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This month's newsletter is part 1 of an update to my book The End of Growth: Adapting to our New Economic Reality.

In *The End of Growth,* published in September 2011, I made the observation that world economic expansion, which has been barreling along for the past few decades, is now stalling. The book further claimed that this is not an outcome we can prevent; we can only choose whether and how to adapt. I argued that economic contraction is inevitable at some point since we are already over-using most of Earth's important resources, and that limits to debt and to affordable oil supplies, along with worsening environmental disasters, are conspiring to bring about the reversal roughly *now* (i.e., this decade). Some countries will do better than others, and temporary partial recoveries are possible. But for the foreseeable future, contraction—not growth—will be the norm.

So: how are we doing just nine months later? Is the global economy mending or teetering on the brink? Is the book's hypothesis confirmed or disconfirmed? Let's take a quick world tour and see.

We'll start with a survey of the European scene; from there we'll expand our gaze to include the United States, China, and Japan. Then we'll take a look at some of the deeper social and ecological factors required for growth—ones that most economists tend to gloss over. We'll end with an overview of some of the more hopeful ways society is coping with the biggest economic transition in history.

Neither a borrower nor a lender be . . .

So much has been written about the Greek debt crisis in recent weeks that there is little point in rehashing what has already been hashed to pieces; however, a grasp of the core issues here is absolutely vital to understanding what's being called the industrialized world's "growth crisis." So let's see if we can get to the heart of the matter. In order to do that, we'll take Berlin—rather than Athens—as our entry point.

If you don't understand Germany, you'll never understand what's happening in Greece.

On its face, the German economy is *gesund*. Companies are raking in profits and employment levels are high. However, the majority of German workers enjoy few of the fruits of what the *Economist* has called "Germany's economic miracle." They're upset about

deregulation of the jobs market and the resulting rise in economic inequality.

What does that have to do with Greece? Plenty, as it turns out.

During the past couple of decades, French and German banks loaned enormous amounts to the Mediterranean countries. Germany's export-driven economy expanded while the peripheral countries piled on more and more debt. To oversimplify: Germany was financing Greek consumers to buy more Mercedes cars.

Germany's ability to export was helped by policies to keep domestic wages down. The country's unemployment rates sank consistently, even after the Lehman collapse, while they rose in every other EU country during the same period. But stagnating wages led to an increase in social inequality also unmatched in any other European nation. High external demand for German products and low labor costs made Germany a powerhouse, but helped keep peripheral nations weak and debt-ridden, and sowed the seeds for eventual social unrest within Germany itself (though that shoe hasn't dropped yet).

With its manufacturing booming, Germany had to pay far less to borrow than did its European counterparts. And now that Greek, Spanish, and Portuguese sovereign debt is looking ever less palatable to potential investors, even more money is fleeing peripheral countries' markets and heading for Germany. Having underwritten most of the Greek bailouts so far, and having seen the crisis in Athens re-erupt repeatedly, Germans are said to be "losing patience," as though the sovereign debt crisis is entirely the fault of the "lazy" Greeks. But the situation is not so simple. Actually, Greek workers put in more hours than those in just about any other European country; their problem isn't laziness, but low labor productivity resulting from less mechanization. In reality, the crisis is systemic, and Germany is an integral part of the system.

Of course, it would be just as wrong to say that Greece's problems are all Germany's fault. The Greeks (and the Spanish and Italians and Portuguese and Irish) took on extraordinary and imprudent amounts of debt—household as well as government debt—in the belief that expected rapid economic growth would make repayment easy, or at least possible. In some ways the German-Greek dynamic is reminiscent of the Third World debt bubble of the 1980s, which was deliberately engineered by Western banks (including the World Bank and IMF), with the complicity of corrupt or merely compliant local regimes (see *Confessions of an Economic Hit Man* by John Perkins). Except this time, rather than a poor African nation with a subsistence economy, the country that's being brought to its knees by structural debt just happens to be the cradle of Western Civilization.

Germany desperately wants to avoid a break-up of the euro zone. It needs trading partners within the EU to continue importing its goods, and it also needs a low-valued euro to keep its overseas exports attractive; if Greece, Portugal, Spain, and Italy were to leave the euro zone, the value of the euro would probably rise. So Germans have little incentive to address underlying imbalances. Indeed, Germany has consistently opposed initiatives to end the euro zone crisis—euro-

area bonds, a more activist role for the European Central Bank, and a drastic increase in the size of the European bailout fund.

