The economic and financial crisis of 2007–09 has brought up and crystallized problems that had been bubbling beneath the surface of the global economy for some years. It has exposed the limits of unrestricted globalization, the gaps and insufficiencies in the governance of global markets, the intrinsic tension between global financial markets and sovereign states. It has raised questions about the soundness and sustainability of the model of economic growth that underpinned the rise in international prosperity for the past 50 years. In many countries it has further deepened the gap between the pursuit of a liberal global agenda and the need to protect domestic interests. Finally, the relative resilience of China and other emerging market economies to the crisis, and their more rapid recovery, have served as a powerful demonstration of the shift from West to East and of the emergence of a multipolar world in which economic power is more diffused, but also less effective.¹

If there is a country that lies at the crux of all these different trends, it is the United States. The crisis not only originated in the United States, but also showed the limits and fallacies of the model of economic growth that it had championed. The effort to contain and eventually resolve the crisis has imposed a huge burden on the already strained US public finances, reinforcing arguments about America’s relative decline and loss of economic supremacy. For the American middle class, already concerned about the progressive erosion of their relative economic wealth, US international commitments – from the intervention in Afghanistan to the promotion of open markets – are often seen as a burden that diverts resources from domestic priorities. The hanging question is who will eventually pick up the bill for the crisis. As the recovery seems to be less...
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dynamic in the United States than in many emerging market economies, with
a large number of jobs lost and fewer created, the pressure for more domestic­
focused economic policies is rising.

Within the context of one of the worst economic crises in decades, pressures
to give priority to domestic imperatives over international concerns are present
in every country. But this chapter argues that the United States is in the best
position to address the dichotomy, and intrinsic tension, between global markets
and national interests. This is certainly not the case for European nations that
seem stuck in a supranational order where they have as yet surrendered insuf­
ficient sovereignty to allow for the smooth and efficient functioning of their
supra-national institutions. Nor is it the case for the emerging powers that are
still learning to be responsible international actors and for whom the balance is
still skewed heavily towards national interests.

The United States will need to overcome the more domestic and inward­
looking concerns of its middle class by creating a more equitable system at
home while promoting stability as well as opportunity in the global economy.
These challenges are embedded in the current debate on US healthcare reform.
The inequity of the current system, dividing those who have cover from those
without it, has come to symbolize all the contradictions – and even to question
the morality – of the US economic system, especially the ‘capitalism without
rules’ of the last couple of decades.

The crisis has highlighted the need for rules in the global economy. But
the emergence of new powers is challenging the notion that the United States
should automatically take the lead in writing those rules simply because of the
sheer size of its economy and the dominance of the dollar in international trade
and investment. Instead, the crisis clearly poses the question of how the balance
of power and leadership in international economic affairs will be shaped in
future years. Who will have the moral authority as well as the economic clout
to lead the global economic policy debate?

For many involved in discussing the future of the international economic
order, the crisis has dramatically ruptured the credibility of and respect for the
American model, questioning the soundness of neo­liberalism, US­led global
growth and the related dominance of the dollar. The crisis has also under­
mined America’s presumed ‘moral’ right to lead, as the model of growth and
the neo­liberal doctrine that underpins it have been discredited. In geopolitical
terms, the financial meltdown, a potentially protracted recession and mounting
US federal debt are seen as catalysts that will end US economic hegemony
and lead to a shift in the world political order – and the rise of China seems
to epitomize such a shift. Great­nation status and global influence rest largely
on economic and financial power, which in turn enable military power. Large
empires, from Ancient Rome to Great Britain, declined at least in part as a
result of economic weakness. Conversely, China’s rapid economic growth and
the potential for other emerging market economies to expand substantially over
coming decades, owing to their large populations and integration in the world
economy, seem to indicate the emergence of a new, more multipolar economic
order. A powerful symbol of this shift is the upgrade of the G20 into the economic summit for heads of state at the expense of the G8. But is this an accurate portrait of the short-term and long-term challenges posed by the crisis? Or is the debate being hijacked by those – individuals and countries – too keen to predict the end of US hegemony, or too worried about it? The key question here is what the current financial crisis means for the standing of the United States in the world. Has the United States lost the right, the capacity or even the will to lead in economic affairs? And should it continue to lead?

