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Next Global Crisis: Greatest Recession in the History of Capitalism is at the Doorstep

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Next Global Crisis: Greatest Recession in the History of Capitalism is at the Doorstep

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Abstract

The main purpose of this paper is to warn academia and general public about the inevitability of the impending global economic recession. Heuristically paper introduces concept of macroeconomic gambling trap within the wider context of global economic history. Macroeconomic gambling trap is then applied to the current situation. The underlying cause for the impending crisis is the growth of debt in the West. Primary progenitor of debt problem is the world's largest debtor nation, United States. Since the 1970s and the unilateral destruction of the golden standard US political and military power guarantee status of the dollar as world reserve currency despite absence of its backing in gold. Debt explosion caused alienation of financial sector from the real economy in most western countries. The impending crisis is foreshadowed by a Great Recession (Financial crisis of 2007/2008). The Great Recession was only temporally stopped by means of unorthodox monetary policy – with quantitative easing programs and by keeping interest rates at record low, even negative, levels. However, this will make forthcoming collapse only more severe. After analysis of the influence of gold standard collapse on the outcome of the Cold War the paper utilizes specific economic indicators, such as velocity of money M2 for USD, growth in total debt, CAPE ratio for aggregate US stock market, US labour force participation and index of the Shanghai Stock Exchange to indicate the immediacy and the inevitability of the next global recession.

Key words

economic crisis, Financial crisis of 2007/2008, gold standard, global reserve currency, currency war, velocity of money

JEL classification

G01, G17, F34, F36, F37,F55, K20, N10

For the love of money is the root of all evil: which while some coveted after, they have erred from the faith, and pierced themselves through with many sorrows.

The Bible (KJV), 1 Timothy 6:10

1. Introduction

The main purpose of this paper is to warn academia and general public about the inevitability of the impending global economic recession. Thus, this publication serves as global economic forecast. The next global economic crisis will be the greatest in the history of capitalism. It is foreseeable, for reasons that will be explained in following chapters, that the crisis will occur soon, possible already in the last quarter of 2015. Fundamental cause for the impending crisis is the growth of the public debt in the West. Debt explosion is a direct consequence of a concept of economic growth supported by unreturnable debt. Primary progenitor of debt problem is the world's largest debtor nation, United States. Since the 1970sb unilateral destruction of the golden standard US political and military power guarantees status of the dollar as world reserve currency[1] despite absence of its backing in gold. Explosion of debt has influenced on the division between financial and real sector of the economy in most of the Western countries. Next global recession is already foreshadowed by the Financial crisis of 2007/2008. Financial crisis of 2007/2008 was only temporarily stopped by measures of unorthodox monetary policy: with quantitative easing programs and by keeping interest rates at record low, even negative, levels. To paraphrase James Rickards, author of popular publications Currency Wars (Rickards, 2011) and Death of Money (Rickards, 2014) impending economic crisis is like inevitable avalanche on the mountain above the town that is just waiting to happen - townsmen below the mountain are just few snowflakes from the destruction of our property.

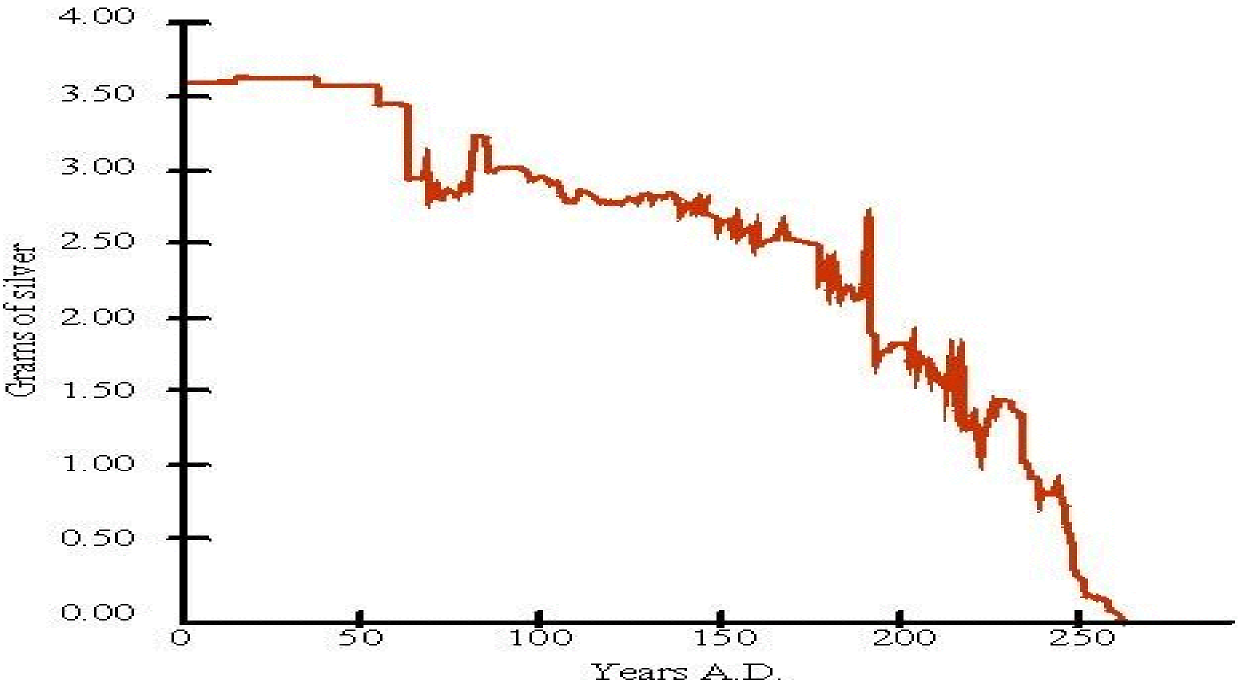
2. Macroeconomic gambling trap: destruction of the gold standard and status of the US dollar as global reserve currency

Throughout the course of the human history, from the civilization earliest times to this day, various public authorities resorted to the printing or minting money to fund state needs. In this process public authority often falls into one specific temptation. Temptation is to reduce, or completely abolish, backing of money in precious metals (of course, most often in gold and silver) or in metal in general. The idea is simple - we will produce for the short-term money without little or no objective value to fund a project that will ultimately create an objective value of the manufactured money. However, plans do not always come true. In that case, public authorities almost always like gambling addicts who is borrowing more in order to pay the original debt, continue with production of money without backing in gold or silver. Then economic collapse becomes inevitable, usually through hyperinflation in the last stage. Let's call this phenomenon the macroeconomic gambling trap. Monetary theory calls money without base in silver or gold by a specific term: fiat money (in Latin fiat literally means let it be done). The key economic and historical fact is that every attempt of long term stabile fiat currency, from the first recorded attempt more than three thousand years ago in the 11th century BC China to this day, ended in complete economic failure. Indeed, not only are all known fiat currency in history failed as legal tender, but also they caused significant economic and political crisis and even influenced on the collapse of empires. For example, at the beginning of the first century A.D. Roman coin -denarius, the official tender of the Roman Empire, was almost entirely made of silver. Emperor Nero in 54 AD reduced the share of silver in denarius to 94%. Roman emperors after Nero subsequently reduced the share of silver in the denarius so that in 218 AD it fell to 43%. In 476 AD, the year when the Western Roman Empire collapsed, share of silver in denarius was 0.05%[2]

[1] Global reserve currency is a currency that is held in significant quantities by governments and central banks as part of their foreign exchange reserves.