With a new government in France and elections looming in the US, Germany is facing more pressure on these issues from allies (even Barack Obama has reportedly told German Chancellor Angela Merkel to lighten up on the Greeks). Merkel's center-right party lost big in recent elections in the most-populous German state, and popular domestic sentiment appears to be building for a loosening of stimulus funds bound for Athens.

But despite public statements of support for measures to stoke economic growth in the peripheral countries, Merkel and Germany are stuck. Sixty-one percent of Germans still support a policy of austerity for Greece, according to recent polls. And Germans are not convinced Greece needs to be kept in the euro zone at any price. Ultimately, that's what it comes down to: the price for Greece to stay, versus the price to leave; and the price to Greeks, versus the price to Germans. Each price appears unacceptable to one party or the other—hence the incentive to delay the day of reckoning. But it cannot be put off more than a few more months, perhaps only weeks.

. . . but especially not a borrower!

Meanwhile in Greece there is a notable lack of enthusiasm for spending cuts and privatization programs that the EU (read: Germany) and International Monetary Fund have been demanding if the country is to remain in the European Monetary Union and avert default. Spending cuts are (quite predictably) eviscerating the Greek economy, leading to ever-higher unemployment, bankruptcies, and a general drying up of public services. Due to a failure by Greece's main political parties to build a governing coalition after the May 6 election, new polls have been slated for June 17; the result may be a coalition that rejects austerity altogether. Many commentators now say it's only a matter of time before Greece leaves (or is kicked out of) the euro zone. The consequences being forecast range from nasty to ruinous, depending on whose analysis you choose to believe.

For Greece itself, the euro exit scenario starts with the requirement to create a new national currency, complete with bank notes. The initial switch could happen over a long weekend, during which all commerce would be halted. Whatever its official initial exchange rate, the new currency (presumably, the new drachma) would very quickly lose value. With Greeks' foreign debt and prices of imported goods denominated in higher-valued foreign currencies (in most cases, the euro), the cost of servicing external debt and of paying for imports would explode. Greece would have to adopt capital controls to prevent deposits from fleeing the country. A massive black market would spring into existence. The country would see a dramatic fall in GDP (roughly 50 percent, according to UBS). Bankruptcies would cascade through the system. The Greek government could resist falling living standards by printing more money (something it cannot do while the euro remains the national currency), but that would lead to inflation—perhaps hyperinflation. For the Greek people, all of this would feel like economic Armageddon.

Some commentators choose to put a cheery spin on Greece's

euro-exit prospects. *The Guardian*'s Simon Jenkins has argued that the pain of "Grexit" is only exacerbated by delay. "Only with the decks cleared of debt can Greece, like Iceland and Argentina before it, start rebuilding its economy at a realistic rate of exchange," he writes. Others say that a Greek exit would actually boost global markets over the short term because the European Central Bank, the Federal Reserve, the International Monetary Fund, and the stronger European governments would engage in quantitative easing, interest rate cuts, stimulus spending, and sovereign bond purchases in order to keep the euro zone from imploding. Free money!—for those with the right connections.

Anticipating more bad economic news in the weeks ahead, Greeks have been withdrawing hundreds of millions of euros from their bank accounts. Over the past few months, a billion euros a month, on average, have fled the country. So far the bank run has not hit crisis proportions, but it is at least symptomatic of what could lie ahead for that nation . . . and others.

One way or another, something has to give—and fairly soon. Here is Theodoros Pangalos, Greece's deputy prime minister, trying to sell austerity to his countrymen by painting a picture of what will happen without spending cuts: "We will be in wild bankruptcy, out-of-control bankruptcy. The state will not be able to pay salaries and pensions. This is not recognized by the citizens. We have got until June before we run out of money. We have been spending the future for half a century. What [the anti-austerity forces] are really asking from the EU is not just to pay our bills, but also to pay for the deficit which we are still creating." But here, on the other hand, is Alexis Tsipras, the 37-year-old leader of Syriza, the principal anti-austerity party: "You saw the results [of austerity]—our country is collapsing. Let's try something new." But what, exactly?

The really dire threat from the Greek crisis is *contagion*: the possibility that if Greece left the euro, this would raise the likelihood of other nations (Spain, Portugal, or Italy) doing the same in order to lower the value of their debt by inflating their (new) currencies. Banks would demand higher rates on government bonds from these countries. Having to pay higher interest on their debt, ex-euro nations would fall further into deficit spending, and would therefore need to borrow even more. This would become a self-reinforcing feedback loop, a prescription for systemic collapse—something far beyond the ability of any central bank to manage. A euro-wide capital exodus would ensue, increasing the chances of a breakup of the 17-member European monetary union.

