

Governments bailed out the wrong people, setting the stage for another asset bubble, writes **Andy Xie**

# Dress rehearsal



The first decade of the 21st century ends with a near death experience. Financial markets that collapsed in 2008 have roared back in the decade's closing year. *Time* magazine has named Ben Bernanke "man of the year" for "saving" the American and global economies. It symbolises the free-lunch-forever ethos of the decade-long party that crashed and burned, only to be bailed out to party again. Bernanke is viewed as a saviour because no one wants to take responsibility for what happened and wishes Bernanke can erase the past.

The magic for resuscitating the financial markets and the world economy has been trillions of dollars for bailouts. That money, not a better economic future, saved the financial markets. It has led to an emerging market bubble that is supporting the global economy. It will take time for the money to become inflation, but when it does it will show the true cost of the crisis. With the world economy still not structured for another growth cycle, stagflation may stalk the world for a decade.

The two decades following the fall of the Berlin Wall will be remembered as a gilded age. After the ideological struggle of the cold war, the world embraced globalisation and making money in any way possible. The pursuit of profit became the most powerful force shaping the world. Factories

were moved to wherever wages and environmental standards were lowest. Local neighbourhood shops were put out of business by supermarkets on the outskirts of towns. Wherever regulation stood in the way, deregulation took its place in the name of efficiency.

This relentless cost cutting has meant a rising share of income for capital and a declining one for labour. If this trend is left unchecked, deflation will follow to destroy returns for capital, as working consumers have less income to buy the abundant products that capital produces.

Financial capitalism extended the profit dream for capital. By shifting capital into paper assets, it shot two birds with one stone. Workers could support their consumption by borrowing against asset appreciation, supporting the returns on productive assets. Capitalists could deploy their surpluses into paper assets, indirectly lending to consumers, rather than physical assets that would hamper returns. This happy combination continued to shift income from labour to capital. The boom laid the seeds for its destruction. The capitalists were unknowingly paying for their profit dream by lending to consumers with overvalued paper assets as collateral.

Two decades of income shifting to capital and asset inflation came to a stop last year when the asset game came apart, as derivatives were exposed as frauds rather than ingenious designs that reduced risk to capitalists with no cost. The lower level of consumption in future will

significantly lower capital's returns. And without asset appreciation to supplement lower wages, workers will demand higher pay. Contrary to the popular belief that a weak economy means low inflation, the opposite will occur this time.

The right response to this crisis would have been to nationalise failing financial institutions, restrict speculation with implicit or explicit government guaranteed funding, subsidise employment, and expand unemployment benefits. Capital mispricing is the root cause of the serial bubble phenomenon. Reforms that lead to

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the right pricing of capital would trigger real economic restructuring and lay the foundation for a new growth cycle.

However, the "bubble establishment" had the clout to obtain government bailouts that saved their skins but cost taxpayers trillions. Taking advantage of the public panic in the crisis, they sold the story that only reviving the financial sector could stem the economic slide. It was a lie. Directly supporting the unemployed would

have cost a fraction as much while stabilising the economy. The remaining fiscal capacity could be used to support economic restructuring.

This round of financial capitalism won't last. The lag between printing money and inflation may be long in the era of globalisation. But it will come. China was a disinflationary force for a decade due to its surplus labour and overinvestment; American prices for manufactured goods declined to China's through factory relocation. This process is over. China's prices are the world's; its production costs are sure to rise due to a shortage of manual labour and soaring land prices. China can no longer hold back inflation during rapid monetary growth.

Global inflation will begin to rise next year. Central banks may raise interest rates, but they will be behind the curve – rates will rise slower than inflation. At heart they will want to maintain loose monetary policies to help growth. Raising rates will be propaganda for cooling inflation expectations – fooling savers into holding onto depreciating bank deposits. But procrastinating about fighting inflation will only cause inflation to surge. By 2012 inflation might be high enough to cause public panic. Central banks will be forced to raise rates quickly. A second financial collapse could follow.