[2] It should be noted, for the sake of academic neutrality that in economic theory there are opposite opinions on the role of gold based money. Furthermore, author of this paper is well aware of the notion of liquidity trap

Figure 1.Mass of silver in Roman denarius



Source:http://www.docstoc.com/docs/168198735/How-The-Romans-Lost-Their-Empire (last accessed: August 31, 2015)

The contemporary global monetary system based on the US dollar as a global reserve currency represents only notable exception, at least for the present time, from the obvious economic and historical pattern that fiat currency in the long run is destined to failure The fact is that the US dollar as the dominant reserve currency was backed in gold until 15 August 1971. On that day US President Nixon announced the unilateral political decision to abolish foreign convertibility of US dollars to gold. Until 1971 status of the dollar as world reserve currency was guaranteed by the Bretton Woods Agreement from 1944, an international treaty legally establishing foreign convertibility of US dollars to gold (at the time of the conclusion of the Agreement US held the two-thirds of the world's gold reserves). Other countries could, since US was obliged to foreign convertibility of dollars into gold, keep their national reserves in dollars instead of gold. Consequently, US dollar rose to the status of global reserve currency. It is interesting to note at the same Bretton Woods Conference International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD) today a part of the World Bank, were established. The former Soviet Union participated in a Bretton Woods Conference, but never ratified the Agreement.

The real reasons for the US unilateral withdrawal from the Breton Woods Agreement in 1971 substantively were economic and political in nature. During the 1960s as a result of the technological progress and the race in strategic nuclear weapons, especially with the advent of intercontinental ballistic missiles with ranges of more than 6,000 km, it had become clear in the West that neither of the two superpowers can win in the hypothetical future nuclear conflict. Moreover, taking into account that such nuclear exchange could led to unprecedented losses in the total human population and to general collapse of social structures Western countries concluded that hypothetical global conflict will never become reality as long balance of powers is maintained. US have adopted military strategy of mutually assured destruction, known by the acronym MAD. US leadership eventually came to the

which originated from the Keynesian economics. Macroeconomic gambling trap should not be confused with liquidity trap because it does not depend on lowering of interest rates or any asset inflation failure at all.

conclusion that there is no acceptable way to the defeat USSR by military means[3]. Consequently, they needed to find other ways to achieve dominance over their main adversary. Furthermore, US Federal budget had to finance growing costs of the Vietnam war, Great Society programs and the race in space - which US won in 1969 with first human landing on the Moon (USSR withdraw from the race due the financial reasons). Solution to the problem was simple and, at least seemingly, brilliant –to create conditions in which long term economic exhaustion of the main strategic adversary is possible. This economic exhaustion will be achieved through public financing that USSR could not ultimately match. Cold war will be won by economics and not by weapons. However, this was not possible with US dollar peg to the gold. Total available amount of gold is always extremely limited – this is main reason why gold was perceived throughout human history as money. Thus, first precondition was to abolish convertibility of US dollar to gold. Of course, President Nixon gave to the surprised but yet supporting public quite different set of reasons for his unilateral decision[4] and falsely presented it as only temporary solution (today, forty-four years later, the decision is still in force). Predictably, after the unilateral decision to abolish the gold standard period of instability for the dollar followed. US economy entered into a stagflation period. Annual inflation rate for the US dollar was high and for the brief period US Government has even issued bonds denominated in Swiss francs. The stability of the US economy was particularly struck by the oil shock of 1973 when the Arab countries, after losing confidence in the dollar, increased the price of oil considerably. Occupation of oil platforms in in the Arabian Peninsula was even considered (but never executed). Instead, US foreign policy managed to reach important deal- USA will guarantee stability of the Sunni Muslim royal house of Al Saud (ruling family of Saudi Arabia), which is one of the cruellest regimes on the planet. In return Arab oil will continue to be sold exclusively in US dollars. To some lesser extent oil has replaced gold as support for the dollar (petrodollar). After the dollar was stabilized as the global reserve currency, by the 1980s, USA could move into the next phase of the financial war with the USSR.

US unilateral destruction of the gold standard in 1971 created a key precondition for the victory in the Cold War - a lever for economic exhaustion of the Soviet bloc. Nixon administration, additional to this monetary decision, made several other important strategic foreign policy moves that will enable in the long-term US to emerge victorious from the Cold War. During the Nixon administration exhausting war in Vietnam was finally ended. Furtherer more, US foreign policy cleverly used the divisions between socialist states to get communist China as an ally against the Soviet Union. This opening of China to the West was pivotal in denying USSR any possibility to win a financial war. After these achievements and with the dollar stabilized United States could announce fabulously expensive military programs such as famous star wars programs. Increasing investment in advanced military technology was not achieved at the expense of the economy and civilian infrastructure because dollar was liberated from its peg to the gold. All was financed with the US dollars that enjoyed guaranteed demand as long status of global reserve currency was maintained. In order only to preserve strategic balance Soviet Union had to invest increasing funds in its military industrial complex. However, Soviets didn't have seemingly unlimited sources of financing like their US counterparts. Cost of preserving status of the superpower was at the expense of consumer goods production and living standard of its citizens. In order to obtain much need liquidity USSR started, at the beginning of the 1980s, to export its oil in increasing quantities. Also, Soviet Government increased borrowing from international financial institutions, which was sustainable with high prices of oil. However, after Saudi Arabia (a key US ally in the Middle East after the 1979 Islamic revolution in Iran), by using its influence in OPEC[5], crashed the global price of oil in 1986 USSR was no longer able to repay debts. The Soviet rubble has devalued. Soviet government was, to put it figuratively, cornered. By the end of the 1980s in real terms as much as 25% of Soviet GDP was spent on financing of the military-

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[3]Soviet military doctrine, on the other hand, was based on the idea that, due to their superiority in the quantity of conventional weapons, after the nuclear holocaust remaining of the Warsaw Pact forces could prevail in a conventional conflict that will follow.

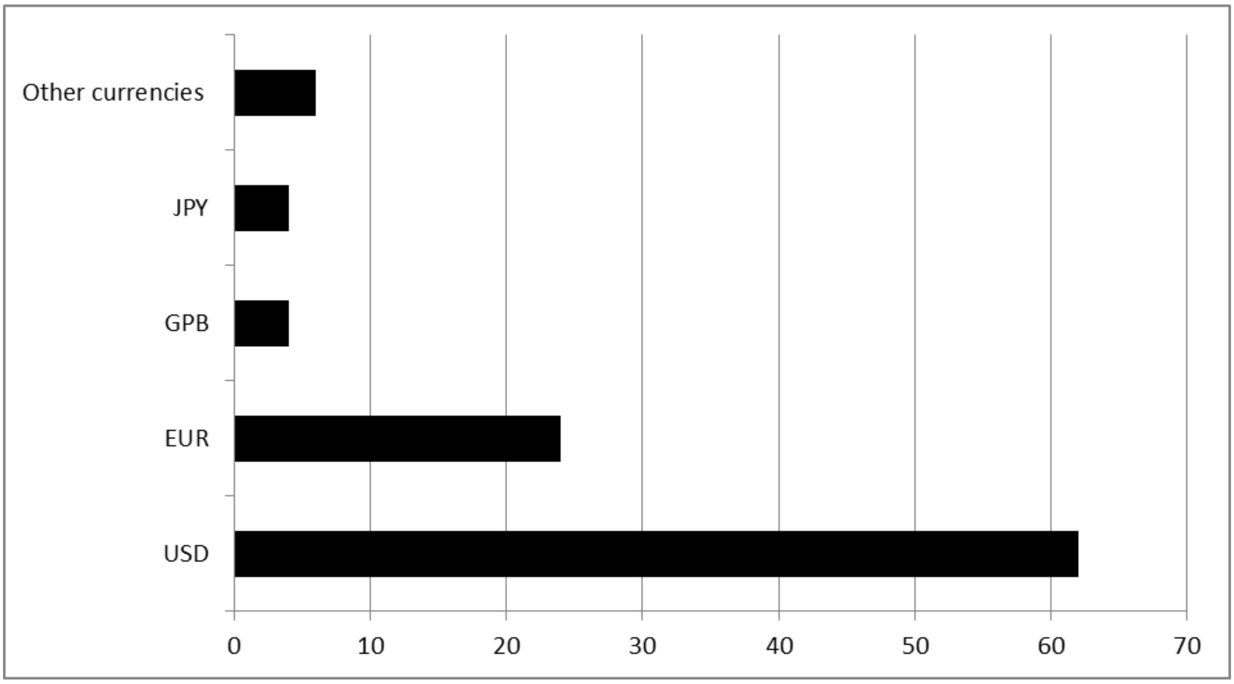
[4]Stability of the global and US monetary system, trade balance and equal position between currencies were mentioned as prevailing reasons.