This chapter points to economic indicators that suggest the continuation of America’s global economic leadership – despite the crisis and the erosion of its relative position. Besides the sheer size and inherent dynamism of its economy and the continuing centrality of the dollar in the international monetary system, being a liberal democracy as well as a developed market economy is what makes the United States the best candidate to continue to lead on the international economic stage. However, the persistence of US capacity for global economic leadership could generate tensions at the international level if other states do not recognize this reality. And, at the domestic level, the desire of the Obama administration to retain its international economic leadership could equally cause tensions if US international commitments are perceived to be in competition or conflict with domestic priorities. The United States faces two challenges here. It has to recognize the undergoing shift in the international economic order, and the relative erosion of its position within that order. Then it has to prove itself fit to manage international economic affairs from a position of equality – as primus inter pares rather than a hegemon – that better reflects the new configuration of the international economic order. Being able to reconcile the country’s international goals and domestic interests would give the United States the ‘moral advantage’ as well as the practical lead in international economic affairs.

Aspects of past US moral leadership could be regained from the country’s ability to lead by example: to show the way forward in dealing simultaneously with national objectives and international goals, to devise and implement a sustainable, balanced and equitable model of growth that reconciles the tension between global markets and national interests, and to use its national example as a basis for offering a new model of governance and new rules for global institutions. Reform of the international financial architecture is the most urgent issue on the international economic agenda and one where the United States should play a key role. The critical question here is how the administration of President Barack Obama can ensure the United States is the driving force of the multilateral dialogue on such reform without losing focus on domestic economic concerns.

The rest of this chapter is organized as follows. The next section examines the fundamentals of American economic power, the extraordinary years for the US economy that overlapped with the administrations of Bill Clinton and George W. Bush, the model of growth and the building of global financial imbalances. This is followed by a discussion of whether the financial crisis of 2007–09 has aggravated the structural weaknesses of the American economy and acceler-
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ated the relative decline of the United States. The chapter then considers the role of the United States as *primum inter pares* in a multipolar economic order, and its relations with the emerging economic powers. The chapter concludes by advocating a more active and responsible role for the United States in setting an integrated agenda for the reform of the international financial architecture.

**THE FUNDAMENTALS OF AMERICAN ECONOMIC POWER, 1992–2007**

**Strong growth in the 1990s, and a ‘new paradigm’**

The 2007–09 financial crisis had a long incubation. Its origins lay in the deregulation of the banking and financial sector that started in the 1980s and continued throughout the 1990s when strong GDP growth saw the building up of bubbles and current account imbalances. The peak for the external imbalance was reached in 2006 when the current account deficit hit $800 billion (or 6 per cent of GDP) while the government budget also remained in deficit (just over 2 per cent of GDP) despite the recovery from the dotcom recession of 2001.

The years between the early 1990s and 2007, however, were a prosperous period for the American economy during which productivity accelerated, unemployment fell and wages rose across the board. This was a big change from the malaise of the 1980s and a big boost to national self-esteem. In 1992, the presidential election was fought against the backdrop of a weak economy, struggling to pick up from the 1991 recession, and an electorate worried about its living standards, its healthcare and the country’s ability to compete internationally. Bill Clinton won by focusing on middle-class America’s economic concerns and promising an activist government that would deliver healthcare reform, big increases in public investment, tax cuts for middle-class families and higher taxes on the rich.

