



**DEVELOPED COUNTRIES SING THE BLUES:
ECONOMIC STRESSES AND POLITICAL LIABILITIES
IN HIGHLY INDUSTRIALIZED COUNTRIES**

Citizens of developed countries sense that their moment of economic preeminence is starting to end and that their standards of living are threatened by changing economic realities. Even as leaders of developing countries face the stressful task of managing rising expectations, leaders of developed countries face the much more daunting task of managing expectations downward. At present, citizens are voicing their displeasure with general economic conditions, inflation, jobs and wages. Their rising anger is already spilling into the streets and is just starting to overflow into markets and elections. This has started to force reactions from leaders, who are yielding to salary demands and changing government policies. As citizens sing the blues louder and louder, economic policies in developed countries will change.

Feeling Bad...but Depressed?

“Everything is just heading south,” explains a frustrated American employee of IBM when describing the economy. “You can’t...make any plans because you don’t know what you can count on.” “I have this feeling,” intones a schoolteacher in Germany assessing the local economy, “that there is a wall in front of us. We’re just not going to get any farther.” “We are cycling against the wind,” adds an economically stretched research associate in France. “We have to pedal faster so we don’t slow further.

But pedaling faster doesn’t mean we will necessarily go faster.” “No one thought during the 1980s,” claims an economist in Germany, “that they could possibly belong to a group of people who [would] slide down the social scale.” A Parisian teacher points to a larger effect of current problems: “This is the most depressing thing: I already know that I will end up poorer than my parents. What does that mean for my children?” A single mother in Spain sees trouble in the making: “The middle class used to live well. And if you have lived well, it’s hard to live so badly.” (*Wall Street Journal*, 4/1/08; *International Herald Tribune*, 4/30/08)

This series of pessimistic perspectives outlines a growing sense among citizens of industrialized countries that their moment of economic glory has started to pass. Their comments are not complaints about transitory troubles but rather suggest that changing conditions are forcing them to rethink their vision of the future. Fully 43 percent of Americans think the next generation will be less prosperous than the current generation – an eventuality that has never happened in U.S. history – and just 27 percent think their offspring will be more prosperous than they are. Moreover, 81 percent of Americans think the country is headed in the wrong direction. In a European survey on three economic indicators – the economy in general, employment and purchasing power – a majority of respondents felt their respective countries were doing badly in all three areas. Consumer confidence surveys in England hit a 13-year low, while in France, similar surveys reached the lowest point since 1987, when such studies first started in the country. A Japanese minister interpreted his country's economic realities by concluding that "Japan can no longer call itself a top-notch economy." (*Financial Times*, 2/28/08 and 2/29/08; *Independent [London]*, 2/29/08; *International Herald Tribune*, 1/27/08 and 2/8/08)

Such a substantial shift in perspectives among those in industrialized countries highlights a problem that will continue to make life difficult for leaders in both the public and private sectors. In the global economy, shifts in influence, resources and wealth are forcing revaluations of conditions in the once all-powerful industrialized giants (see "'Global Markets Are Well Supplied': State-Owned Suppliers and the Market for Critical Resources," **IF 2906**, 3/20/08).

While economically difficult times still await developing countries, their standards of living are on the upswing, creating the problem for their leaders of how to manage rising expectations. At the same time, while economic advantages are still quite evident in developed countries, their citizens' standards of living are, in general, contracting, creating the problem for their leaders of how to manage expectations downward. While neither leadership prospect is rosy, our observations suggest

that of the two – managing rising expectations or managing expectations lower – the latter will be more challenging and more fraught with conflict and risk.