At this writing, it appears that German policymakers are cobbling together a plan to ease Greece's exit from the euro zone. Bondholders will be compensated. The European Central Bank is said to be ready to inject emergency funding and to resume its purchases of sovereign bonds from Spain, Italy, and Portugal. There is probably also a plan to assist Greece in its transition to the new drachma, including stimulus money to prevent the nation's economy from entering free-fall.

Thus the end game for Greece itself constitutes a sort of economic banishment. After two years of privatization and cuts to payrolls and

pensions, the nation will be unceremoniously cut adrift. And then the focus will shift to the next country in dire straits.

What do you mean, "we"?

For the European Monetary Union generally, the fundamental problem seems startlingly obvious: How can a single currency serve 17 nations with 17 different public debts—which bond markets can target one by one? A nation ordinarily fends off such attacks, at least temporarily, by devaluing its currency, but members of the EMU cannot do this. Critics say it's a fatal flaw built into the heart of the euro experiment. (Even Mario Draghi, president of the European Central Bank, now calls the structure of the euro zone "unsustainable.") Since member nations have no monetary policy tool with which to reduce the weight of sovereign debt, the weaker ones will eventually reach the point where they must choose: either pay off the banks by allowing their country to be looted, or stiff the banks and endure a banking crisis, complete with ruined investors and swooning stock markets. There's not much middle ground.

Given this setup, it's understandable that a global debt and growth crisis would show its worst symptoms in Europe early on.

For the Europeans, low or negative economic growth makes matters profoundly worse than they would otherwise be. With stagnant or declining economic activity, debt payments become harder to make. Greece, Spain, Italy, Portugal, the Netherlands, Ireland, Slovenia, and the UK are all now in "technical" recession. According to OECD Chief Economist Pier Carlo Padoan, the euro zone economy could contract by as much as 2 percent this year.

The EMU will eventually (that is, within the next few months) either have to endure a monumentally costly break-up, or forge a tighter fiscal union with "debt-pooling," joint budgets and tax systems, and guarantees against default. The domestic political resistance to the latter would be prohibitive in several nations—and even a single country might be able to torpedo collective efforts to centralize and shore up the euro system. It's just remotely possible that European political and financial leaders might be able to cobble together one short-term fix after another until some sort of workable long-term solution can be agreed upon—but that's only possible if there is enough economic growth in the interim to keep all wheels on the tracks. Without growth, it's difficult to see how a train wreck can be averted.

And the growth signs are not good, as becomes ever more apparent the more deeply we drill into the data.

According to statistics institute INE, Spain's economy contracted by 0.3 per cent in the first quarter of 2012. Spanish Prime Minister Mariano Rajoy told the Senate recently that the country's banks, corporations, and regional governments have been locked out of international credit markets. The only institution in Spain that is still able to issue debt, according to Rajoy, is the Spanish Treasury itself. On May 17, Spain held a bond auction at which interest rates shot up to levels similar to those that resulted in the need for bailouts for Greece, Ireland, and Portugal. Meanwhile the nation's banks are stuck

with nearly $200 billion euros' worth of what the Bank of Spain calls "problematic" real estate-linked assets. On May 25, the nation's fourth-largest bank (Bankia) asked the government for 19 billion euros to reinforce its "solvency, liquidity, and solidity." The problem is systemic: Moody's has cut the debt ratings of 16 Spanish banks, and the entire sector appears headed for crisis. Meanwhile, Spain's unemployment rate is 25 percent and rising, and retail sales declined in April by nearly 10 percent.

Italy's government would actually be running a surplus were it not for the need to pay interest on its debt. But markets have recently demanded higher interest on Italian bonds, and the nation will soon be paying over five percent of its GDP on interest payments on government debt. Like Spain, Italy is seeing slight declines in GDP.

Ireland was the only euro zone member that made its agreement to the new euro-zone Fiscal Compact Treaty (which Merkel championed, with help from Sarkozy) contingent upon a referendum—which took place May 31. Despite the fact that Ireland cannot possibly comply with the treaty (which demands a balanced budget and no higher than a 60 percent debt to GDP ratio), the Irish government pushed strongly for an affirmative vote anyway, and won it. Meanwhile house prices in Ireland are still falling, as are retail sales, construction, and industrial production. The economy has contracted for the past two quarters.

The economy of France is stuck in neutral, having failed to grow in the last quarter of 2011. The nation recently tossed out Nicolas Sarkozy, who had been providing Angela Merkel significant support at EU financial meetings, and elected François Hollande, a socialist who believes the solution to the Greek crisis lies in investment and spending to boost growth. But if growth doesn't materialize, more stimulus spending will simply mean bigger deficits, more borrowing, and higher interest payments.