The decade of strong growth began with the recovery from the 1991 recession. From 1992 to 2000, the US economy enjoyed a ‘golden age’ in which growth only fell below 3 per cent in two years (1993 and 1995, when it was 2.7 per cent and 2.5 per cent respectively). By the end of 1995, American business was doing exceptionally well – profits at large companies were up 18 per cent and the stock market had had its best growth in 20 years. Fiscal and monetary policy were both working well, with the 1996 deficit projected to shrink to less than $110 billion, and inflation still below 3 per cent. Job creation was strong and the unemployment rate fell from over 6 per cent in 1994 to less than 4 per cent in 2000. In the process, the economy spawned 16 million new jobs. Both the economy and the stock market continued to boom. In spring 1996, GDP growth was over 6 per cent – calling into question the conventional view that 2.5 per cent was the maximum growth the US economy could healthily sustain. As noted by the then Chairman of the US Federal Reserve Alan Greenspan, ‘We were doing a lot of rethinking at the Fed. [...] *Something* extraordinary was happening.’ Clinton asked Greenspan to stay at the Federal Reserve: ‘He was asking for faster growth, higher wages, and new jobs. He wanted to see what this rocket could do.’
America and a Changed World

**Bubbling bubbles**

These years of exceptional performance for both the real economy and the financial markets saw the formation of a series of bubbles. There were concerns among economists that interest rates were too low although their analysis tended to focus more on the risks of inflation than on bubbles. Inflation concerns were dismissed by the Clinton administration on the basis of high productivity growth generated by the technology boom – by then, a symbol of America’s success in reforming and modernizing the economy.\(^{11}\) Even when the dotcom bubble burst in early 2001, the Federal Reserve hardly changed its stance on monetary policy. After 9/11, it lowered the federal funds rate to nearly one per cent and maintained it near that very low level for three years.

The extraordinary performance of the US economy – especially when compared to those of the euro area and Japan – generated a good deal of complacency; nobody wanted to spoil the party. In addition, Greenspan’s near ‘god-like status’\(^{12}\) somehow constrained the economic policy debate. Research shows a change in the character of Federal Open Market Committee (FOMC) deliberations after 1993, when policy-makers became less willing to express disagreement with any proposal brought forward by Greenspan.\(^{13}\) As a result, from the late 1990s Greenspan went almost unchallenged and could shape the consensus within the FOMC towards his preferred outcome: in its 65 meetings from 1998 to the end of Greenspan’s mandate in 2006 there were only 15 dissenting votes.\(^{14}\) ‘In 2000, as speculation built to a fever pitch, there was not a single dissent.’\(^{15}\)

With interest rates remaining at a historically low level during most of Bush’s first term in office,\(^{16}\) liquidity was growing. This reflected, among other factors, the enormous financial surplus realized by countries like China and the oil producers – what the then Fed chairman-to-be Ben Bernanke in 2005 called ‘the global savings glut’. Until the mid-1990s, most emerging economies had run balance-of-payments deficits as they imported capital to finance their growth. But the Asian financial crisis of 1997–98 changed this pattern. In many emerging markets, increasingly large trade surpluses, resulting from strong manufacturing activity and rising oil prices, were consistently recycled back to the West, in particular to the United States, in the form of portfolio investments. Seeking higher yields, huge amounts of capital thus flowed into the sub-prime mortgage sector, which provided higher and allegedly low-risk returns through the securitization of mortgages, and towards risky borrowers of all kind. In 2006, for example, the annual volume of US sub-prime and other securitized mortgages rose from a long-term average of approximately $100 billion to over $600 billion. This flow of mortgage money prompted an unprecedented rise in prices for commercial and residential properties. Whereas the average US property had appreciated at 1.4 per cent annually over the 30 years before 2000, the appreciation rate was 7.6 per cent annually from 2000 until mid-2006.\(^{17}\)
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From the sub-prime failure to the financial and banking crisis

When house prices began to fall in mid-2006, this started to undermine the value of the multi-trillion dollar pool of sub-prime mortgages. Moreover, many of those mortgages that were structured to be artificially cheap at the outset began to convert to more expensive terms. An increasing number of borrowers could no longer afford such mortgages and delinquencies became more frequent. Losses on these loans began to emerge in mid-2007 and quickly became bigger and bigger. The rest of the story is well known. The final year of the Bush administration saw the escalation of the financial crisis, that had started in August 2007 in the sub-prime mortgage market, with the banking and financial system on the verge of collapse. The first alarm bells in the summer of 2007 were followed by the nationalization or takeover of Fannie Mae and Freddie Mac, AIG, Bear Stearns, Merrill Lynch, Wachovia and others. Lehman Brothers was famously not rescued.