Reasons to Sing the Blues

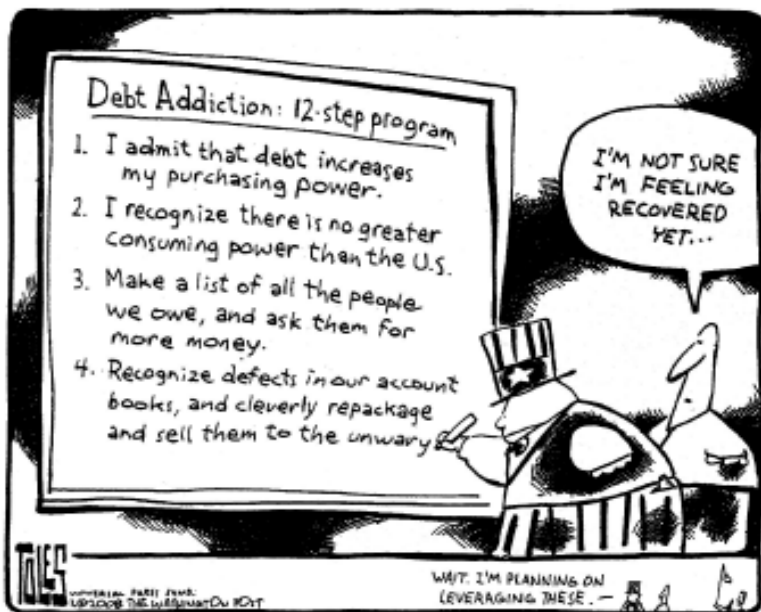
The negative sentiments that are creeping into individuals' perspectives on their current and future conditions reflect the stresses in their economies in general. What seems to worry those who are "singing the blues" is the sense that this is not a normal cyclical slowdown. Economic downturns have come and gone with some regularity since World War II. But many of these citizens sense that this downturn is qualitatively different. Wealth is being squandered – or aggregating to fewer people at the top – and the standard of living for roughly 90 percent of the population is melting away. Many Americans feel that something structural, systemic and permanent is taking place, shifting money, power and status away from industrialized countries to developing countries such as Brazil, Russia, India and China (BRIC) – thus, the negative assessments of the years ahead. Whatever the perspective, developed countries' economies continue to spew less-than-optimal numbers.

Overall economic realities – Acknowledging that labor forces in most industrialized countries are decreasing in size relative to the overall population, a

recent report for the Conference Board reckoned that advanced countries “will need to raise productivity growth rates to well beyond 2 per cent a year over the next two decades to maintain current per-capita income growth rates.” From 1945 through 2004, the U.S. had averaged roughly two percent annual increases in productivity. Last year, the U.S. increased its productivity by 1.1 percent, the third year in a row of below-average increases. Meanwhile, in the European Union (EU), the 15 core members (those joining before 2004) managed to increase productivity by only 1.3 percent in 2007. In short, their productivity figures are not generating the kind of growth necessary to sustain even minimum expansions of the economy. (*Financial Times*, 1/15/08)

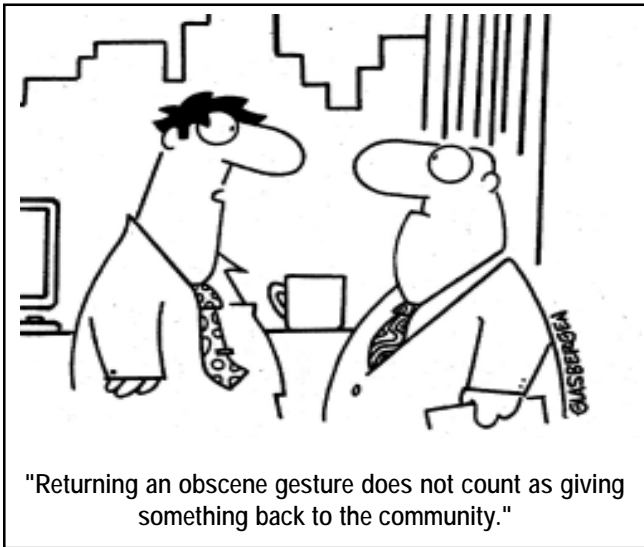
In the final months of 2007, Eurozone economic growth slowed considerably, with the fourth-quarter gross domestic product (GDP) of the 15 core countries expanding by just 0.4 percent. In February, despite a slight upturn that would eventually increase first-quarter growth to 0.7 percent, the European Commission lowered its expected 2008 GDP for the 15 countries from 2.2 percent to 1.8 percent and did the same for the larger European bloc of 27 countries, from 2.4 percent to 2 percent, with Germany expected to supply most of the boost. The British government just announced that it expects the English economy to contract for at least two quarters, the country’s bleakest forecast since Labor took power in 1997. (*Wall Street Journal*, 2/22/08 and 5/16/08; *Financial Times*, 2/14/08 and 2/22/08; *Investor’s Business Daily*, 5/15/08)

Inflation – The gloom pervading citizens of most industrialized countries has much to do with their own sliding status, and the most recent cause of that slide has been inflation. In the U.S., wholesale price increases for all of 2007 reached 6.3 percent, the biggest annual gain since 1981. Across Europe in January of this year, inflation was running at an annual rate of 3.2 percent, the highest in 15 years. Of course, a sizable portion of this inflationary move results from energy costs, a significant shift in costs that are, for the most part, in the hands of governments and leaders **not** from the developed, industrialized countries—a sign that influence and power are drifting away from highly developed countries. “It’s flabbergasting,” exclaimed one shopper in Dublin. “Things are going up by the week.” (*Associated Press*, 1/15/08; *International Herald Tribune*, 1/11/08 and 4/29/08)



