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# Revisiting the Future: Geopolitical Effects of the Financial Crisis

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The report highlighted the emergence of a multipolar global order with rising states like China and India economically overtaking most of the older Group of Seven (G-7) powers by 2025. The United States' traditional partners, Europe and Japan, would increasingly be challenged to maintain economic growth in view of their aging populations. While the rising states would want seats at the international high table, the report anticipated that they would be cautious about assuming global burdens, despite a packed agenda composed of new challenges like climate change and energy security in addition to growing threats such as nuclear proliferation and weapons of mass destruction (WMD) terrorism. By 2025 the international order, although unrecognizable from its post-World War II contours, would remain in transition and be one in which the United States, though still preeminent, would be less dominant even as others would still look to it to shoulder many of the global burdens.

> Theories about emerging markets decoupling from the U.S. economy have been dispelled.

Such was the world the NIC foresaw as the crisis unfolded. Now, emerging markets the world over have lost more than half of their value since September 2008 alone. Banks
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# How Much of a Geopolitical “Game Changer” is the Financial Crisis?

Mapping the NIC's predictions against early facts, one of the most interesting observations is less about any particular shock generated by the financial crisis and more about its global reach. If anything, the crisis has underscored the importance of globalization as the overriding force or “mega-driver” as it was characterized in both the NIC's 2020 and 2025 Global Trends works. Developing countries have been hurt as decoupling theories, assertions that the emerging markets have appreciably weaned themselves from the U.S. economy, have been dispelled. This second epicenter of the crisis in emerging markets could also continue to exacerbate and prolong the crisis. Alongside foreseeable exposures, such as Pakistan with its large current account deficit, are less predictable panics like Dubai, whose debt was financed on suddenly expensive dollars. Even those with cash reserves, such as Russia and South Korea, have been severely buffeted.

At the same time, globalization itself may be transformed because of the financial crisis. The spectacular growth in global liquidity that took effect in the past decade, allowing for an era of free money, may be ending. Recent data suggests that the NIC
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high and its authorities appeared to be trying to lower the value of the RMB against the dollar, in effect trying to restore the status quo ante. Export-led growth models, however, have been unsustainable and prone to volatile unwinding. German attempts to forge export-led growth atop U.S. consumption proved unsuccessful in the 1960s. Japan tried and failed in the same manner in the 1970s, and similar attempts by the East Asian tigers met the same fate in the 1990s.

Such lessons also apply to any U.S. attempts to reinstitute past patterns of mutual dependence. After noting the familiar definition of insanity, repeating the same action and expecting a different result, a Wall Street leader recently summarized the future of U.S.–China relations, stating that the incoming U.S. leaders must ask themselves if they are willing to double down again on the country's national debt to facilitate the economic rise of those insistent upon an export-led growth model.

Inauspicious as traditional prospects surrounding the U.S. financing of export-led growth might be, the crisis suggests this may now be an even riskier bet than in previous eras. In 1971, then-Treasury Secretary John Connally simply pulled the plug on Japanese undervaluation by refusing to exchange dollars for gold. Likewise, former president Ronald Reagan issued credible threats that forced cooperation from Germany and Japan in the Plaza and Louvre Accords in 1985. The United States enjoys no such unilateral options today, as the current crisis involves more actors and few willing allies in adjust ... more so than either Be ...

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perhaps too quickly in Beijing's view, China's decisionmaking remains almost exclusively domestic. This is consistent with the report's view of China as a status quo power which has benefited from the current geopolitical arrangement and now sees itself in a waiting game. Beijing is loathe to play its hand too early for fear of taking on too much risk or disrupting prospects for its continued rise. Hence China's reluctance to use its reserves to come to the rescue of other countries in need, or subsequently to have far more say in how the new economic order is constructed.

## An Enlarging State Role …

The 2025 report pointed to the resurgence of the state in economic affairs, particularly for the rising powers. As with previous countries whose economies had taken off, such as South Korea and Taiwan in the 1960s and 1970s, the state is playing an important economic role not just in authoritarian states like China, but arguably even in rising democracies like Brazil and India. The financial crisis would seem to have further heightened the role of the state, potentially even more so where governments in the West are funding bailouts and coordinating stimulus packages.

Perhaps the best known, but hardly the only, mark of these collapsing firewalls between state and markets is the upsurge in sovereign wealth funds in recent years. It is worth recalling that sovereign wealth funds came into fashion roughly fifty years ago, initially to aid in … e long-term upward … e liquidity buffers t… isen as byprodu… e surpluses are due … ommodity prices.