Over the course of the debt-financed spending spree, the debt/income ratio of US households rose steadily and reached a peak of just over 130 per cent in 2008. And, although at this stage government debt was only around 65 per cent of GDP, it ballooned as the crisis deepened in 2009. The heavily leveraged banking and financial sector risked collapse when the property bubble burst. Only the prompt intervention of the Federal Reserve, on an unprecedented scale, allowing banks to stay in business, avoided a bigger disaster. The Federal Reserve injected liquidity in the imploding financial system by expanding its own balance sheet and the monetary base. At the same time, the government intervened to bail out the financial sector and to provide a public-sector substitute for sharply falling private-sector consumption. The result of these policies was a huge increase in the US deficit and debt position.

The US public debt is now a major cause for concern. An ageing population is already putting strains on the Medicare programme of healthcare for the aged, the cost of which is due to rise rapidly in the years ahead – from 2.8 per cent of GDP now to about 6 per cent of GDP in 2030. Further strain is due to come from 47 million Americans, or 16 per cent of the population, without medical insurance. This figure has been rising gradually by one- or two-tenths of a percentage point for the last 20 years and is due to further increase in the years ahead as the recession causes the number of unemployed to rise. Economic hardship will be reflected in further demand for government-provided health insurance, which currently covers about 27 per cent of the American population (40 million, or 14 per cent, insured by Medicare and 38 million, or 13 per cent, by Medicaid). On top of these actual and projected costs comes the cost of the $700 billion bank bailout (and an additional $100 billion of tax provisions for businesses and the middle class).

As a result, the public debt-to-GDP ratio will trend up faster than otherwise in the coming years, although the exact path will depend on the behaviour of interest rates and on the prevailing growth scenario. The most likely scenario currently is one of low growth and high debt accumulation. The US
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Congressional Budget Office estimates that the public debt-to-GDP ratio will rise from 40 per cent to 80 per cent in the next decade, depending on the performance of the economy. If long-term interest rates were to increase to 5 per cent, the resulting increase in the interest rate bill alone would be about $450 billion, or 3 per cent of GDP.

THE CRISIS AND THE US ECONOMY

Coming out of the crisis

The financial crisis of 2007–09 was comparable to the Great Crash of 1929 in which stress in financial markets led to prolonged recession. After several weeks of market turmoil, the world economy took a ‘synchronized dive’, recovery from which promised to be slow. In the case of the US economy, the financial crisis generated a sharp recession. Because of severe strains in financial institutions, extremely loose monetary policy found it difficult to unclog the credit market. In addition, households suffered from large financial and housing wealth losses, much lower earnings prospects and uncertainty about job security, all of which drove consumer confidence to record lows. These shocks depressed consumption, with the result that the household saving rate, having dropped for two decades, increased sharply to average close to 5 per cent in the second quarter of 2009 – from a low point of around 0.5 per cent in 2005–07.

The policy response to the crisis was timely and massive. In October 2008, the Troubled Asset Relief Program (TARP) provided capital injections to stressed financial institutions and bolstered financial markets. Guarantees were offered on selected bank assets and liabilities and expanded on deposits. In the meantime the Fed lowered interest rates to an all-time low and unambiguously communicated the intention of keeping monetary policy loose until clear signs of economic recovery emerged. In February 2009, the administration unveiled a massive fiscal stimulus of more than 5 per cent of GDP (albeit over the period 2009–11). In the same month stress tests to assess banks’ resilience to the economic downturn were launched; they bolstered confidence in financial stability when results were announced in May. In the meantime the G20 summit in London helped stabilize confidence, especially in the United States.