The world had a near death experience in 2008. It may not be so lucky in 2012.

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## No silver bullets

The fight against piracy in the Indian Ocean has just become a little more complicated. Reports that the owners of a hijacked Chinese ship have paid US\$4 million to pirates to free a mainland crew held off Somalia for more than two months confirms that Beijing has no secret weapon to solve this worsening scourge.

When the coal carrier *De Xin Hai* was hijacked by Somali pirates on October 19, some in the embattled shipping community hoped, against the odds, that China's intensified involvement would mark a turning point.

Somehow it would be the beginning of the end; somehow Beijing would find a way of breaking the cycle of hijacking-ransom-release that has left international navies and the world's biggest shipping firms impotent in the face of a rag-tag bunch of fishermen-turned-gangsters.

As a proud, emerging power, China would not simply negotiate and pay up, the thinking went. Beijing would find a way of showing, either through force or tough backroom deals, that the whole point of being a big power is that you don't have to.

"Imagine if it was a hostage crisis in Xinjiang (新疆) or some other restive province... do you think Beijing would negotiate or worry about possibly killing hostages to send the toughest possible message?," asked one frustrated Hong Kong shipping executive. "I don't think so."

One must remember the desperation many across the shipping community felt in the face of increasing attacks. Over the last year, more than US\$80 million is estimated to have been paid in ransom to Somali pirates, who now routinely travel hundreds of kilometres deep into the Indian Ocean to find new victims, rather than simply targeting their old stomping grounds in the Gulf of Aden. They have attacked more than 200 ships in the last year, keeping some crews hostage for months.

China is now one of 40-odd navies co-operating across the vital sea lanes that link Asia to the Middle East and Europe – a presence that has yet to dent the number or reach of attacks.

That presence, of course, raises the stakes for Beijing. While other mainland vessels have been hijacked, the *De Xin Hai* was the first since the historic deployment last December of three Chinese warships to the international anti-piracy effort.

**Those leery of China's rising naval might will be heartened by its show of restraint**

It was also seized northeast of the Seychelles as it headed from South Africa to India with 76,000 tonnes of coal – a sign that ships far from the Horn of Africa were now vulnerable.

With special forces teams on-board, PLA navy chiefs would have been itching for action, some believed.

Yet not a shot has been fired in anger during the entire *De Xin Hai* crisis – not during its capture and race to the safety of the pirates' lairs on Somalia's east coast, during negotiations, nor after the safe release of the crew.

PLA naval officials have made clear that they are following internationally-recognised rules of engagement – opening fire only if attacked and pirates can be positively identified. The pirates, of course, routinely carry frozen tuna in their skiffs to wave above their heads whenever foreign navies are close, highlighting their credentials as innocent fishermen.

They have also apparently heeded the lessons of other powers, such as India and France, who have both failed to use force without killing hostages during previous rescue attempts. In April, French commandos killed a hostage while storming a hijacked yacht in the Gulf of Aden, while last November an Indian warship sank a Thai trawler it believed was a Somali pirate "mother ship".

Those in the region leery of China's rising naval might will be heartened by its show of restraint. But those hoping for some kind of bold approach to seize the initiative from the pirates are likely to be again disappointed.

The odds suggest that at some point soon another Chinese vessels will be attacked. And the only difference in the way it is settled will be the price at which its crew will be released from the threat of death.

**Greg Torode is the Post's Chief Asia Correspondent**

## Voices: The past decade

# Asia faces natural barriers as West's fortunes dim

**Gwynne Dyer**

Decades don't usually have the courtesy to begin and end on the right year. The social and cultural revolution that Western countries think of when they talk of the "Sixties" only got underway in 1962-63, and didn't end until the Middle East war and oil embargo of 1973-74. But this one has been quite neat: the "noughties" began with Islamist terrorist attacks on the United States in 2001, and ended with a global financial melt-down.