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Ultimately, we anticipate that the shift toward a greater state role in the economy may be more permanent than not. State-owned enterprises (SOEs), long seen by the report and others as a more insidious threat, may gain greater market prominence and heightened political stakes amid increased state presence in markets and revamped industrial policies. The report recounts how SOEs, once mere exercises in job creation, are not only resurfacing, but are newly aggressive, and in many cases (e.g. Gazprom, Lenovo) are expanding beyond national borders to become global household names. Even before the crisis, state wealth was increasingly deployed to subsidize non-tariff barriers that lend SOEs advantages over private firms. This competitive advantage is particularly concerning as SOEs increasingly operate across national lines. Now, as the state finds itself managing more industries, as job creation again becomes a core concern, and as neo-mercantilism looms ever larger, SOEs may become a dangerous source of attraction.

## … But Authoritarianism May Face A More Uncertain Future

The report predicts that even for successful state capitalists, authoritarian regimes would face a day of reckoning when, at some point, they would have to loosen the political reins and open up, partly in order to encourage continued investment and greater scientific and technological innovation. Turbulent experiences, such as the
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public hostility during times of economic strain. The admirable growth performances of many non-democratic emerging states moved several economists and commentators to publicly question whether democratic developers, such as India, bear a "democracy tax," and whether China and other strong state developers, enjoying greater concentration and reach of decisionmaking power, might perhaps offer a more efficient growth alternative.[2] But as these "state capitalist" countries fall under severe strain, their leaders are finding that with centralized responsibility comes a conspicuous target for accountability. Without any open election to vent popular frustration, the likelihood of increased domestic turmoil and conflict may be even greater than originally forecasted.

The report hypothesizes that a reversion to more political liberalism in Russia would only happen in event of a prolonged economic downturn. The same may be true for China. While economic growth appears to be falling, the Chinese Communist Party, whose legitimacy has rested on continued growth, may have to reinvent itself and that might include greater accountability.

## A More Distant Post-Carbon World

The report highlighted the emergence of a new global agenda centered around climate change and an energy transition out of fossils fuels. The volatility that the world has
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## The Future of the United States

The report projects that the United States will remain the preeminent single power by 2025, but the gap between it and others will narrow. This is the result of several factors, not just due to the increasing economic powers of rising states like China and India. Power itself has for some time been diffused with non-state actors rising in importance. As seen most recently in Iraq, military power, on which the United States will remain technologically superior, can be blunted with the use of asymmetrical strategies and others, like China, are expected to narrow the high-end technological edge with the United States. Cyber and space are two areas where the United States currently has a near monopoly, but by 2025 it will disappear. The financial crisis raises the question whether the United States' relative decline, particularly in the economic realm, will arrive sooner than anticipated in the report or whether the crisis will be an opportunity for the United States to emerge stronger in coming years, helping to maintain a bigger edge for a longer time into the future.

Recessions are a relative game, and historically, the United States has proven more adroit at responding to them than most. The United States emerged from oil shocks of the 1970s far faster than more heavily oil-dependent counterparts like Europe and Japan. It … dollar's global re… ded upon Europe i… ecession of the early… est rival, entered … new strategy… s to its unprece… ed States' tradit… in a better posit… that appears … the country through …

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antipathy not forgotten, the commonly described “unhappy marriage” between China and the United States could metastasize into a mistrusting union between Beijing and Washington, spilling over into widespread distrust of the United States among swaths of emerging and mature economies. Global financial protectionism, while not a big feature in the report, represents a new danger. Its forms, such as numerical leverage ceilings and outright bans on entire markets, may be greater and more systemic than traditional trade and investment protectionism. Should imminent domestic regulatory battles aggregate into destructive and futile “what touches here, clears here”-style regulation, credit markets would be left balkanized even as regulatory blind spots would grow.

> The United States has historically proven more adroit at responding to recessions than most.

The dollar's recent strengthening suggests that the NIC was perhaps unwarranted in flagging concerns over the dollar's ability to maintain its role as the world's leading global reserve currency. Comforting as it would be to believe in such an eternal flight to quality, the dollar's rebound may have more to do with the unwinding of dollar-
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The report's 30,000 ft. lesson that historic changes in the global economic and financial landscape require corresponding shifts in foreign policy thinking, is, if anything, even more apt. Artificial divisions between “economic” and “foreign” policy present a false dichotomy. To whom one extends swap lines and how the IMF is recapitalized are as much foreign policy as economic decisions. Several states openly hinge support for NATO and U.S. coalition efforts upon domestic economic conditions which in turn, they insist, is contingent on U.S. monetary and fiscal aid. Others blend the two with even greater calculation: China using its SWF to compel Costa Rica to disavow Taiwan, Russia resorting to military tactics to scare would be investors away from competing pipeline projects.