Looking at the financial crisis several months after its peak, it is surprising to see the relative speed of adjustment compared with predictions in late 2008 of a deep recession leading to protracted depression. The US economy returned to growth in the third quarter of 2009 even if, at the time of writing, there are still considerable downside risks – in the labour and export markets, in particular – that could constrain recovery.

Besides the short-term picture and the immediate issue of crisis resolution, it is the medium to longer run that poses some major challenges. These include, for the medium term, formulating exit strategies from interventions to stabilize the financial system, as well as extraordinary monetary policy stimulus. For the longer term, challenges include addressing the weaknesses in financial supervision and regulation, stabilizing the public finances and coping with an
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environment of rising saving and slower growth as household balance sheets adjust. The key question here – and the one with the most serious long-term implications – is whether these challenges will constrain the future expansion of the US economy, undermining the American position in the world economy while at the same time enhancing the current distress and limiting the scope for future policy action. Is the crisis acting as a catalyst for the erosion of the American economic supremacy, accelerating the process of relative decline, or is it provoking a necessary set of adjustments that will strengthen the US economy in the long term?

The end of US economic and monetary hegemony?

The crisis has certainly exacerbated the economic weaknesses that were ignored over the last decade because of foreign investors’ willingness to invest in the United States. The US debt position and its long-term projection, which are unlikely to improve soon, are rightly a cause of concern because of the potential instability and vulnerabilities associated with protracted indebtedness. In addition, large fiscal deficits as a consequence of bailout measures and the financial rescue plan, an ageing society²⁰ and the resulting higher cost of the Medicare programme of healthcare for the aged are likely to put further strains on the already large debt. Despite a substantial improvement in the national savings rate and in the current account deficit, a decline in the rate of dollar-denominated asset accumulation by foreign investors, especially by countries such as China, remains a reason for concern for long-term interest rates and the value of the dollar. International investors may lose confidence in the dollar, thereby undermining its status as the key international currency. The idea floated by the governor of the Chinese Central Bank of using Special Drawing Rights (SDRs) as the international reserve currency has added further concern to the debate.²¹ All these vulnerabilities might constrain policy initiatives by the Obama administration, and even its successors, in a number of areas, from military intervention to discretionary international aid and projects.

The case of the relative decline of the United States is intensified by the relatively strong performance of China and other emerging-market economies through the crisis. China stands out as by far the most successful economic story since the 1990s. It has also braved the current economic turmoil better than any other major economy, to the extent that it may achieve its target growth of 8 per cent at a time when most countries have nosedived into recession. In fact, the growth of China and, to a lesser extent, India was the main positive contributor to world GDP for 2009. But even before this, growth rates were very strong, averaging over 10.4 per cent during the 1992–2008 period, translating to a nearly five-fold increase in real GDP. China’s share of the world economy has shot up from barely over 4 per cent in 1992 to over 11 per cent in 2008, and its position in world trade is just as prominent, rising from barely 2 per cent to nearly 12 per cent (excluding intra-EU trade) during the period in question; it is now the largest exporter outside the EU.
Equally important are the huge reserves of capital that have transformed China into the world’s largest global creditor. Chinese foreign exchange reserves have surpassed the $2 trillion mark and China is the single largest investor in US Treasury securities, with holdings quoted at more than $800 billion in late 2009 (representing around 8 per cent of the US government bond market). While there is much debate over the sustainability of this savings imbalance, it is one of the reasons why the US–Chinese relationship is arguably the most important in global economic affairs today.

Although none of other BRIC economies has achieved the level of ascendency that China has, their performance during the past two decades has been remarkable as well. India began a series of liberalization reforms in 1991 after decades of centralized economic planning. These reforms opened the nearly bankrupt country to foreign investment, liberalized capital markets, deregulated domestic business and lowered barriers to trade. As a result, India’s economic performance improved, numerous industries took off – particularly IT – and, by 2005–07, its GDP was growing at around 9 per cent per annum – nearly as strongly as China’s. Furthermore, the country has weathered the current global malaise quite well. Nevertheless, India faces major disadvantages compared to China, particularly its poor trade performance and persistently high levels of poverty. These will hold back its economy from achieving the same level of dynamism as its Asian neighbour.