Jobs & Wages – What makes inflation even more troubling is the fact that wages have not kept pace with inflation, essentially sending household incomes into negative territory in real terms. For instance, consumer prices in France, which increased 3.2 percent in the 12 months ending in March, have increased four times faster than workers’ salaries. In Spain, a “mleurista,” a term coined to describe a generation of young people whose entry-level salaries have not kept pace with inflation, cannot afford to buy or rent a place to live in Madrid. Real employee salaries in the U.S. remained essentially flat between 1999 and 2005 and are for the most part down since then, triggering one of the greatest expansions in overall

consumer debt in history (from \$7.4 trillion in 2000 to \$14.4 trillion at the end of 2007). Meanwhile, in Japan, average wages have declined every year in the past decade except two, resulting in a decline in consumer spending in seven of those years. In a global context, workers in developed countries see their salaries drifting downward, and it does not feel good. (*International Herald Tribune*, 4/30/08; *Newsweek*, 4/28/08; *Wall Street Journal*, 1/7/08)



Anger Rising

"In France, when you can't afford a baguette anymore, you know you're in trouble," an irritated Frenchman notes, before adding ominously, "The French Revolution started with bread riots." While bread riots have yet to materialize and while the walls of the Bastille have not been scaled in anger, citizens of France and other developed countries have not gone quietly into their night of economic misfortune. In fact, the combination of their economies' quest for increased productivity in the midst of substantial inflation and stagnating (or declining) salaries has started to trigger public discontent.

◆ In England, teachers, college lecturers, coast-guard staff and civil servants joined in a "day of discontent." More than 50 rallies took place across the country, the most the country has experienced since Labor came to power in 1997. In fact, that action marked the first teachers' strike in England in 21 years. Meanwhile, oil workers in the North Sea also went on strike, demanding that their pensions

remain the same and their pay increase. (*Guardian Weekly*, 5/2/08)

◆ In late May, truckers and haulers in England clogged the streets of London's city center, protesting 50 percent increases in diesel fuel, made worse by a hefty government tax added at the pump. (*Associated Press*, 5/27/08)

◆ Rail-worker strikes earlier this year paralyzed Germany and resulted in a settlement that increased wages by more than 4 percent for most workers and even by double-digit figures for some. More recently, IG Metall, the country's largest union, staged "warning strikes" across the country and was sufficiently compelling in its demonstration of determination that steel companies agreed to a 5.2 percent increase in wages across the board for its workers. (*Wall Street Journal*, 2/21/08)

◆ Hundreds of thousands of teachers and public-sector workers went on strike in France, protesting the government's plan to cut as many as 11,200 jobs from education. Meanwhile, Greece's two largest unions staged strikes that shut down airports, banks and government offices. They were expressing their anger over government plans to change pension contracts and privatize more enterprises. (*Wall Street Journal*, 5/16/08)

◆ On docks up and down the West Coast of the U.S., longshoremen went on strike to protest the money being "wasted" on the war in Iraq. That money could be better spent in the U.S., the protesters alleged. In addition, 3,600 United Auto Workers have been on strike at the Axle & Manufacturing plant in Detroit, protesting planned wage cuts. (*New York Times*, 5/2/08)



These actions are the most overt manifestations of citizens' pressure being exerted on leaders of developed countries. The squeeze of higher costs and lower salaries has forced consumers in Japan, the U.S. and Europe to make cutbacks in their spending, and some of those cuts (*e.g.*, baguettes) seem to remind them rather harshly that their standards of living are declining. As a result, they are turning against current leaders, no matter what their political persuasion.