The terrorist threat to the West was minor, but the West's hugely disproportionate and ill-considered response was a key factor in the great shift that defines the decade. The "war on terror" and all the rest did not deter a Muslim Nigerian student from trying to blow up an airliner over Detroit last Saturday. It motivated him to do so. But it also accelerated the rise of Asia and the relative decline of the West.

That shift was happening anyway. When China and India are growing economically three to four times as fast as the West, it's only a matter of time until they catch up with the older industrial economies.

In 2003, however, researchers at Goldman Sachs predicted that the Chinese economy would surpass that of the US by the mid-2040s. By the middle of this year, they were predicting that it would happen in the mid-2020s – and this year, for the first time, China built more cars than the US. That acceleration is in large part a consequence of the huge diversion of Western attention and resources that was caused by the "war on terror".

Prestige is a quality that cannot be measured or quantified, but a repu-

tation for competence in the use of power is a great asset in international affairs. After the centuries-old European empires wasted their wealth and the lives of millions of their citizens in two "world wars" in only 30 years, their empires just melted away. Nobody was still in awe of them, and they lacked the resources to hold on to their colonies by force.

Something similar has happened in the past decade to the US. Unwinnable wars fought for the wrong rea-

**Two trends that could slow or even stop [power shifting to Asia] are peak oil and global warming**

sons always hurt a great power's reputation, and wars fought amid need-less tax cuts, burgeoning deficits and financial anarchy are more damaging if the country's power depends heavily on a global financial empire.

The US spent the past decade cutting its own throat financially, ending with the near-death experience of the 2008-09 financial meltdown. The Europeans made all the same mistakes, only more timidly, and the Japanese sat the decade out on the sidelines, mired in a seemingly endless recession. The old order is passing, the US dollar is on its way out as the sole global currency, and the real power is shifting to mainland Asia.

Or is it? There are two trends that could slow or even stop this shift. They seemed quite distant at the start

of the decade, but now they look very big and frightening. One is peak oil; the other is global warming.

In Europe, North America and Japan, energy consumption is growing slowly or not at all, and it is relatively cheap and easy to reduce dependence on imported oil. Just the fuel efficiency standards already mandated by the Obama administration could reduce American oil imports by half by 2020. Meanwhile, Chinese and Indian dependence on imported oil is soaring. So is their use of coal.

That's unfortunate, because for purely geographical reasons these countries are far more vulnerable to high temperatures than the older industrial nations. At even 2 degrees Celsius higher average global temperature, they face floods, droughts and storms on a massive scale, probably accompanied by a steep fall in food production. That sort of thing could abort even the Chinese and Indian economic miracles.

So we're back in the old world where the future is uncertain. But, what else did you expect? We can only observe trends, and try to remember they are always contingent. But at the moment, it looks like the decade when the West lost its domination over the world's economy.

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## Voices: US military

# Setting a straight course through party lines

**David Ignatius**

This was another year of the vanishing centre in America. Despite the election of a president who promised to govern across party and racial lines, partisan division seemed to engulf nearly every important institution and topic – with one notable exception: the US military.

At year's end, I want to examine the person who came to symbolise the military's apolitical unity, Admiral Mike Mullen, chairman of the Joint Chiefs of Staff. A year from now, I'd love to be able to say there are more Mullens in our national life and fewer Rush Limbaughs.

Mullen managed the military's transition from George W. Bush to Barack Obama, from surging in Iraq to withdrawing US troops. He worked with the new president while Obama painstakingly decided to up the ante in Afghanistan. Through it all, Mullen remained out of the limelight most of the time, which is where a military leader ought to be.

Mullen got the chairman's job because he had developed a reputation as an unselfish leader – something that isn't always true in a Pentagon where each service struggles to protect its turf. When Mullen was chief of naval operations in 2007, a top aide to Defence Secretary Bob Gates asked Mullen what worried him most. His generous answer – "the US Army" – is said to have convinced Gates that he was the right person for the chairman's job.