From a global perspective, the relative strength of China and other emerging market economies has been a stabilizing force during the recession. It has also further revealed the vulnerability of the US economy in the post-crisis economic and political landscape. For many commentators this is a sign of the inevitable shift of economic power – and political influence – from West to East.

**Trend growth and relative position**

Deleveraging from the excess debt of the past is likely to be a long and slow process for the American economy, and one that will result in lower growth rates for both the United States and the world. As US consumer demand still plays a key role in global growth, an increase in the savings of American households in order to pay off their debt will have a constraining effect. Whether countries will be able to recover their pre-crisis growth rates is crucial to how they will perform in the world economy. Currently, the US share of the world economy in purchasing power parity (PPP) terms is 20.7 per cent while the EU has an even larger share at 22.1 per cent. This compares with 11.5 per cent for China. Is there a risk that reduced trend growth as a result of the crisis will result in a reduced share of the world economy for the United States in the long term? Post-crisis trend growth seems to be more of a concern for Europe than for the United States. Although a few warning shots have been fired regarding a possible scaling back of future trend growth, the authorities in the United States seem to have faith that its economy will not only climb back to its pre-crisis levels of growth, but recover its crisis-related losses as well (see scenario A in Figure
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**Figure 1: Post-crisis growth scenarios for the US economy**

- A) Crisis losses fully recovered
- B) Crisis losses not recovered, but potential output growth maintained
- C) Potential output growth permanently downgraded

Sources: IMF data and estimates by Chatham House International Economics.

**Figure 2: Pre-crisis and post-crisis growth trend for the US and the euro area**

- US GDP (pre-crisis potential after 2014)
- US potential GDP (IMF est.)
- Euro area GDP (downgraded potential after 2014)
- Euro area potential GDP (IMF est.)

Sources: IMF data and estimates by Chatham House International Economics.

1) Their expectations are based on evidence from previous cycles. American GDP bounced back sharply after the 1991 plunge and even more dramatically after the early 1980s recession, achieving a massive 7.2 per cent growth rate in 1984. Emerging economies have also registered sharp recoveries from even more devastating crises, as happened in most East Asian economies after 1998 and
Latin America after 1995 and 2001–02. Should this be the case again, it will leave the United States not only maintaining a higher rate of growth than the euro area, but widening the GDP gap even more.

Past experience is less reassuring for the euro area, for which the most likely scenario is one where its GDP recovers its pre-crisis growth rates, albeit at a lower level owing to the losses incurred by the crisis, i.e. the output gap is never recovered and the economy grows below potential (Figure 2). A less likely scenario, given recent forecasts for the euro area, is one in which growth surges above trend levels in the next few years because of better than expected GDP growth. In this case the output gap may close, losses may be made up, and the region would return to pre-crisis growth rates, maintaining in any case the GDP gap relative to the United States.24

**Excessive concern about decline**

Claims that American economic hegemony is over are therefore premature, as are predictions of China’s imminent takeover. Despite being badly hit by the credit crisis, the United States will still show great resilience. What factors account for the more optimistic prospects for future US output? Labour flexibility and innovation are arguably the most important. The US economy has shed jobs far more rapidly than have European economies, where governments have taken concrete steps to protect employment and where structural characteristics – such as large public sectors – have also prevented dramatic rises in unemployment. But the massive job losses in the United States had a positive effect on productivity, which rebounded in the second quarter of 2009.25 Job losses have also helped the US economy ‘thin out’ its less productive sectors. In so far as innovation also feeds into increased productivity, the US economy is likely to be far better poised than Europe to return to ‘business as usual’ once the effects of the crisis have receded.

