

Commentary

BUFFIN PARTNERS INC.

ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

Après Dégringolade?

When the phone rang in our office at 2am New York time on the morning of Monday September 15, our French and Swiss colleagues had already assessed the implications of the crisis in the American financial system and had recognized the tipping point into dégringolade. Their consensus thinking was that the immediate short-term problems would require calling out the American “fire-brigade” to react to the evident crisis, but the real questions that demanded careful and creative thinking would be the long-term implications for the global financial system. Would the US dollar be able to maintain a significant role as a reserve currency? Would creditor nations continue to hold US debt securities? Would the balance sheet of the US Federal Government be impaired? Would the US Treasury be able to maintain its reputation as issuer of risk-free bills, notes and bonds? Would an inflationary scenario emerge in future for the US economy? Would the value of the US dollar decline in relation to other currencies? Would the International Monetary Fund (IMF) be called upon for advice and assistance to protect the global financial system? These questions all need to be asked, considered, debated, researched and answered in the framework of *Après Dégringolade*, Quoi?

A week later, a new *Franglais* term “le Paulson program socialiste” was being used by our European colleagues to describe the historic outcome of a week that will undoubtedly be recorded as a cathartic event in the history of American capitalism. In retrospect, the rhetorical question “Are we witnessing the end of capitalism as we know it” asked by Tom Wolfe, author of *The Bonfire of the Vanities*, at the New York Stock Exchange on June 22, 2007, when the private equity specialist firm, Blackstone Group, went public with a

huge IPO, effectively selling out at the top of the market, has a timely resonance today. A brave new world of *realpolitik* has emerged in Washington, as practiced by Treasury Secretary Henry Paulson, former Chairman of one of Wall Street’s most prestigious firms, Goldman Sachs. *Realpolitik* is widely recognized as being distinct from ideological political doctrine, inasmuch as it is dictated by practical exigencies rather than by adherence to established dogma.

IMF managing Director Dominique Strauss-Kahn, a former French socialist finance minister, will be facing immense challenges in leading the IMF and its team of world-class economists in clearly setting out the path for protecting the other nations of the world, that together account for about 95% of the world’s population, from the effects of the US financial crisis. These same challenges are high on the agendas of the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD). BIS is the Basel, Switzerland-based international organization that fosters cooperation between central banks and other agencies in pursuit of monetary and financial stability; BIS is a prime counterparty for central banks in their financial transactions. OECD is an international organization that helps governments tackle the economic, social and governance challenges of a global economy.

The IMF will have a difficult task in guiding the United States and protecting the rest of the world while maintaining a record of consistency with the way it has dispensed advice in various financial crises in recent history. The role of the IMF in the Asian financial crisis of 1997 is well-remembered. At that time the IMF was opposed to a strategy for Asian governments to apply public money to support the capital of ailing financial

institutions; this IMF-dictated policy allowed many failures and bankruptcies to impact the economies of Thailand, Indonesia and Korea. Today, IMF policies must recognize the economic power of China and India, and the financial resources of China, in particular, as a major creditor that is a critically important source of borrowing to help finance the large and expanding fiscal deficits of the US government.

It appears likely that the acronym SDR will become more widely known in the financial press and media as concerns about the role of the US dollar in the international monetary system gain the attention of the world’s leading economists. The SDR is an international reserve asset, officially referred to as *Special Drawing Rights*, created by the IMF to supplement the existing official reserves of IMF member countries. The SDR is denominated as a composite basket of four currencies comprising the US Dollar, the European Euro, the Japanese Yen and the British Pound; the US dollar has a 44% weighting in the SDR; the other three currencies have a combined weighting of 56%. It is possible to envision a scenario where the SDR serves as a model for replacing the role of the US dollar as an international reserve currency and as a major currency for pricing commodities and various international contracts with an SDR-like virtual global currency.

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