Trading Places

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Summary

The past two decades have witnessed extraordinary shifts in global economic and political power. The booming economies of East and Southeast Asia have grown to the point of challenging the economic dominance of the U.S., Western Europe, and Japan. Powerful multinational corporations combined with free and open markets guided the flow of manufacturing, technology, and intellectual capital from West to East. Technological innovation, too, is increasingly centered in the Pacific Rim, as companies gear their research and product development to satisfy the wants and desires of the middle classes of China, India, Korea, Southeast Asia and, to a lesser extent, Latin America. The U.S. and Western Europe muddle through with sluggish growth, and heavy social burdens related to aging populations. Governments are pressured to do more — impossibly — with less. Privatization and deregulation offer only partial relief to strained government budgets. In the U.S. and Western Europe, unemployment is relatively low but underemployment is high. Consumers work hard and long hours, with little leisure time. For most, life is hard, but still bearable. There is a sense of inevitability to the tremendous changes that have taken place in the global economy. However grudgingly, consumers accept their diminished status. Mature market consumers are still the most materially fortunate in the history of the world. It is just that the rest of the world is now catching up at breakneck speed. Sooner or later, the “emerging” emerge; the “declining” decline.
In 1996, *emerging* economies were all the rage. The original “Group of Seven” industrialized countries (which at that time included the United States, the United Kingdom, France, Germany, Italy, Spain, and Japan) saw great promise in the then-underdeveloped but rapidly growing economies of China, India, Indonesia, and the other export-oriented economies of Southeast Asia as well as those of Latin America. What the mature economies failed to realize at the time was the extent to which their own economic problems and declining competitiveness, in the context of free and open global markets, would accelerate the progress and development of the Emerging Markets and significantly narrow the gaps between the “haves” of the mature markets and the “not yet haves” of the Emerging Markets. The ascent of the latter has been no less than remarkable, as symbolized by China and Korea’s admittance to the world economic power club. Today, it is known as the Group of Eleven (and growing).

U.S. and European investment in the Pacific Rim progressed at a steady pace through the end of the 1990s and the early 2000s. Though the majority of dollars, pounds, and marks found their way to Asia, select Latin American countries, notably Chile, received attention as well. Chile itself grew increasingly integrated with the Pacific economy. In the process, truly global companies emerged, with the ability to rationalize R&D, sourcing, production, distribution and servicing on a worldwide basis. The pronounced concentration of market growth in Asia Pacific resulted in a very large share of financial, infrastructural, industrial, and intellectual investment in that region.

Increasingly, the national origins of most of the world’s large companies became difficult to determine. Trade barriers dropped — there was no point anymore in trying to shut out another nation’s goods and services; there was room for everyone — as the explosion in privately developed information networks and widespread commercialization of the Internet greatly facilitated global commerce. The nascent but highly effective World Trade Organization kept all the players honest.

Across Asia and Latin America, rapid and sustained economic growth created a shortage of managerial and technical human resources. In response, both governments and multinational companies expanded sponsorship of advanced studies in the leading U.S. and European universities. Consequently, foreign (and especially Asian) enrollment in U.S. engineering and management science programs skyrocketed. So great, in fact, was demand for advanced training that many top flight schools opened up campuses in Asia. It was a big deal when Harvard announced the opening of its Shanghai satellite campus (the “Harvard on the Yangtze”), but by the time Yale, Princeton, and UCLA followed with their campuses in Santiago, Kuala Lumpur, and Jakarta, respectively, few seemed to notice or care.

In the West, the U.S. and European economies appeared deceptively healthy at the dawn of the twenty-first century. To be sure, both regions were benefiting from the robust trade with the developing world as lower labor and manufacturing costs that came with the move of factories offshore caused corporate profits to hit record levels. U.S. and European stock markets soared. In Washington, tight fiscal policies enabled the government to stem the increase in the national debt. To many citizens’ amazement, the budget was actually balanced by 2002, as promised back in 1996, and the nation had begun to dig itself out from under its heavy debt burden. Confident in this perception of economic and corporate health, some leading-edge baby boomers started
retiring at age 55, and didn’t seem to mind when Washington made cuts in Social Security and Medicare benefits to help balance the budget. They didn’t need to worry; their investments and retirement provisions promised a very comfortable lifestyle.