[5] Organization of Petroleum Exporting Countries (OPEC) is a textbook example of a cartel. Thus, there is no free market competition in the global oil trade (price is basically determined by the joint decision of the members of cartel).

industrial complex (Åslund, 1990). Majority of the industrial output of the USSR was going for military use and not to the civilian population. Such enormous share of defence spending is unsustainable in the long run for any country. USSR no longer had the money to maintain superpower status and meet the basic needs of its citizens. Shortly after the fall of oil prices in the mid-1980s the Soviet government adopted a program of comprehensive social reforms and easing tensions with the West, the famous perestroika. This will ultimately lead to the disintegration of the Soviet Union as a functioning state.

United States has not yet paid the price for the victory in the Cold War. Pivotal decision from the 1971 that enabled economic exhaustion of the strategic adversary (abolition of the gold standard) also opened macroeconomic gambling trap. USA has entered into that trap. Status of US dollar as global reserve currency is prevailing circumstance that prevents exit to this day. US dollar status is the main barrier to the solution of the debt problem in the West. It should be noted, purely for explanatory purposes, that the US dollar is not the only world's reserve currency. Among the few existing competitors only the euro is worth mentioning. However, euro did not prove capable of seriously endangering the status of the dollar (king dollar). US guarantees status of the dollar as dominate global reserve currency with economic, political and military power. Majority of foreign exchange reserves, despite recent efforts by Russia and China, are still held in US dollars. Additionally, majority of the global oil trade is executed in dollars (petrodollar). Actually, status of the dollar as global reserve currency is stable despite its volatility linked to the growing US debt. Thus, the risk for the global economy is higher. United States have not only failed to avoid the risk of macroeconomic gambling trap, but in recent times with quantitative easing programs and unorthodox monetary policy have fallen so deep into that trap that there is virtually no way out of it (as long as the dollar is global reserve currency).

Figure 2: Foreign exchange reserves (%) in 2013.



Source: author based on the IMF data

3. Debt in the Western World and the Great Recession

3.1. Debt in the Western World

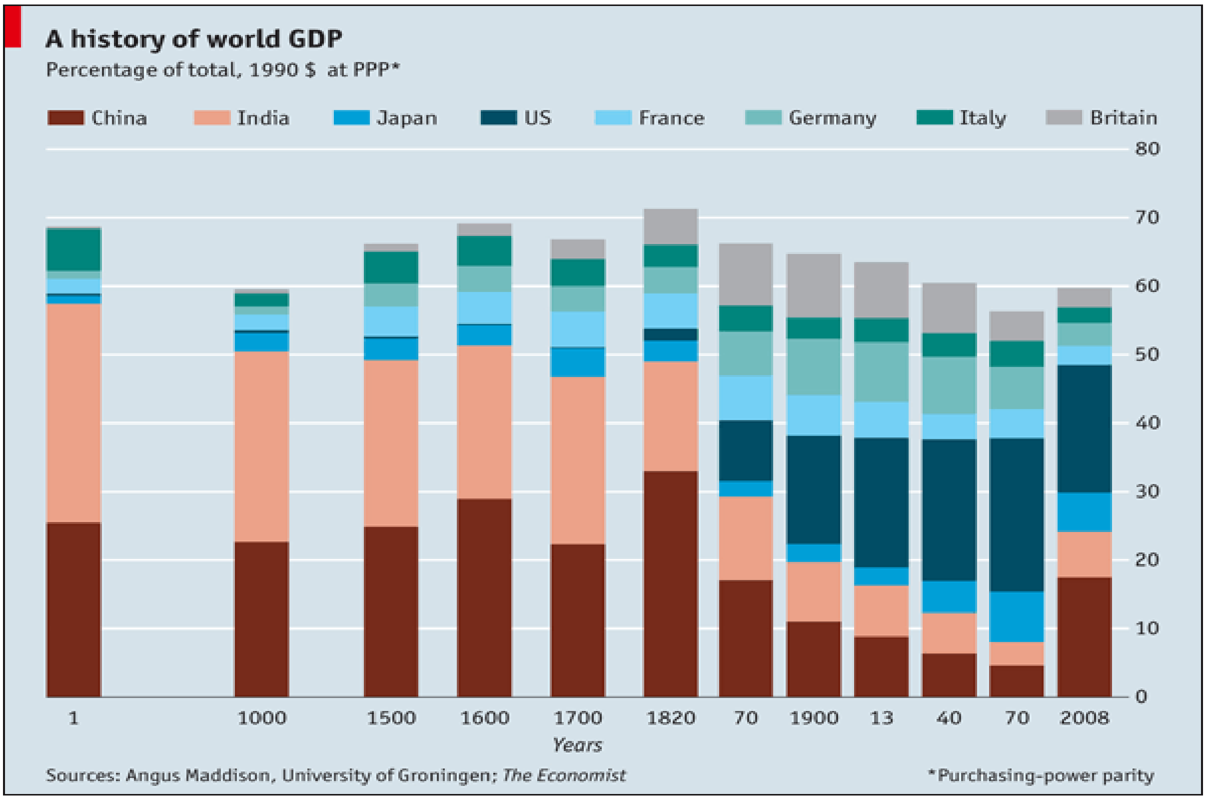
One of the fundamental economic truths is that debt by itself is not a bad thing. However, paramount factor is ability to repay and profit or at least ability to return the debt at all. Economies with high GDP growth rates are able to borrow profitable, economies with low or negative growth rates have their possibility to return the debt diminished. Fact of general knowledge is that majority of developed countries have not experienced high growth rates for decades. US, UK, Germany and Switzerland, in the 2000-2010 period for example did not even for one year recorded growth rates above 5%. In that same period GDP growth rate for the People Republic of China never receded below 7%. Thus, in principle, developed economies have less capacity for growth then countries in development. This general principle indicates that countries in development should have higher debt growth and be more indebt than developed counties. This is pure logic. However, in reality situation is the exact opposite. Most developed countries are also most indebt nations in the world. This situation, in addition of being supported in prevailing monetary theory, is caused by the fact that United Sates, world greatest debtor, has managed to impose its general view on the economy as role model for the whole world.

In order to demonstrate scale of the problem we shall mention only several quantitative indicators. The largest debtor in the world is the United States. The total debt of the United States is more than 18 trillion, of which the public debt represents more than 13 million US dollars. USA cannot possibly return all of its debt without defaulting. Japan debt to GDP ratio in 2013 has been 245% and it continues to grow. Dutch debt in 2014 was 226.503,00 USD per capita. In the same time per capita debt in Greece was 47.636,00 USD. Thus, contrary to popular opinion, average Dutchman is more broke than average Greek.

