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Commentary

BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

Geopolitical Implications of the Financial Crisis

The current financial and economic crisis is a dramatic global event with significant long-term implications for geopolitical outcomes. One result of the global financial crisis is that the credibility, reliability and viability of long-held tenets of capitalism are being challenged as governments implement interventionist policies that in normal times would be anathema to the economic philosophy of free-market capitalism. It is generally accepted that regulatory failure is at the heart of the current crisis; inadequate regulatory controls and the absence of remedial actions are apparent in the area of bank supervision, in the role of the Securities and Exchange Commission, and in the oversight of credit rating agencies. Unprecedented losses incurred by financial institutions have destroyed a great part of the capital in the banking system. As a result, credit markets have experienced a freeze, and brought the global financial system to "a systemic meltdown" according to a recent pronouncement of Dominique Strauss-Kahn, Managing Director of the International Monetary Fund (IMF). Traditional monetary and fiscal policy responses to the current crisis may not be adequate to halt the unfolding recession affecting the world's major economies. As the extraordinary policy responses to the financial crisis by the United States and Europe are implemented, the role of nation-states is increasing and the role of the private sector is declining. The economies of the United States and Europe are projected to decline through 2009, with their weakness characterized by lower levels of consumer spending, increased unemployment and lower personal income levels. According to some preliminary budget estimates for the United States, the aggregate effect the recession and the US government policy responses to the economic and financial crisis will likely produce a deficit for the current fiscal year of around 1.75 trillion dollars, the largest deficit in the history of any nation, and equal to more than 12 percent of the US GDP. The potential magnitude of economic stimulus initiatives and economic recovery plans in the United States could potentially increase the deficit to even higher levels.

It is now widely accepted that the leadership and influence of the United States and Europe on the world stage have been adversely affected in geopolitical terms by the economic and financial crisis. As the power and influence of the United States and Europe decline, other economic powers are gaining in stature and influence, most notably China, with its estimated foreign exchange reserves of around $2 trillion and its relative strength in terms of possessing far greater liquidity than any other nation. China is able to use its financial strength to invest in natural resource development in other nations, particularly in Africa. China's GDP is projected to surpass that of the United States in about twenty-five years; its GDP is expected to increase at a rate of 8.5 percent in 2009 according to the IMF. China's financial management is exemplary; it operates with a budget surplus, has a relatively small amount of government debt and generates an enormous current account surplus. Saving, rather than spending, is a very significant part of the Chinese culture; according to some estimates, the average Chinese saving rate is about 40 percent of household incomes. China is heavily involved with the Association of Southeast Asian Nations (ASEAN) in the creation of the world's largest free-trade area and wields considerable geopolitical power and influence in the region based on its commitment to policies aligned with its philosophy of "peaceful rise" as a world power. Many observers have noted the increased geopolitical influence of China in Latin America and Africa as it invests in infrastructure projects and extends its trade and development activities in these regions. China is also expected to increase the capital base of the IMF and extend its own influence on the direction of future activities of the IMF. However, serious questions arise concerning the limitations of the IMF to influence global economic developments beyond the roster of troubled nations that depend on IMF funds and goodwill. The emergence of a new form of nationalization by sovereign wealth funds is evidence of a major geopolitical power shift to the OPEC member nations, China and other members of ASEAN.

The global economic and financial crisis calls into question the ability of the IMF and other Bretton Woods organizations to respond effectively to events before they develop into a systemic meltdown. There is evidence of a nascent campaign for significant reforms to be made to these organizations. Their suitability to continue to serve in their present form as major players in the new global economic environment is being challenged on many fronts. Many experts believe that they will require significant reforms and a new model Bretton Woods II if they are to function in the best interests of all nations for global economic and financial stability.

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