In reality, however, serious economic problems loomed just beneath the surface. By 2004, a large and rapidly growing share of the intellectual and physical assets of key sectors such as automotives and electronics was now located in China, Southeast Asia, and Latin America. The U.S. aerospace industry was hanging by a thread. Much reduced were the high-wage jobs that were the hallmark of these industries. This sparked protectionist opposition in the U.S., but no large-scale revolt. People still had jobs and managed to pay their bills. Besides, consumers had grown smart about world trade matters. They liked the inexpensive and increasingly world quality imported goods to which they long enjoyed access. The last thing they wanted was a trade war (which by the way would inevitably victimize some family member employed in an export-oriented industry).

True U.S. leadership remained concentrated in — non-manufacturing industries like information technology, health care, and pharmaceuticals. Though the U.S. suffered only one actual recession during this time (1997-1999), overall U.S. GDP growth averaged a paltry 1.5 percent between 2000 and 2005.

China and Southeast Asia, meanwhile, capitalized on the problems of the increasingly aging and noncompetitive markets of the West. Singapore emerged as a strong financial market after a series of trading scandals in Tokyo shook investment markets in the early 2000s, setting the government on a strict financial markets reform binge. Asian companies succeeded at gradually increasing their ownership shares in formerly U.S. and European manufacturing assets. Likewise, Asian companies and governments now accounted for a very high share of Internet traffic and, before long, took the lead in creating their own Asian language information networks and communication protocols.

The internal markets of Asian countries “took off.” By the turn of the century, China boasted the world’s third-largest market after the United States and Japan. Many Western pundits had an exaggerated sense of China’s frailties.

Deng Xiaoping’s passing in 1998 failed to create the tumultuous succession struggle in Beijing that the world had for so long anticipated, adding to China’s ability to steadily grow its economy through the turn of the century. (At the fifteenth annual Brookings Institution China After Deng conference in 1997, leading Chinese scholars again predicted a prolonged succession struggle.) However, when Deng’s successor Jiang Zemin perished unexpectedly in 2004 (when his Chinese-manufactured Boeing 737-1200 crashed off the coast of Hong Kong), neither Beijing nor the world was prepared for the brief but intense power contest that ensued. Under Jiang’s rule, China’s liberal faction had reemerged as a potent political force and was poised to make a play for party and government leadership. The military, long pacified by Jiang’s modernization policies, grew nervous over the prospects of a reformist government. The military staged a feigned move against Taiwan, not so much to achieve independence (the Taiwanese and Chinese economies were so closely integrated by this time that even the People’s Liberation Army recognized the dire
economic consequences that would follow military action against Formosa), but more to reassert its influence in domestic Chinese politics.

Sadly, the United States grossly misinterpreted the Chinese Army’s actions. Because of growing animosity over China’s growing economic prowess fueled by the protectionist camp (as well as a massive outflow of talented China analysts from the U.S. Intelligence Community), the prevailing view inside the Beltway was that an invasion of Taiwan was imminent, and the U.S. administration was pressured to slap heavy economic sanctions on Beijing. The U.S. failed to marshal international support for its actions (European governments had correctly interpreted China’s military maneuvers as nothing more than Chinese political infighting), and the economic sanctions had a negligible effect on China’s economy. By the time the U.S. lifted the sanctions in 2006, its reputation as a reliable trading partner was greatly tarnished not only in China but also throughout Asia. A market of more than 2 billion people was virtually lost.

The convergence of a loss of Western industrial leadership in key sectors, growing Asian economic and political power, the trade dispute with China and its aftermath, and structural economic problems in the U.S. set the U.S. economy on a downward slope in 2006. With the bulk of the U.S. labor force increasingly finding employment in low-wage service jobs (want ads for the Gap appear weekly in the Sunday New York Times where solicitations for computer programmers and electrical engineers once ran), U.S. tax receipts declined. This coincides with the bulk of the baby-boom generation’s entry into old age, placing enormous pressures on the tinkerered-with-but-unreformed Social Security and Medicare systems. The increasing political power of this demographic group — the ranks of the AARP swelled by 20 percent between 2006 and 2012 — made it almost impossible to achieve structural reform in the entitlements system, causing the U.S. budget deficit and debt to balloon to levels that surpassed the debt of the early 1990s, sending the nation into recession. Unemployment approached 10 percent, underemployment was severe, and overall consumer confidence was at a 20-year low. In a much ballyhooed event, U.S. and European governments held a conference in 2011 to discuss ways to achieve drastic reform of their beleaguered social welfare systems.