After the abolition of the gold standard and US victory in the Cold War there has been no limitation in debt emission in the West. Contrary, we have seen an unprecedented over development of the financial sector that is starting to dominate Western economies. Temptation of macroeconomic gambling trap prevailed over self-restrained debt management. In conditions of fiat money and fractional reserve banking any debt, public or private, represents creation of new money. Eventually all money becomes debt. Total bowering crosses from the prevailing state control to control of private banks and financial institutions. With constant accumulation of debt at low or negative growth rates returning of debt become impossible. The entire system must collapse at some point. This is all a global Ponzi scheme of huge proportions. Majority of the developed countries now deeply depend on private banks and financial institutions. Reason for that is that this banks and private financial institutions are main buyers of national debt or the main intermediaries in the purchase of that debt. Consequently, role and importance of the financial sector in the overall economy is growing significantly. Furthermore, due to globalization and the opening of China to the West (which started by crucial foreign policy achievement during Nixon administration) majority of physical production already relocated from West to China and other counties in development. From the standpoint of international trade this is quite expected - capital moves to a secure and stable environment with lowest cost of production. Huge and long-standing US trade deficit is clearest evidence that, in substantive terms, wealth production relocated from the West.

Described processes are nothing new in the economic history of the world. In fact, when we look at historical data global economic dominance of the West is actually a relatively recent phenomenon. During the last two thousand years China and India are predominantly leading global economies. China was until 19th century the world's leading economy generating greatest amount of wealth. The West becomes a globally dominant by surpassing China only after the momentum of the industrial revolution in the 19th century. Further, even more surprising is the fact that in last two millenniums overall global economic leader for most of the time is India, reaching a peak in the Middle Ages (this is reason why the European rulers invested substantial resources to find a sea route to India).

Figure 3 Share of the world GDP per countries during two millennia



Source:http://www.economist.com/blogs/graphicdetail/2012/06/mis-charting-economic-history, (last accessed August 31 2015).

3.2. Great Recession

During first decade of the 21st century US financial private sector with help of its growing influence and advances in computer technology has successfully find numerous ways to evade regulation and consequently create huge market bubbles in the form of financial derivatives. Collapse of market of derivatives based on mortgage loans (mortgage based securities) caused Financial crisis of 2007/2008, the greatest economic crisis since Great Depression of the 1930s. Global consequences of the Financial crisis 2007/2008 were so large that resulting global recession was named Great, in clear reference to 1930s Great Depression. The derivative bubble was not created only as result of actions of private financial sector, but with the full blessing of the state. US Federal Government encouraged the conclusion of credit contracts founded on mortgage based securities for persons that in standard banking business would not be considered creditworthy. The Financial crisis of 2007/2008 was undoubtedly enabled by the regulatory failure in the financial sector. Fusion of the standard commercial banking business with investment banking in the move to deregulate largely enabled the anti-market behaviour of the financial sector (Riles, 2011). Investment bankers were not guided by market principles to earn profit for their clients, but were investing into highly risky complex derivatives, which themselves created, in order to receive high commission fees. Ultimately this brought the entire economy to the brink of collapse. Brink of collapse has become evident to the public in September 2008 when investment company Lehman Brothers filed for bankruptcy. Bankruptcy of Lehman Brothers is the largest bankruptcy in history (up to present moment), including private entities and defaulted nations.

The crisis has affected the status and role of the financial sector in the West. The collapse of the sector would cause a disruption in the emission of the government debt, which in turn led to the collapse of the entire global monetary system. The bubble of government debt, which is of course significantly larger than bubble in derivatives, in that case would begin to collapse. The United States in order to avoid immediate collapse issued unprecedented emergency subsidies of financial assistance amounting to over 700 billion US dollars to the private financial sector. Ben Bernanke, who at that time in 2008 was US Fed[6] chairman, uttered following sentence regarding huge state aid to the private financial sector: "*If we don't do this, we may not have an economy on Monday*"(New York Times, 2008).

Unprecedented emergency subsidies of the US to the private financial sector in 2008 prevented the immediate collapse of the global monetary system. However, these measures did not stop overall economic decline. The crisis, with the exception of Poland, spread literally throughout all of the Western World. When it became clear that the recovery will not come US Fed started to emit, or as it publicly known to print, unprecedented amounts of money. They named this dangerous monetary policy with interesting name: program of quantitative easing (QE). Through a three tranches of quantitative easing (QE 1,2,3) Fed bought in newly, out of thin air, created US dollars, securities in the amount exceeding 3.7 trillion USD. Simultaneously Fed significantly reduced the interest rates to levels very close to 0% so that the further debt has become very cheap[7]. The Fed maintains what they call moderate optimism (Board of Governors Fed, 2015) publicly claiming that they have created conditions for economic recovery and that the US economy actually is in recovery. In reality what dumping huge amounts of new money into the system has done is to return the air in to the deflating bubble and thus only postponed future systemic crash. Fed's policy is what they call data depend and it functions within the dual mandate (price stability and employment). Thus, US employment rate is viewed as one of the key indicators. However data on the unemployment rate are ambiguous, they need to be analysed comparatively with civilian labour force participation and wage growth in order to have a clear picture, as we will see in next chapter of this paper.

Fed's views on the economic recovery do not correspond with economic reality. Private financial sector did not direct money obtained by quantitative easing into real sector of the economy but rather in the acquisition of new debt. At the same time the Fed finds itself in a position where it holds enormous monetary base of high-risk securities as its capital. Due to this capital structure Fed is paralyzed and can do nothing but try as long as possible to delay the inevitable collapse. These measures have made a bubble even bigger today that it was in 2008. The whole monetary system is about to collapse. Fed will never return to normal monetary policy and it will never raise interest rates to normal levels (despite public assurances that Janet Yellen, current chairperson of the Board of Governors of the Fed, regularly makes) because that would mean beginning of the end for the dollar. On the contrary, it is quite certain that at some point they will be forced to enter the fourth tranche of quantitative easing (QE4).

4. Inevitable collapse is near

4.1. Geopolitical indications of change in the global economy

Countries in development have not stand aside when the US took malignant steps to stem the Financial crisis of 2007/2008. Realizing that constant emission of debt by the West eventually must bring about the collapse and having confidence in the fact that the material production relocated from the West most powerful among them began to coordinate and organize. Economic coordination between member countries of the BRICS (consisting of Brazil, Russian Federation, India, PR China and South Africa) is acting directly contrary to US global economic concept, maybe best represented by the IMF and World Bank. BRICS countries have at present 41% of the world population and 25% share of the

[6] Federal Reserve System (Fed) is the central banking system of the United States. It is very interesting to note than unlike central banks of the other countries Fed is not a only a public institution but also has a strong private component (it essentially co-owned and co-managed by the commercial banks) .

[7]Fed policy was followed by other major central banks in the West. European Central Bank (ECB), as the second most important, started its own quantitative easing at the beginning of 2015 while keeping interest rates at extremely low levels.

global GDP. Confidence in the US domination concept is fading along with confidence in US foreign policy that has thrown Middle East in the state of chaos (in the aftermath of the terrorist attacks in September 11 2001). According to James Rickards the world is as of 2010 in currency war (Rickards, 2011). The term currency war was first used in that year by Brazilian Finance Minister Guido Mantega and it relates to competitive devaluation of national currencies.

