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Whose Economy Has It Worst?

With Europe, China and the U.S. in crisis, the real question is which of them will stumble first

By IAN BREMMER and NOURIEL ROUBINI

It's no wonder that global markets are so jittery. The world's three largest economies can't continue along their current paths, and everybody knows it. Investors watch nervously for signs that China is headed toward a hard landing, that America will sink back into recession, and that the euro zone will simply implode.

Edel Rodriguez

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In all three cases, kicking the can down the road has staved off disaster so far, but the cans are getting bigger and heavier. Which economy will be the first to stumble on its problems?

In Europe, the tough decisions have been put off because the principal players don't agree on how or why the trouble began. Germany and the other better-off countries blame the profligacy of Greece, Portugal and Italy and fear that an early bailout would relieve pressure on them to mend their ways. For their part, the debtor nations believe that the entire euro zone is out of balance and that more prosperous countries like Germany should export less and consume more to set things right.

Other Europeans say that a shared currency cannot survive indefinitely when monetary policy is centrally managed but each government decides how much to tax and spend. Still others warn that access to market capital requires a form of collective insurance, preferably in the form of a euro bond. Not surprisingly, Germany resists this solution because it implies a gradual transfer of wealth from the core economies to the periphery, a "transfer union" from rich to poorer states.

Yet another European view holds that the austerity plans now envisioned by Germany and the European Central Bank are worse than the disease. The Continent needs growth, not just reform and belt-tightening, they argue, and only a surge of stimulus across the entire euro area can achieve it.

The 17 countries and four European institutions now entangled in the euro zone crisis will continue trying to muddle through, but their dawdling can't be sustained. Markets are already losing confidence in piecemeal reform. Doubts about Italy, an economy too big to bail, will only add to the volatility.

An improved political picture in Italy together with a new prime minister in Greece, is helping to patch up fragile investor sentiment, but some analyst say it could be short-lived. Stacy Meichtry joins Paul Vigna and Jonathan Shipman on Markets Hub.

The market continues to pin its hope on massive intervention by the European Central Bank to restore market confidence once the new Greek and Italian governments are in place. But that may be wishful thinking. Simon Nixon joins The Markets Hub.

Associated Press

A salesperson talks to a woman visiting a housing fair in Nanjing in eastern China's Jiangsu province on Oct. 13.

European markets may have calmed down but with the future of the euro still unresolved, interest in the dollar should be on the rise. If not the dollar, then where should the hunt for a safe haven turn to next? Dow Jones's Alen Mattich discusses.

In an interview with WSJ's Rebecca Blumenstein, former U.S. Secretary of State Condoleezza Rice says she is very concerned about Europe's future as it

Europe will be the first to drop out of the game of kick the can: Expect a disorderly debt default in Greece, more trouble for European banks and a sharp recession across the continent.

In China, the need for economic reform also has become obvious. It has been four years since Premier Wen Jiabao first warned that the country's economic model is "unstable, unbalanced, uncoordinated and ultimately unsustainable" and three years since the financial crisis made clear that China's growth remains dangerously dependent on exports to Europe, America and Japan.

To ensure long-term economic expansion (and political stability), Beijing must figure out a way to encourage Chinese consumers to buy more of the products that local manufacturers make. This will demand a massive transfer of wealth from the state and China's state-owned companies to Chinese households.

But Beijing is moving in the opposite direction. The leadership responded to Western market turmoil not by boosting consumption but by increasing state and private spending on fixed investment, which now accounts for nearly half of China's growth. The result has been an explosion in residential and commercial real estate, more state spending on infrastructure and more cheap loans from state-owned banks to state-owned enterprises.

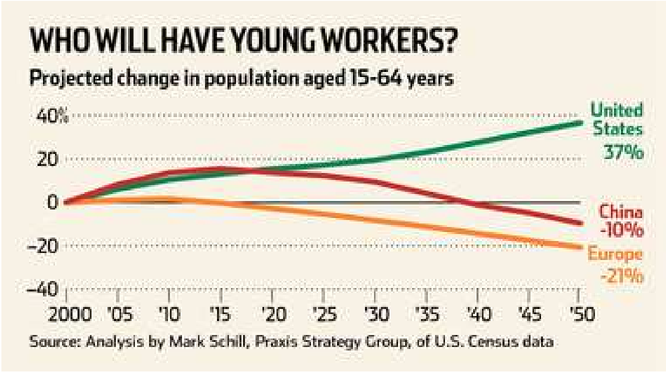
Indeed, a key obstacle to reform is that China remains so heavily invested in its state-managed model of capitalism. Of the 42 Chinese companies listed in the 2010 edition of the Fortune 500, 39 were state-owned enterprises, and three quarters of China's 100 largest publicly traded companies are government controlled. Party officials with a stake in the success of state-owned enterprises have amassed considerable power within the leadership, and they ferociously resist efforts to transfer away their wealth to private enterprises and ordinary citizens.

China has the cash and foreign reserves to postpone a crisis. But growth is slowing, financial stresses are rising, and there is good reason to fear that China's days of can-kicking are numbered as well.

Which leaves the U.S. No one can restore confidence in America's long-term fiscal health without a credible plan to cut spending on entitlements and defense while raising revenues, which are now at a 60-year low as a share of GDP. But don't expect any immediate solutions from Washington. The campaign season will only exacerbate petty partisanship and political gridlock, which means that the structural problems of the U.S. economy are likely to persist.

But the longer-term future appears much brighter for the U.S. than for either Europe or China. America is still the leader in the kind of cutting-edge technology that expands a nation's long-term economic potential, from renewable energy and medical confronts a political crisis that threatens to destroy its unity.

devices to nanotechnology and cloud computing. Over time, these advantages will yield more robust economic growth.



The U.S. also has a demographic advantage. In Europe, declining birthrates and rising sentiment against immigration point toward a population that will shrink by as much as 100 million people by 2050. In China, thanks in part to its one-child policy, the working population has already begun to contract. By 2030, nearly 250 million Chinese will have passed the age of 65, and providing them with pensions and health care will be very costly.

Despite debate over illegal immigration, the U.S. population will likely rise from 310 million to about 420 million by midcentury. Between 2000 and 2050, according to Mark Schill of Praxis Strategy Group, the U.S. workforce is expected to grow by 37%. China's will shrink by 10%. Europe's will contract by 21%.

Finally, despite the rising exasperation of the American public, the U.S. is significantly more likely than Europe or China to quit kicking the can down the road. Nothing much will change during the election year, but 2013 offers a chance for real fiscal reform.

Next November, Republicans are likely to win both houses of Congress. If a Republican is elected president, the GOP will face enormous public pressure to deliver on its reform promises. Even if President Obama is re-elected, the outlook for a grand bargain is bright. He would be free of the most immediate demands of electoral politics, and like other second-term presidents, he could begin to consider his legacy.

Make no mistake: The challenges that the U.S. faces are formidable, and persistent political gridlock could delay badly needed fiscal and structural reforms. But everything is relative, and the best can to be kicking down the road just now is undoubtedly the one made in America.

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