Significant research and development capacity followed U.S. and European manufacturing overseas, and what little R&D was left was cut to the bone by short-term-minded corporate leaders trying to squeeze even more profits. Real economic recovery would not occur for another six years. At the same time, the foreign students that streamed into U.S. colleges and universities are now returning home to capitalize on the opportunities there at the same time that U.S. applications drop, leaving classrooms and laboratories — and endowments — virtually empty. College has become an increasingly unattractive option for many; the lack of high-paying jobs hardly makes the average annual tuition of $100,000 worth it. Very little new intellectual capital was being generated in the United States.

Meanwhile, Asian economies in the late 2000s truly came into their own. Japan got its financial house in order and was once again a strong investor in the region. China and Southeast Asia are on their way to becoming industrialized societies and have assumed solid leadership in several sectors, especially those that are technology and R&D-intensive. When the Shanghai-based Xingou Technologies began mass producing and exporting its “biochip”— a device that
transformed artificial intelligence into the real thing — China was finally able to tout its status as a world leader in both biotechnology and computer hardware. Before long, almost every Asian economy found its industrial niche: in Malaysia, it was automobiles; India, software; Indonesia, aerospace. In Latin America, Mexico, and Brazil were the regional hubs for automotive manufacturing; Chile was the leading developer of Spanish-language software.

The late 2000s also saw a dramatic shift in political and military power eastward. Distrust of U.S. motives in the Pacific Rim remained strong in the aftermath of the ill-fated U.S. trade war with Beijing, and few tears were shed when Washington announced that it would relocate more than 80 percent of its military assets in Asia back to the U.S. due to budgetary constraints. China, which had invested heavily in its military and now possessed state-of-the-art fighter aircraft and naval platforms, quickly stepped in and became the dominant regional military power. It resurrected the Southeast Asian Treaty Organization and goaded (somewhat forcibly) its southern neighbors into a rigid security pact; even Vietnam felt compelled to join. In a quirk of history, the new SEATO charter was signed on the very same day that NATO, whose members were unable to sustain their respective security commitments, announced the dissolution of its military pact. To the north, Japan, still wary of Chinese military intentions, struck a tenuous security alliance with Russia and India.

Fortunately, global security threats were relatively low. Ideologies have been replaced by the desire to cash in, and no major regional tensions are apparent. Even the Middle East was uncharacteristically stable after mild turmoil in the late 1990s, allowing for healthy petroleum supplies at prices that rise only modestly, in pace with inflation. The most significant military threat for the new Asian security system is the occasional flare-up of domestic turmoil in countries that have been left behind the economic wave. China has on occasion been forced to send peacekeepers to “the three B’s” (Bangladesh, Burma, and Bhutan) when civil unrest threatened to interfere in regional trade flows.

By 2015, the transformation was complete. The U.S. and European economies had rebounded from their late 2000s downturns and, though hardly robust, were getting by. Consumers, however, exhibited a weary resignation to the extraordinary changes that had taken place in the global economy, and a sense of missed opportunities was pervasive. The decline in wages had leveled off, but the absence of well-paying jobs meant that most middle-class wage-earners were holding down two jobs, creating intense time poverty pressures. Job security was tenuous.

The U.S. technical and research infrastructure is tiny compared to what existed in the 1990s. A record number of private U.S. universities closed between 2011 and 2015, and the small percentage of middle-class high school seniors opting for college tend to favor community colleges over larger, four-year institutions. Corporate investment in R&D tends to be overseas. U.S. servicemen and women have been introduced to no new military platforms in nearly 10 years, and the services are struggling to extend the life of systems well beyond their intended longevity. The nation’s infrastructure is crumbling as federal and local agencies are able to afford only patchwork repairs to the road, rail, and telecommunications networks. The only bright spot: the emergence of the U.S. as the world’s most popular tourist destination for Asian vacationers. The best roads in the country can now be found in the greater Disney World vicinity, and the
Orlando airport has displaced New York’s JFK as the initial U.S. point of entry for the majority of international travelers.

Asian governments, meanwhile, are now moving quickly to the center of global political, economic, and military power and influence. Their economies are developing, their militaries modern, and they hold considerable sway over the rules of international commerce. Asian needs and interests are now figured into international aviation treaties and landing rights agreements. The International Civil Aviation Organization has moved its world headquarters to Tokyo.

The emerging have emerged; the declining declined.