Currently two BRICS strongest members, China as the global production powerhouse and politically and militarily strengthened Russia are united in the move to dethrone US from global dominance. Russia found itself in 2014, after the beginning of the Ukrainian crisis, in open rivalry with the West. China's position is very complex because a large part of China's state reserves is denominated in US dollars. China is the single biggest holder of US debt, and moreover has the largest reserves of liquidity in the world. Thus, the slowdown in the US economy reflects on China and vice versa. Relationship between China and USA is the relationship between creditor and debtor that are mutually dependent. Nevertheless, China's economic policy after the Great Recession and especially recently, has turned to the reduction of reserves denominated in the US dollar in order to reduce the risks of exposure. But it is a gradual process that only recently accelerated. In fact, if China would decide to get rid of all its reserves denominated in US dollars at once a global financial shock with serious consequences would immediately occur. One strong indication of the current economic war that everyone can feel is the movement in the oil prices. The sharp drop in oil prices at the end of 2014 was caused by the decision of Saudi Arabia to increase production and thus reduce the price - a scenario very similar to the mid-1980s when Saudi Arabia drew an identical move which in turn led the budget of the Soviet Union to the brink of collapse. However, it seems that this time history will not repeat itself because of the different situation in Russia. Russia today has small and serviceable debt, e.g. Russian debt to GDP ratio in 2014 was only 18%. Furthermore, the Russian government has demonstrated unwillingness to increase of debt despite Western sanctions that caused slowing of the national economy. Finally, Russia today does not have enormous cost of military-industrial complex in comparison to Soviet times and yet manages to keep the largest nuclear arsenal in the world. On the other hand the US military budget today, even though it accounts for only 3.5% of GDP, according to the Stockholm International Peace Research Institute (SIPRI, 2014), is the largest in the world, seven times higher than the Russian and four times higher than Chinese defence spending. Additionally, it is important to note that the Russia was largest buyer of gold in the world in 2014. In an interesting reversal of roles, this time Saudi move to decrease price of oil actually threatened US economy. Recently in the US new technology of shale oil extraction has been applied at large scale. Assuming high oil prices shale sector production (that has grown dramatically in recent years, investments in the sector are around 1 trillion dollars) would allow US to be energy independent, which is a long desired US strategic dream. However, with falling oil prices whole US shale oil sector becomes unprofitable and burden for the national economy.

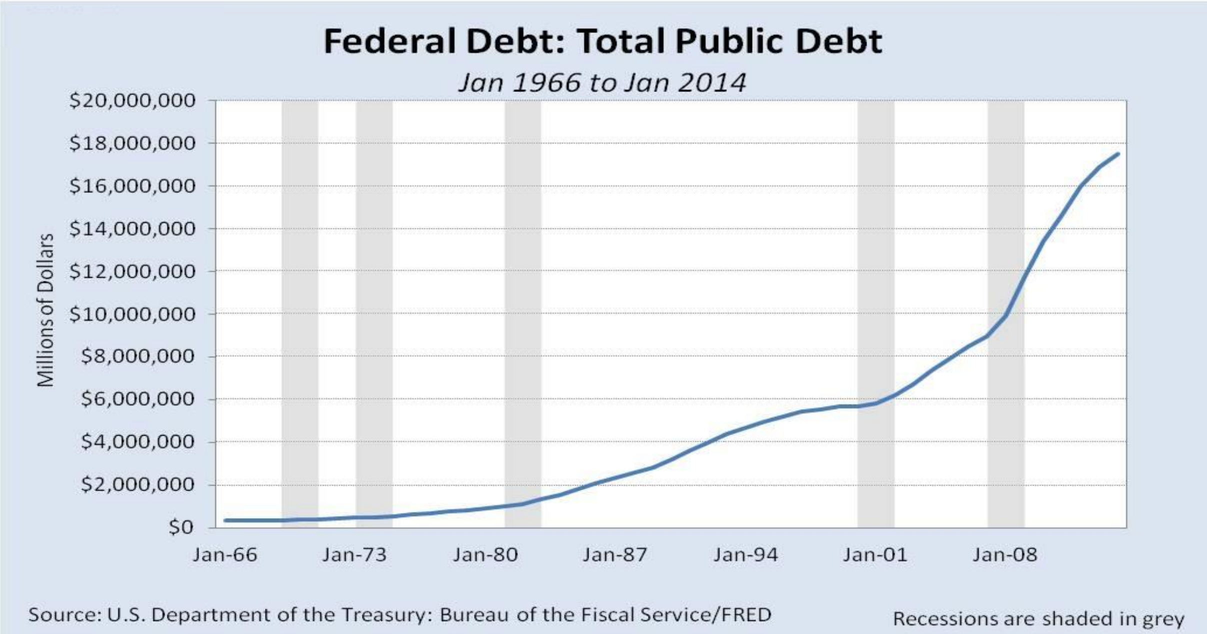
Recently economic conflict between BRICS countries and the West is intensifying. The Treaty on Eurasian Economic Union (EEU), trade bloc which includes Russia, Kazakhstan, Belarus, Armenia and Kyrgyzstan, has come into force on 1 January 2015. Eurasian Economic Union is legally modelled similarly to the EU (four market freedoms/internal market, possibility of introducing a common currency). This new regional economic integration has larger landmass than any other trade bloc. The main reason for the outbreak of the Ukrainian crisis is also economic one. Planed conclusion of the Association Agreement between the EU and Ukraine would create free trade zone between two entities. Russian diplomatic influence prevented conclusion of the Association Agreement with EU in 2013 which in turn resulted in the US supported coup d'etat in Kiev. Russian political and military activities in Ukraine throughout 2014 were essentially aimed at preventing trade integration between Ukraine and EU. In order only to maintain part of the Ukraine not held by pro-Russian separatist West has approved, through the IMF loan package, amount of 17 billion US dollars. It is clear that there is no possible way for Ukraine to return this debt. Furthermore, BRICS nations are working on the development of a parallel global financial system. In 2015 they established New Development Bank (NDB BRICS) based in Shanghai with aim of gradually replacing the World Bank and the IMF (based of course in Washington D.C.). Latest developments related to the rapid conclusion of free trade agreements between Russia and third countries can also be viewed as signals of coming shift in global economic paradigm. Only during the preparation of this paper totally dislocated Egypt has concluded a free trade agreement with the Eurasian Economic Union and Vietnam entered into a customs union.

US strategic goal is to stop any autonomous economic coordination and integration of countries in development. Clearly, any such integration that would include Eurasian area jeopardizes global dominance of the United States. Official current US military doctrine (of course MAD is no longer in effect) is named full-spectrum dominance. US Department of Defense summarizes this doctrine in the following way: *the cumulative effect of dominance in the air, on land and sea, space and information environment, including cyber space, allowing the implementation of joint operations without effective resistance or interference* (US Department of Defense, 2015). It is clearly envisaged that such dominance should be achieved globally. Any strategic economic alliance between countries of the Eurasian area that includes both Russia and China (BRICS) constitute a substantial threat to this concept of global domination. It makes official US military doctrine unenforceable. The idea that the US can achieve complete global dominance seems equally unrealistic as ideas of former Soviet leaders that the Soviet Union must be able to defeat the combined force of United States and the People's Republic of China in a conventional war that would follow nuclear exchange (!). Process of challenging US global economic dominance, or the West in a broader sense, is nothing new or unusual. History teaches us, as we saw earlier, that economic dominance of the West is only a recent phenomenon. Viewed from a broad historical perspective the end of Western economic dominance does not seem to be impossible. Indeed, if we are to learn something from the economic history is that this kind of development would be quite expected. Consequently it is not hard to conclude that concept of placing USA into position of long-term global dominance is unlikely to be achieved.