Mullen knew there would be a presidential turnover during his watch as chairman, and he began preparing for it early. He wrote an article in July 2008, when some

soldiers were nervous about having a Democrat president, that "the US military must remain apolitical at all times and in all ways".

Advising the new president on the war in Afghanistan has been the trickiest part of Mullen's job. An early challenge was replacing General David McKiernan as commander. When McKiernan didn't answer an important question during a video briefing for Gates, the chairman advised: "I don't think we have the right guy there." Gates agreed, and Mullen recommended General Stanley McChrystal as a replacement.

During the long White House review of Afghan policy, Mullen had the delicate task of advising, but not pushing, Obama. In congressional testimony in September, he said that, in his view, more troops were needed – for which he was rebuked by Rahm Emanuel, the White House chief of staff. Mullen kept his head down after that.

The Afghanistan decision tested the civilian-military balance. Some liberals worry that Mullen and the generals co-opted the president; conservatives argue that Mullen unwisely endorsed the president's July 2011 withdrawal timetable. But the decision achieved that rare Washington moment of a consensus both sides could live with.

Meeting troops this month in Afghanistan, Mullen offered some advice that revealed a lot about his own leadership style – modelled on his hero, General George Marshall. "Lead quietly", he told them, "lead listening". That's a sentiment that wasn't heard often enough in 2009 in a noisy Washington.

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## Voices: Myanmar

# Nixon and Kissinger set precedent for Obama

**Ian Holliday**

A prominent foreign policy initiative in the first year of the Obama administration was a first step to reshape bilateral relations with Myanmar. Long built on rejection of an authoritarian regime, US policy is now moving towards engagement.

As the process unfolds, it is worth exploring striking parallels with a major shift launched 40 years ago when the Nixon administration sought to bring in China from the cold. Then, as now, a new president was confronted with bipartisan support for an isolationist stance.

In 1969, Richard Nixon inherited a Red China policy that demonised Mao Zedong's (毛澤東) Communist regime and allied the US with Chiang Kai-shek's Taiwan. In 2009, Barack Obama was heir to a Burma policy that denounced Senior General Than Shwe's junta and linked the US with Aung San Suu Kyi's democrats. Both presidents knew instinctively that US policy had strong emotional and ideological underpinnings. But both saw that it was not working.

In the late 1960s, the result was major policy change. Nixon began to abandon prevalent Red China discourse and talked instead of the People's Republic. National security adviser Henry Kissinger established secret contacts with premier Zhou Enlai (周恩來). Ping-pong diplomacy took American athletes inside China. A secret trip by Kissinger in July 1971 set up the diplomatic coup of February 1972: Nixon in China.

Four decades later, Obama has travelled no more than a fraction of this distance with his Myanmar initiative. In February, Secretary of State Hillary Rodham Clinton acknowledged US policy failure and

instituted a formal review. In September, state-to-state contacts were re-established in New York. In November, US officials completed an exploratory mission to Myanmar. In response, the ruling generals minimally expanded dialogue channels with Suu Kyi.

At this early stage, what lessons Obama might take from Nixon? Clearly there are differences, marked by China's sheer size and influence. But with a population of 55 million and strategic location, Myanmar is not unimportant. Perhaps the one significant distinction in the Myanmar case is a general election promised for 2010, which has no Chinese equivalent. If this results not in confirmation of the junta, but in a bolstering of democratic forces and institutions, Nixonian stratagems will not be required.

However if, as seems likely, a darker scenario unfolds and the core elements of an oppressive state remain defiantly in place, then the time will surely come for the US to bite the bullet of direct, high-level engagement aimed at hauling Myanmar into the modern world.

The process is unlikely to be pretty. When Nixon and Kissinger dealt with China, they deceived Congress and the American people, discarded a central plank of US foreign policy, and reneged on statehood guarantees made to Taiwan. But the result was stunning.

In his Nobel lecture, Obama signalled an openness to new foreign policy ideas. If change does not come from within Myanmar in 2010, Obama should look to the case of Nixon in China for inspiration.

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