Conservative leader Nicolas Sarkozy, elected president of France less than two years ago with a 53 percent majority, has seen his approval rating plunge into the mid-twenties, an approval rating he shares with U.S. President George W. Bush. Italy recently ousted its liberal leader and returned the conservatives to power. England's Labor Party Prime Minister Gordon Brown, having just replaced Tony Blair a year ago, is losing popularity rapidly, and his party is losing local elections across the country. Germany's Chancellor Angela Merkel's party is losing local elections as well, triggering infighting among coalition partners. Meanwhile, three separate U.S. elections for replacement seats in Congress have gone against the incumbent Republican Party, "safe" seats the Republicans had held for decades. Meanwhile, the approval rating of Japan's governing party, which recently captured the prime minister's office, has fallen to a dismal 20 percent. (*Guardian Weekly*, 5/2/08; *Christian Science Monitor*, 5/7/08)

Turnover is likely to continue, and so, leaders are working to deflect responsibility. Recently, for instance, the Indian government publicly blamed the U.S. for creating the worldwide crisis in food prices, and French Finance Minister Christine Lagarde blamed the U.S. and its weak dollar for soaring oil prices. President Bush seemed to blame developing countries and their expanding economies for the rapid rise in food prices. At the same time, other governments are yielding to citizens' demands. As one example, Germany has put economic reforms on hold and will spend more public money on social services. In England, Gordon Brown reversed an

earlier action—increasing taxes on those in the lowest tax bracket – and used public funds to refund money to those who paid the higher tax. In the U.S., Congress passed a bill – at a veto-proof level – that would continue subsidies for farmers, even though food prices are at historically high levels. (*International Herald Tribune*, 4/21/08; *New York Times*, 5/14/08 and 5/22/08)



Tough Times for Leaders

Citizens of developed countries are singing the blues, and leaders are going to have to deal with that reality. Political statements that spew facts to contradict what the citizens are singing is wasted energy... and could be politically costly. The crux of the problem is this: How can a national leader – or a corporate leader, for that matter – manage expectations downward?

The standards of living and the lifestyles that citizens of major industrialized countries have enjoyed face daunting, systemic problems. The huge shift in wealth currently taking place from industrialized/consuming countries to producing countries (*e.g.*, manufacturers like China and Vietnam and energy providers like Russia, Dubai and Saudi Arabia) suggests

why slow economic growth, inflation and stagnating salaries have hit highly developed countries: They are exporting wealth and assuming more debt. For instance, the U.S. government has borrowed at least \$500 billion every year since 2003, sending the government's overall debt past \$9 trillion – not an economic plan to sustain standards of living into the future (see “A New Financial Architecture Emerges: Wealth Transfers and Spreading Growth Force Changes,” **IF 2828**, 11/27/07; *Salem News* [Oregon], 3/15/08).

Meanwhile, the expansion of developing countries continues, with the so-called BRIC countries alone accounting for 50 percent of the world's economic growth last year. And now, the recycling of the money developing countries have accumulated has started. Those countries' sovereign wealth funds are looking at international investments – that is, foreign state-owned entities are now using money acquired from developed countries to buy portions of the non-state-owned industrialized world (see “Global Markets Are Well Supplied’: State-Owned Suppliers and the Market for Critical Resources,” **IF 2906**, 3/20/08 and “A New Financial Architecture Emerges: Wealth Transfers and Spreading Growth Force Changes,” **IF 2828**, 11/27/07).

Citizens seem uncomfortable with the direction of such activities. For example, after Citigroup and Merrill Lynch accepted multi-billion-dollar capital infusions from sovereign wealth funds in the Middle East, citizens' trust in both U.S.-based corporations declined. (*Financial Times*, 1/22/08)

The idea that the developing world is buying the developed world has been triggering nationalistic sentiments in many industrialized countries, adding another level of complexity to any leader's efforts to address already troubling realities. When a sovereign

fund “saves” a giant U.S. financial institution, it reminds those who are already having trouble with their sliding economic status that the slide may well be deep, substantial and national. That is not reassuring. Moreover, when a U.S. president visits the head of state in Saudi Arabia, as President Bush recently did, and cannot convince the leader of that oil-producing giant to increase oil production to lower global prices, American citizens might see that as further evidence of the erosion of power and influence among developed countries. That is, such a turn of events adds another verse to the blues they are already singing.

At present, citizens in industrialized countries are singing the blues, and their voices are getting louder and the beat getting angrier. This makes things difficult for leaders who must manage the economic stresses that these countries face and do so in a way that helps individuals recognize and accept their changing status in the world. In the U.S., for instance, corporations are divesting themselves of nearly all safety-net responsibilities for their employees, claiming that to pay for health care and retirement will make them uncompetitive with international companies. That means the government will need to assume more and more of those expenses, which also means that governments in the U.S. will need to increase taxes, triggering more disposable-income squeezes on consumers.

We expect the verses of the developed-country blues to get more dissonant and strident in the months ahead, pressuring governments to take additional extra-market actions to bolster GDP, slow inflation and positively affect the job market. If they do not, we expect more and more officials – no matter what their political persuasion – to be turned out of office, as citizens sing the blues while voting.