4.2. Economic indicators of impending collapse in the global economy

Increase in debt impedes nation's ability to generate economic growth from new debt. This is exactly what is happening in the United States. True economic recovery escapes despite enormous growth in debt. Macroeconomic gambling trap (concept explained earlier in this paper) for the US has now fully closed. First economic indicator is, of course, sheer amount of debt in US and the West in general. Not only is the US the largest debtor in the world, as shown before, but that debt is growing at extremely fast rate and US economic growth cannot keep up with it. Illustratively, only during the administration of President Obama US total public debt has almost doubled. In the same period, US GDP has never increased annually at a rate higher than 2.5% (highest was 2.4% in 2014 according to World Bank). Therefore, it's perfectly clear that the debt cannot be repaid and that moment of hyperinflation of US dollar is rapidly approaching.

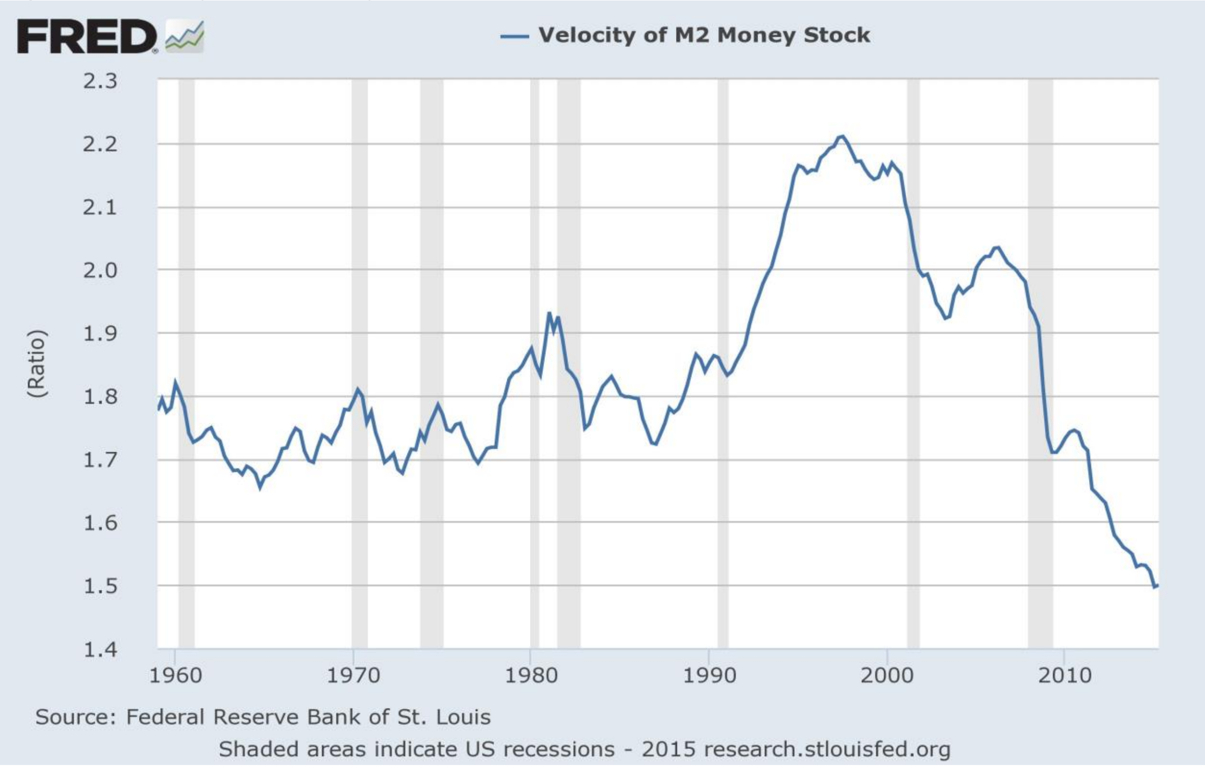
Figure 4: total US public debt in the period 1966-2014



Another economic indicator of impending collapse is velocity of money[8] for US dollar. Velocity of money is measured in relation to a given component of the money supply (or monetary base) - most standard components being M1, M2 and MZM. M1 monetary base is the narrowest component and it refers to currency in circulation (e.g. paper money and coins). M2 is broader component that includes M1 in addition to saving deposits, certificates of deposit and money market deposits for individuals. Velocity for USD on M1 monetary base is rapidly declining, it is now at lowest levels since the mid-1970s (currently M1 velocity for USD is 5.967). However, what is really troublesome is the velocity of money for US dollar in relation to M2 money supply. Current velocity of US dollar ratio in relation to M2 monetary supply is at its lowest level in recorded history - 1.5. This indicator is very alarming and points to an imminent and dramatic change.

[8]Velocity of money is a ratio of nominal GDP to a measure of the money supply

Figure 5: Velocity of M2 money stock for USD



Sharp decrease in velocity of US dollars to M2 money supply coincides with the start of currency war in 2010. However, this indicator is largely ignored or dismissed as reason for concern. Usual explanation is that decreased levels of velocity in M2 money supply were to be expected because of the crisis and that the economic recovery will eventually lead to increasing velocity for US dollar. This explanation is completely misplaced. Taking into account enormous quantitative easing programs and Fed's unorthodox monetary policy with interest rates close to 0% it would be perfectly reasonable to expect that velocity for US dollar increases in all aspects, especially in relation to M2 money supply. This would be the case if such measures were truly effective. However, data clearly points otherwise. Money is not directed into the real sector of the economy. Economic cycle is not revived by injecting huge amounts of newly created money into private financial sector, original birthplace of the Financial Crisis 2007/2008. On the contrary, as we have already mentioned, this only returns air back into the balloon and thus makes inevitable future decline more severe.

Author of this paper is convinced that the Fed will not raise interest rates, but it will be forced at certain point to embark into fourth tranche of quantitative easing (QE4). Despite keeping interest rate close to 0% Fed maintains its optimistic outlooks based largely on employment data (assessment policy naturally influenced by the dual mandate). Data on the US unemployment rate indeed seemingly suggest economic recovery since the introduction of quantitative easing program. US unemployment rate was, according to the data of the U.S. Bureau of Labor Statistics, 5.3% in June of 2015, which is lowest level since 2008. However, aforementioned data is misleading due to the several reasons. First, it should be viewed in conjunction with data on civilian labour force participation. US civilian labour participation is at its lowest point since beginning of 1970s (currently at 62%).