Another factor likely to help the United States to recover its pre-crisis growth rates is the ability to attract foreign investors. Over the short term, the attractiveness of the US market may be hindered by concerns about continuing economic risk and low returns due to the US debt position and the weakness of its domestic economy. Empirical evidence, however, seems to support the view that foreign investors will choose to purchase US portfolio investments in order to benefit from what are, compared to many other countries, a highly developed, liquid, and efficient financial market, good standards of corporate governance and strong political and regulatory institutions.26 Again, evidence from the crisis and the rally first in the dollar and later in the US stock market suggests a relative preference among many foreign investors for the US market.27 The catch, of course, is that anything that undermines the liquidity and efficiency of US financial markets – and the financial crisis might be such a factor – could also seriously undermine the sustainability of capital inflows. Good policy choices by the Obama administration in managing the next phase of economic recovery will be critical, therefore, in fostering investors’ confidence.
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The United States is also the country best endowed with the economic flexibility and natural and human resources needed to get past present difficulties: it is highly attractive and open to migration; it hosts the world’s leading institutions of higher learning; and, as Anne-Marie Slaughter and others have noted, it possesses the most networked society and economy in the world. Moreover, despite China’s call for a ‘multipolar reserve currency system’, inertia and the lack of serious alternatives will ensure that the dollar will continue to lead the international monetary system for years to come. The euro is far from having a global role and, hence, is still unable to challenge seriously the greenback’s dominance, while no other currency is emerging as an international alternative.

As the global monetary hegemon, therefore, the United States will continue issuing its debt in its own currency, and as a result enjoy great flexibility in servicing its dollar-denominated foreign debts. Unlike other countries, the United States can continue to go deeply into debt with the rest of the world in its own currency while facing little foreign exchange risk. However, there are now more potential threats than in the past when the United States could expect all other countries to adjust to its policies. Today surplus countries might decide to stop covering US debt, revalue their currencies, and reduce their dollar reserve holdings. Although this scenario is more likely now, as a result of the US debt position, its probability remains low, given the implied capital losses for dollar-holding countries.

Finally, in spite of all the talk about ‘decoupling’, the United States remains the engine of the world’s economic growth. Following years of high growth, emerging market economies are surely more ‘self-reliant’ than before and so far better insulated from the effects of the financial crisis, partly because their financial sectors are still relatively small and disconnected from the global economy. However, they still rely on demand from advanced economies for their exports.

PRIMUS INTER PARES AND THE POST-CRISIS ECONOMIC ORDER

Despite the devastating economic and financial crisis, the United States is set to remain the largest economy in the world – and the engine of its growth – at least for some years to come. However, the financial straitjacket it must live within and the loss of its ‘moral authority’ – not direct consequences of, but exacerbated by, the crisis – now throw into question the United States’ ‘right to lead’ in international economic affairs. The rise of new powers – especially China – challenges the leading role played so far by the United States and its dominant influence in multilateral economic institutions such as the IMF and World Bank. As a result, the United States has to accept that other players have come to the fore; it must take their preferences into account and put up with the resulting constraints to its own policies – something it has never experienced in the post-Second World War international economic order.

Reflecting this shift, during the G20 summit in Pittsburgh in September 2009 President Obama recognized the G20 as the new permanent forum
for international economic cooperation – and its transformation from crisis committee in the face of the crisis. President Obama also gave his blessing to the reform of the IMF board. These two issues are implicitly related, as they both acknowledge that the balance of power needs to be tilted towards the new rising powers. Streamlining the ‘G’ process – something which President Obama hinted at during the July 2009 G8 summit in Italy – and shifting responsibilities from the G8 to the G20 would imply a dilution of influence for some of the G8 countries, in particular Italy and Canada, and to some extent Japan at the regional level. Shifting – by a five percentage point margin – the ownership of the IMF from industrialized to developing countries and cutting the number of directors from 24 to 20 would hit the main European countries – Germany, France and the United Kingdom, each of which has a director on the IMF board. In both cases, then, these European countries would suffer a diminution in power. In the view of the US administration, adjusting the global balance of power involves a shift – in a zero-sum game – from Europe to the developing world.