> Hostility toward the U.S. as the source of the crisis may have received too little credence.

## Economics as High Politics

As markets prove truly global in reach and risk, as margins progressively thin, and states assume ever-more market presence, the fictional barriers between “economic”
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Of course, the report encompasses more than economics and indeed believes the future is likely to be the result of a number of intersecting and interlocking forces. With so many possible permutations of outcomes, each with ample opportunity for unintended consequences, there is a growing sense of insecurity. Even so, history may be more instructive than ever. While we continue to believe that the Great Depression is not likely to be repeated, the lessons to be drawn from that period include the harmful effects on fledgling democracies and multiethnic societies (think Central Europe in 1920s and 1930s) and on the sustainability of multilateral institutions (think League of Nations in the same period). There is no reason to think that this would not be true in the twenty-first as much as in the twentieth century. For that reason, the ways in which the potential for greater conflict could grow would seem to be even more apt in a constantly volatile economic environment as they would be if change would be steadier.

In surveying those risks, the report stressed the likelihood that terrorism and nonproliferation will remain priorities even as resource issues move up on the international agenda. Terrorism's appeal will decline if economic growth continues in the Middle East and youth unemployment is reduced. For those terrorist groups that remain active in 2025, however, the diffusion of technologies and scientific knowledge will place some of the world's most dangerous capabilities within their reach. Terrorist
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rivals combined with underdeveloped surveillance capabilities and mobile dual-capable Iranian missile systems also will produce inherent difficulties in achieving reliable indications and warning of an impending nuclear attack. The lack of strategic depth in neighboring states like Israel, short warning and missile flight times, and uncertainty of Iranian intentions may place more focus on preemption rather than defense, potentially leading to escalating crises.

Types of conflict that the world continues to experience, such as over resources, could reemerge, particularly if protectionism grows and there is a resort to neo-mercantilist practices. Perceptions of renewed energy scarcity will drive countries to take actions to assure their future access to energy supplies. In the worst case, this could result in interstate conflicts if government leaders deem assured access to energy resources, for example, to be essential for maintaining domestic stability and the survival of their regime. Even actions short of war, however, will have important geopolitical implications. Maritime security concerns are providing a rationale for naval buildups and modernization efforts, such as China's and India's development of blue water naval capabilities. If the fiscal stimulus focus for these countries indeed turns inward, one of the most obvious funding targets may be military. Buildup of regional naval capabilities could lead to increased tensions, rivalries, and counterbalancing moves, but it also will create opportunities for multinational cooperation in protecting critical sea lanes. With water al ... anage changin ... d between states in ...

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The diversity in both type and kind of actor raises the likelihood of fragmentation occurring over the next two decades, particularly given the wide array of transnational challenges facing the international community.

Because of their growing geopolitical and economic clout, the rising powers will enjoy a high degree of freedom to customize their political and economic policies rather than fully adopting Western norms. They are also likely to cherish their policy freedom to maneuver, allowing others to carry the primary burden for dealing with terrorism, climate change, proliferation, energy security, and other system maintenance issues. Existing multilateral institutions, designed for a different geopolitical order, appear too rigid and cumbersome to undertake new missions, accommodate changing memberships, and augment their resources. Nongovernmental organizations and philanthropic foundations, concentrating on specific issues, increasingly will populate the landscape but are unlikely to affect change in the absence of concerted efforts by multilateral institutions or governments. Efforts at greater inclusiveness, to reflect the emergence of the newer powers, may make it harder for international organizations to tackle transnational challenges. Respect for the dissenting views of member nations will continue to shape the agenda of organizations and limit the kinds of solutions that can be attempted.

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## Addit

Mathew J. Burrows
Mathew J. Burrows is a counselor in the National Intelligence Council (NIC), the principal drafter of Global Trends 2025: A Transformed World

Jennifer Harris
Jennifer Harris is a member of the NIC's Long Range Analysis Unit who worked closely on the report

## Notes

1. National Intelligence Council, Global Trends 2025: A Transformed World, November 2008, http://www.dni.gov/nic/PDF_2025/2025_Global_Trends_Final_Report.pdf.

2. Morgan Stanley Asia chief Stephen Roach articulates this growing view: “What we're seeing is that the Chinese command-and-control system can actually work more effectively than other market-based systems in times of economic stress.” Quoted in Rana Foorohor, “Why China Works,” Newsweek, January 19, 2009. While offering no normative endorsements, Robert Kagan of The Washington Post and Gideon Rachman of the Fi [illegible] s.

3. Globa [illegible] (Washington D.C.: Wo [illegible]
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