In the Netherlands, the minority government recently lost support from the Wilders party, which did not approve the proposed austerity measures; new elections are scheduled for September. Yet another rebuke to the cheerleaders of austerity. Which means not just that Angela Merkel must be feeling lonely these days, but that European economic policy is in flux. That's not good news to the bond markets.

The UK is a major player in the European Union, but because it retains its own currency it's not part of the euro zone. Yet despite being somewhat insulated from the euro crisis, Britain's economy shrank by 0.3 percent in the first three months of this year. Its longer-term prospects are not much better: Britain has for decades allowed its productive base to languish, hiding the fact by squandering its North Sea oil and gas revenues (which are now quickly evaporating) and by taking on far too much debt. No help there.

In sum, a critic looking for evidence to debunk *The End of Growth* would do best to pretend that Europe simply doesn't exist. Nothing to see here, folks. Move along.

The US blues

Surely there's cheerier news to be gleaned from the world's biggest economy, that of the United States. This nation is ostensibly in recovery, though (as discussed in chapter 2 of *The End of Growth*) most if not all post-2008 GDP growth has been attributable to Treasury and Federal Reserve actions—borrowing, spending, and bailouts.

The real current status of the American economy is a matter of controversy. There are several relevant metrics—including GDP, unemployment, house prices, durable goods orders, government deficits, trade deficits, new debt, personal income, and personal spending—and some numbers look better than others. Which ones are more important? You can describe the glass as half-full or half-empty, depending on your preferences and how you cherry-pick the data. Still, just about everyone agrees that the statistics show persisting weakness. Job growth and GDP growth are both slowing. And the ratio of US government spending to government income rose to 1.46-to-1 in calendar year 2011. Immediately on the horizon is a gradual curtailment of extended unemployment benefits for the millions who lost their jobs after the 2008 meltdown: this will decrease the buying power of consumers just as the economy struggles to gain altitude.

But it's not so much the monthly numbers as the deep, structural trends that are the greatest cause for concern. The unsustainable bubble of household debt built up over the last 30 years still has a long way to go in order to deflate back to realistic levels, while tranches of toxic assets still lurk in the asset portfolios of major banks. And Wall Street appears to have learned nothing from the 2008 crisis, as shown by JPMorgan's recent $2 billion trading loss. If European sovereign defaults occur on a large scale, derivatives contracts will be triggered—contracts written (in most cases) with Wall Street investment banks, which will quickly be sucked into the whirlpool.

Of equal concern is the highly dysfunctional US political system, which now seems incapable of solving even the most trivial of problems, and is apparently intent on exacerbating just about every crisis the nation faces. Substantive policy appears to emerge not from the public deliberations of elected leaders, but from unaccountable government agencies and private interest groups with highly disparate agendas. One of the two US political parties has evidently taken leave of reality altogether, preferring to exist in its own hermetically sealed ideasphere in which climate change is a hoax and all economic problems can be solved by cutting spending and taxes, and in which everyone who disagrees with that agenda is by definition a Communist-terrorist-Muslim. The other party, which spends most of its time shoring up the allegiance of its traditional constituencies, takes mostly center-right positions on issues, is ineffectual, and has no realistic strategy for coping with the economic unraveling. It's probably safe to say that most dinner conversations these days among knowledgeable journalists, social scientists, and retired public figures eventually devolve into expressions of the opinion that the United States is showing all the signs of an empire in steep decline. Heads nod wearily until someone changes the subject.

There's been no more relevant and disturbing symptom of this

national political incapacity than last year's showdown on the debt ceiling, which Republican House Speaker Boehner has voiced intentions of restaging this year. In 2011, the crisis was defused only with a joint agreement to a series of mandatory spending cuts that are scheduled to kick in soon after this year's presidential election—unless nearly inconceivable budget reforms are achieved. Erskine Bowles, co-chairman of President Obama's budget-deficit commission, recently described the series of "cliffs" the country faces at the end of 2012, when the George W. Bush tax cuts expire and the mandatory cuts begin. "If you add all those up," said Bowles, "it's probably $7 trillion worth of economic events that are going to occur in December. And there's been little to no planning for that." The Congressional Budget Office is now warning that the economy will shrink by 1.3 percent in the first half of next year if these measures go into effect.

It's likely that last-minute negotiations will keep the country from going over the cliff solely as a result of the mandatory spending cuts. But America appears to be careening from crisis to crisis, and the stopgaps are losing efficacy.