Figure 6: US Civilian Labor Force Participation Rate

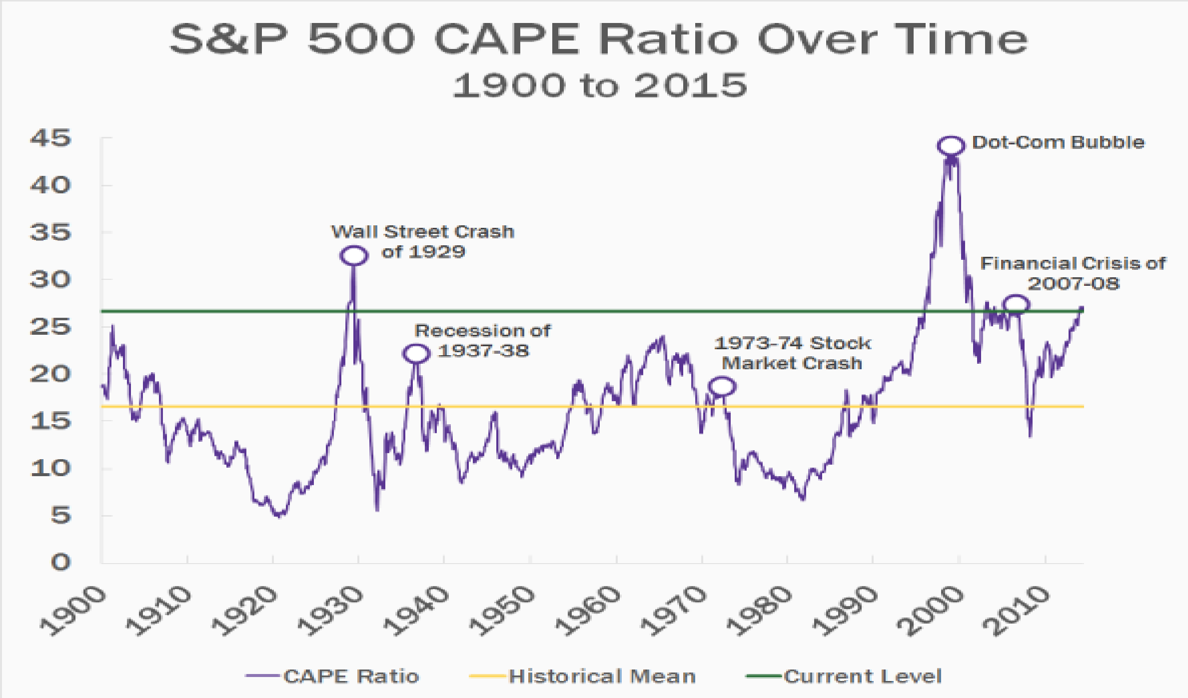
Recently in the US number of employed persons who are finding themselves in a situation in which they cannot meet basic needs with only one job, and therefore are working two or even more jobs, is increasing. Furthermore, due to the high education level caused by surge in student loans many people are employed at jobs completely inappropriate for their education and professional experience (e.g. masters working as a waiter for a salary close to the minimum). Described process has increased significantly due to the liberal labour legislation and public policy of student loans that actual incites students not to enter into labour market early in life. Second reason why data of US unemployment rate are misleading is methodology. Unemployed persons who are not actively seeking a job for more than a year are not included in statistical category of the unemployed.

US Nobel Prize winning economist and a Yale scholar Robert J. Schiller has also issued warning regarding impending global recession (New York Times, 2015). In order to measure stock market overvaluation Shiller uses a specific type of price to earnings ratio named CAPE (cyclically adjusted price-to-earnings ratio or Shiller P/E or P/E 10 ratio)[9]. CAPE ratio in July 2015 for US stock market index S&P 500 was 27. This is one of the highest levels ever: CAPE for S&P 500 index was only higher in 1929 and in the 1996 - 2002 period[10] (Schiller, 2015). Conclusively, according to CAPE indicator with the exceptions of 1929 (prior the Great Depression) and period prior to internet bubble bursting (in 2002) US stock market was never been more overvalued. Schiller (2013) noticed that one of the first American neoclassical economists Irving Fisher established a link between high levels of debt and deflation as signs of an impending economic recession (Fisher, 1933). Both of these signs - debt and deflationary pressures are globally exceptionally high today

[9] Shiller, along with other economist like John Y. Campbell, Benjamin Graham and David Dodd constructed P/E 10 ratio. Rational for Schiller receiving Nobel Memorial Prize in Economic Sciences in 2013 was exactly his contribution in the field of empirical analysis of asset prices.

[10] Schiller data on CAPE (or P/E10) ratio are regularly updated and downloadable on following web page: http://www.econ.yale.edu/~shiller/data.htm.

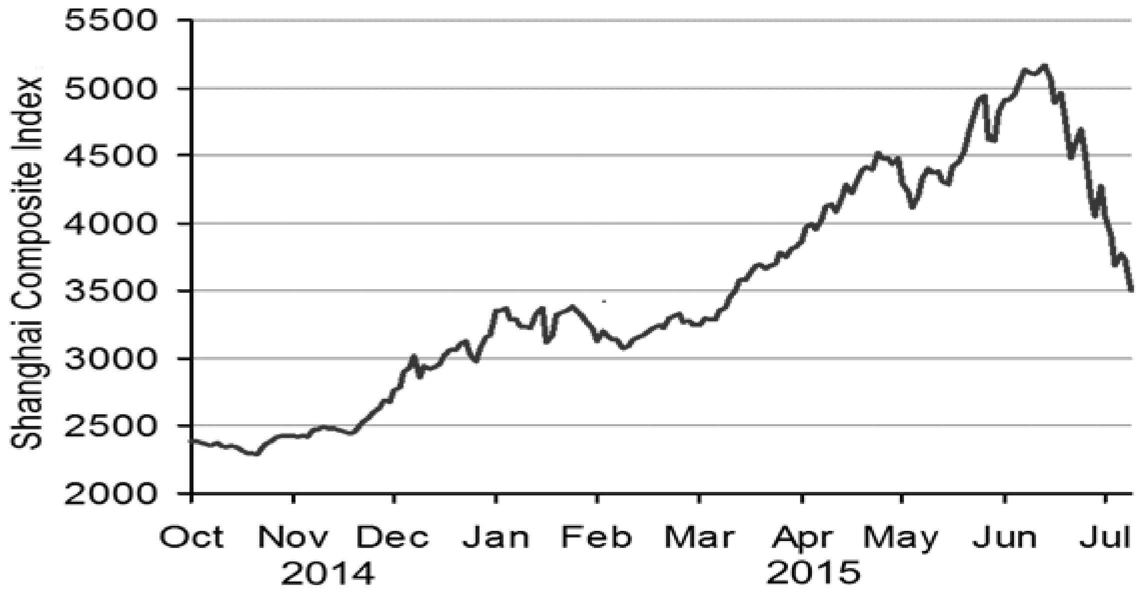
Figure 7: CAPE ratio for S&P 500 index in the period 1900-2015



Source: http://etfreference.com/articles/2015/1000405/why-stock-market-overvalued/ (last accessed September 11 2015).

The United States is in the midst of the economic war with the BRICS countries, especially with Russia and China. China's economy, main engine of the global economy in terms of material production, has started to rapidly deaccelerate in 2015. For the first time in many years planned growth rate of China's GDP is around 7% (with strong possibility of further downgrade). Since 12 June 2015 index of the Shanghai Stock Exchange (Shanghai Composite, SSE) fell by more than 31%. Value that local stock market has lost is bigger than 3.2 trillion US dollars - that is more than the annual GDP of Germany or the UK! This led to the sudden decision of the Chinese authorities in August 2015 to devalue the national currency yuan. In addition of being a measure that will make Chinese exports cheaper and thus, as communist rulers hope, reduce sharp slowdown in economic growth, this is yet another step in the currency war, which effectively paralyses the possibility for the Fed to return to normal monetary policy. Simultaneously PR China is rapidly gaining gold reserves, they are currently fifth largest holder after the US, Germany, IMF, France and Italy. It should be noted that China has largest reserves of liquidity in the world. On the other hand the United States, compared to the size of its economy has virtually negligible liquidity reserves (less than, for example, Switzerland), which is of course a consequence of the status of the dollar as world reserve currency.

