imports growing strongly again, the world's finger-pointing would turn into high-fives. But that depends on reviving American consumption and investment, and the outlook for that is mixed at best.

Washington's optimists point to recent gains in a number of important indicators -- but look closely, and they're less encouraging. Retail sales in August were up 2.7 percent over July, for example. But that's 5.3 percent below levels a year earlier, when things already were pretty grim. It's the same story with other measures. Housing starts were up 1.5 percent in August, but down 29.6 percent from a year earlier; and industrial production was up 0.8 percent, to a level still nearly 11 percent below August 2008. These are the numbers that led Ben Bernanke and Janet Yellen to caution that while the recession may be technically over, hard times could be with us for another year or longer.

The bottom line for most Americans is that the steep decline in the value of their investments and homes is driving them to cut back their spending and restore some savings. Mostly, they're paring down the record credit card debt they ran up during both the first stage of the recession and an expansion before it which didn't produce income gains. This spending slowdown is unlikely to change soon. And as we have argued here for more than a year, jobs will probably continue to contract for two or three years after this recession ends, just as they did after the 1990-1991 and 2001 downturns. It's hardly a recipe for a recovery strong enough to lift U.S. incomes or the prospects of other economies.

Nor can we expect help from other countries boosting our exports. Of our five largest foreign markets, U.S. imports are still falling in three of them (Canada, China, and the UK); and American imports in all five (Mexico and Japan, plus the other three) are still running 17 percent to 27 percent below their levels a year earlier.

What if the modest pick-up we're seeing now only reflects the President's stimulus package finally kicking in? Republicans had some cynical fun a few months ago charging that the stimulus had failed, since everything was still headed down. Now, it's the Democrats' turn, as its effects increase over the next several months. The hard question is whether the economy will keep growing once the stimulus runs out. The administration's economic strategy depends on the stimulus triggering self-sustaining growth -- by creating jobs, which boost spending and

then, in turn, lead to more jobs, more demand, and finally more investment. That's also the basis of their financial strategy, hoping that expanding growth will bring down foreclosures and bankruptcies, easing the pressures on banks so they can lend more.

Their economic logic is perfectly reasonable; but it may be a long shot in the world where we now find ourselves. And it certainly doesn't take account of the possibility of yet another nasty shock to the economy. The most likely candidate is an implosion of securities based on commercial real estate. Price movements in commercial estate have been running 12 to 16 months behind those in residential housing. So, they remained strong for more than a year after the housing bubble began to deflate -- and then began to fall sharply in the last six months. Now, more and more commercial developers can't keep their properties sufficiently occupied to service the loans they took out to build them. As they default, the securities and derivatives based on those loans also go bad. It could be another very nasty hit, with most of the impact falling on the regional and local banks across the country that made the loans. That's why we're already seeing a sharp rise in bank failures.

The good news is that the Fed and the Treasury have more advance notice this time, and they have a better idea of what works and what doesn't. The bad news is that at after what we've already been through, Washington couldn't borrow the money required to manage the failures of large numbers of big commercial banks, with all of the fallout, without risking the credit of the United States.

There's a good chance we'll dodge that particular bullet. But even if we do, the prospects for a strong U.S. recovery are slim, especially one strong enough to help the rest of the world. And that will be the biggest, unspoken disappointment at this week's G-20 meetings.

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