The sun also sets

By now skeptical readers may have concluded that we are cherry-picking the evidence to confirm our hypothesis that global growth is ending. An argument *against* that hypothesis would surely start with data from China, whose economy has continued expanding at about 9 percent per year in recent years even in the face of deepening worries elsewhere.

But China is slowing too. And its problems may end up being just as deep as those in Greece or the US. Beijing has built the world's preeminent export economy—and now some of its biggest foreign buyers are losing consumption capacity. Loaning even more money to the US won't help much.

Shipbuilding is down. Government investment in railways is down. Electricity consumption is down. Housing sales are down. The amount of new loans is falling. Ambrose Evans-Pritchard writes in the *Telegraph:* "All key indicators of China's money supply are flashing warning signs. The broader measures have slumped to stagnation levels not seen since the late 1990s. Narrow M1 data for April is the weakest since modern records began. Real M1 deposits—a leading indicator of economic growth six months or so ahead—have contracted since November. They are shrinking faster than at any time during the 2008-2009 crisis, and faster than in Spain right now. . . . If China were a normal country, it would be hurtling into a brick wall. A 'hard-landing' later this year would already be baked into the pie."

Of course, China is *not* a "normal" country—the government can restructure the economy at will. But does that mean China can escape the economic laws that apply everywhere else? Perhaps to a certain extent or temporarily, but not entirely.

The latest news: Chinese officials have said that they have no intention of repeating the massive stimulus spending of 2008-2009 in

order to stoke more economic growth. Prepare for that hard landing.

India, Russia, Brazil, South Africa—all are seeing slowing rates of growth. India's industrial output fell in March (according to the *New York Times,* "the rupee is falling; investment is down; inflation is rising; and deficits are eating away at government coffers"). Brazil's car sales are down 15 percent on an annual basis and industrial production is contracting.

The overall picture is certainly not brightened much by Japan, the world's third-largest economy. The country's weak banking system, softening exports, and lack of domestic energy resources are challenge enough. But the lingering Fukushima nuclear nightmare is surely Japan's the biggest worry. The spent-fuel pool at reactor 4 is in a precarious state, such that a moderate quake could release far more radioactive cesium than Chernobyl did. Meanwhile, Japanese scientists acknowledge a greater than 90 percent probability that an earthquake of at least 7.0 magnitude *will* occur in the next three years somewhere near Fukushima-Daiichi. Japan and Tokyo Electric Power Company do not have adequate nuclear technology and experience either to defuse the situation in time (TEPCO says the soonest it can begin emptying the spent-fuel pool is late 2013), or to handle a disaster of the proportions that are at least conceivable, if not likely. The fate of the nation—and the health of millions in the Northern Hemisphere—may hang upon the fortuitous absence of significant aftershocks.

Our solution is our problem

We have not surveyed all the world's nations. Some others are doing quite well, thank you (Qatar had a 2011 growth rate of 18.7 percent, Ghana 13.5 percent, Mongolia 11.5 percent). But if Europe, the United States, and China falter, global GDP cannot hope to grow. The European economy alone represents nearly one-third of world GDP.

And so the hypothesis stands: Maximum world economic output is nigh. If that is truly the case, the most reasonable forecast would be for a significant decline soon, as debts default and as investors pull back. We may be in for a series of subsequent booms and busts (the booms never managing to bring us back to current output levels, the busts plunging us further into economic turmoil). Mere stagnation would be a benign outcome, one that would require considerable planning and effort to achieve, but even then resource limits (which we'll get to in Part 2, next month) would ensure contraction sooner or later.

Our solution is our problem and its name is growth. We can't live with it because, as Herman Daly points out, most growth is now uneconomic—we're actually worse off because of it. More growth just means more debt, more pollution, more loss of biodiversity, and a further destabilization of the climate. And yet we can't live without it: absent growth, there will be insufficient tax revenues and jobs, and existing debt levels will prove unsustainable in the starkest sense of that term.

The purely financial or monetary aspects of our dilemma will probably continue to take center stage in the public discussion. National

treasury officials and central bankers will strive to stabilize the system, and may be able to do so for a while—probably a matter of weeks or months rather than years. They will need a long-term strategy, though, because eventually stimulus and bailout Band-Aids will lose adhesion. Yet there is little evidence of such a strategy.

Even more, they will need a sense of ecological and historic context, so that they understand that the current growth crisis is not just a momentary speed bump on an inevitably soaring ramp of progress, but an irreversible phase change for the economy and for civilization itself.