Figure 8: Shanghai Composite Index (SSE)



Source: http://www.tradingeconomics.com/china/stock-market , last accessed June 30 2015

Clearly the devaluation of the yuan will further global deflationary pressures. Enormous market bubbles are in existence currently in China. Bubbles exist in the Chinese financial sector (in shadow banking in particular) and in the construction industry. Due to the constant growth of the national economy these bubbles have so far not had a chance to deflate. Bubble in the Chinese financial sector is significantly higher than it was in the United States before the Financial Crisis 2007/2008 and it is directly linked with real estate prices. Sudden deacceleration of Chinese growth will produce pro-recessionary effects globally. The most alarming aspect of the matter is that due to the unorthodox monetary policy implemented and advocated by the Fed there are very little, if any, available measures of standard economic policy that can effectively stop this process. However, it should be understand that essentially Chinese slowdown is not caused in China. The fact that the material production relocated from West to China because of the need for the cheap labour in stable conditions leads to an obvious conclusion: slowdown of Chinese economy is caused by a drop in global demand. Falling demand in Western countries is causing China to slowdown. In light of such narrative devaluation of the yuan becomes completely logical and expected move by Chinese authorities - after devaluation costs of goods and services produced in China are cheaper. However not even further lowering of the cost of Chinese production cannot prevent the impending crisis. The fundamental cause for the next crisis will be the debt of the Western world that simply cannot be serviced without complete restructuring of the global monetary system. Particularly worrisome are latest information's that the Chinese authorities began in 2015 to use economic doomsday weapon (to express it figuratively). China has sharply increased sales of US government securities and stopped further purchases of US Government debt. China is the largest single holder of US government bonds and largest US creditor. Prevalent belief among analysts that China will never enter into adventure of decreasing value of US government bonds as this reduces the value of its own reserves and stops its own economic growth has suddenly became shaken. Contrary to this belief the latest alarming data are showing exact opposite situation. According to estimates made by the bank Societe General, published by the CNBC, in August 2015 the People's Bank of China sold on the international markets more than 106 billion of reserves denominated in US dollars (Clinch, 2015). If China's dumping of US debt continues at this rate US recession and collapse of global confidence in the US dollar is eminent.

Economic indicators used in this chapter of the paper are all pointing to inevitable and impeding global recession. Ultimately, this crisis will cause a collapse of confidence in the US dollar as a world reserve currency and will result in a birth of a new global monetary system. While the Financial crisis of 2007/2008 was primarily crisis of the private sector next depression will primarily be a sovereign debt crisis. This new crisis will not be felt the same everywhere. Most difficult will be for the countries that are having oversized financial sector and that are most indebted. Furthermore, cultural conditions should be taken in consideration. US population for decades lived in conditions of massive trade deficit and largest debt in the world, far above their real economic capabilities. On the other hand, China's population does not yet enjoy a standard of living similar to the Western counties and is culturally much more resistant to possible economic difficulties, even if the crisis significantly affects China. One should not forget that the biggest productive potential is in their hands. Golden reserves could prove to be very useful for nations in the reshaping of the global monetary system that will follow. Nations that are left without golden reserves will be in disadvantage in comparison to countries with substantial amount of gold. Narrative of this paper suggests that the upcoming crisis is a only a continuation of Financial crisis of 2007/2008, full effects of which were only delayed by measures of unorthodox monetary policy.

4.3. New global reserve currency

Under underlying assumption that economic forecasts expressed in this paper are correct following question naturally comes to mind: What will be new global reserve currency? After the dollar the largest quantity of foreign exchange reserves is denominated in euros. However, given that the Eurozone does not fulfil widely accepted conditions for optimum currency area presented in a famous paper authored by the economist Robert Mundell (1961) it is difficult to imagine how the euro would replace the dollar. Furthermore Eurozone has, exactly because that it does not meet conditions for optimal currency area, recently been through several crises with more probably coming. Thus, it is highly unlikely that euro, without substantial reform in the EU that would entail strong fiscal integration, has a real potential to become a global reserve currency. Chinese yuan, despite recent efforts by the PR China is still not capable of even seriously endangering minor alternatives to US dollar such as pound sterling of Japanese yen. Thus, it also unlikely, at least for some time, that yuan could have real capacity to be a global reserve currency.

One possible future alternative to the US dollar would be the special drawing rights (SDR), which is as a unit of account for foreign exchange reserves used by the IMF. SDR represents a basket of currencies (USD, euro, yen and pound sterling) a not a currency for itself. The interesting underlying fact is that of the world five largest holders of gold IMF has smallest debt. Therefore, the monetization of the SDR could represent an effective alternative to the dollar. SDRs were initially created in the period of dollar instability in 1969 and were useful in stabilization of global monetary system after US unilateral decision to abolish dollars foreign convertibility for gold in 1971. Since Financial crisis of 2007/2008 quantity of SDR in existence has significantly increased. Main problem with SDR being a global reserve currency is geopolitical one. They are issued by the IMF, institution that is perceived by BRICS nations as exponent of US global economic dominance. In current circumstances it would be difficult to imagine BRICS nations agreeing to such new reserve currency. Introduction of SDR as new global reserve currency would be much easier in the situation of weak Chinese economy. This situation could create preconditions for a new agreement with greater role of BRICS nations in global monetary system. Global agreement on a new monetary system, such as the one achieved at Bretton Woods conference in 1944, this time with greater influence of developing countries is therefore one of the likely methods of introduction a new global reserve currency. It is interesting that the IMF at least since 2009 considers the possibility of replacing the US dollar as a world reserve currency and one of the possible solutions mentioned are special drawing rights (Cohen, 2009). Unfortunately simple restructuring of global monetary system and sovereign debts is the most optimistic development. History teaches us that the periods of great economic crisis are often followed by political instability and even devastating wars. Let us remember, Bretton Woods conference was organized while the Second World War was still raging. In any case, it is likely that this new global currency will be issued exclusively in the electronic form.

5. Conclusion

Next global recession that will inevitably ensue is fundamentally caused by unsustainable debt of the United States. Foundations of the crisis were laid back long time ago, in the days of the Cold War when the US unilaterally abolished gold standard (in 1971). While maintaining the status of the dollar as world reserve currency, without gold coverage, United States has created the ability to economically exhaust its strategic rival (USSR) when there was no way to overcome by military means. However, US did not yet pay the price for the victory in the Cold War. Even after that victory US, like a gambling addict continued to accumulate debt, which is currently higher than 18 trillion USD. Combined with malignant role of financial sector of the economy and the fact that physical production has relocated mainly into China US debt will result in the largest recession in US history. Naturally, this recession will have serious global consequences.

Financial crisis 2007/2008 in fact has already led the US economy to the brink of collapse. Complete breakdown was prevented at the last moment. Deflating of air back into enormous bubble has been executed by unprecedented amounts of state subsidies to financial sector that caused 2007/2008 crisis in the first place (uncontrolled development of financial derivatives with the full blessing of the state). Furthermore, unorthodox monetary policy measures including keeping interest rates at levels close to 0% and emitting of huge amount of new money in the form of quantitative easing helped maintain illusion of weak recovery. However, all this steps only made future collapse more severe. Market bubbles throughout global economies, e.g. market in financial derivatives, are today larger than before Financial crisis 2007/2008. Measures of monetary policy that could avert total collapse are becoming increasingly more limited (interest rates are near 0%, each additional tranche of quantitative easing significantly increases systemic risks for the global monetary system). Additional to enormous debt of the USA there are several other specific quantitative indicators warning of the impeding paradigm shift in the global economy. Velocity of money for US dollar, especially in relation to M2 money supply which is at its lowest level in recorded history (currently at 1.5), CAPE ratio for aggregated US stock market and sharp slowdown in the Chinese economy are only some among these indicators.

Overall narrative of this paper suggests that the effects of the impending crisis will be more destructive than the Financial Crisis 2007/2008. In the aftermath of the next global rescission international monetary system will have to go throughout complete restructuring with introduction of new global reserve currency. Unfortunate historical pattern is that periods of economic crisis are often followed by political instability and wars. It is interesting to note that this paper was published just after the seventh anniversary of the largest bankruptcy in history (Lehman Brothers bankruptcy in 2008).

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