As in the post-war and Cold War years, when US leadership was closely linked to the creation and extension of international institutions that at once limited and legitimized American power, the post-crisis economic order will be shaped by international institutions where national interests will be tamed and economic policies will be coordinated. Within this context the United States will have the duty to share power with other countries and to engage developed and developing countries alike in the governance of the world economy. It should be able to accept some redistribution of power in order to achieve this. But how much hegemony is the United States likely to give up as it attempts to re-engage in multilateralism? Assuming that the Obama administration is successful in these attempts at re-engagement, and the current crisis does not halt the process of global economic integration, then the most plausible scenario for the years ahead is a world in which economic power is more diffuse, and in which the governance of the world economy is increasingly a matter of multilateral coordination. In this scenario the United States will cease to be a superpower and become primus inter pares.

As in the post-war period, the United States should recognize its responsibilities in this position of first among equals by, for instance, initiating a debate on the international monetary system. This debate needs to focus on the still unresolved imbalance, in some economies, between the ability to generate surplus and the capacity to absorb it, and on how to use their surpluses to support the global economy rather than destabilize it. Countries with balance-of-payments surpluses – mainly Asian countries and oil exporters – use the dollar as their key intervention currency while keeping their own currencies anchored to the greenback in order to gain stability from the volatility of international capital flows. The over-accumulation of foreign exchange reserves in Asian countries is a prominent aspect of this system. Even if there is a clear asymmetric advantage for the United States, the lack of any viable alternative means that this system is unlikely to change in the foreseeable future. The crisis, however, has shown the
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limitations of the dollar-based system and prompted a lively, but so far fruitless, debate on the reform of the international monetary system. This is exemplified by the concerns expressed by China's central bank governor Zhou Xiaochuan on the eve of the G20 London summit in April 2009, as noted above.

The coordinated response to the crisis through the work of the G20 has highlighted China's willingness to be engaged in a broad discussion of policy lessons to be learnt from it and of the principles upon which a new financial architecture should be based. Rethinking principles and norms is possibly one of the best contributions that these countries can offer while working to develop a new consensus on rules.

There is no doubt that the current arrangements need some rethinking and the United States should be playing an active role in fostering and leading such debate while supporting the principles – multilateralism, democracy and market economy – on which the economic order is based. Otherwise, the discussion about the reform of the global economic governance risks remaining an intellectually stimulating exercise devoid of any ambitions and practical outcomes.

The United States' international standing has taken a tumble during the current financial crisis. If it wants to maintain its position as international leader, it needs to rethink how it approaches that position and accept the emerging reordering in the world economy. This implies accepting fairer arrangements that reflect the changing distribution of economic power and a more balanced governance of the world economy – especially with regard to the international financial institutions. It also means sharing the burden of the adjustment necessary to rebalance and stabilize the international monetary system. In this new context, the challenge for the Obama administration is to reconcile its domestic agenda with its international economic priorities. This means overcoming domestic opposition to the United States playing an increased multilateral role and persuading Americans to continue paying for global ‘public goods’. It is reasonable to expect the United States to remain more effective in implementing international policy than domestic policy. However, the Obama administration should continue in its effort to reconcile domestic interests and international responsibilities. Only if the Obama administration is unable or unwilling to do so will there truly be an American crisis.

NOTES

3 For Peer Steinbrück, a former German finance minister, the end of US hegemony is not even a matter of time: ‘The United States is no longer a financial superpower’, he said in an interview in September 2008. Bertrand Benoit, ‘Germany sees an end to US hegemony’, *Financial Times*, 26 September 2008, http://www.ft.com/cms/s/0/a8ab34ea-8b63-11dd-b634-0000779f8c1c.html. For Fareed Zakaria the rise of new
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4 There is a sense of having been here before. People have been phrasing the question in very much these terms since the 1960s. See Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton, NJ: Princeton University Press, 1989).

5 Alan Greenspan, *The Age of Turbulence: Adventures in a New World* (London: Penguin, 2007). 'The economic growth boosted the national psyche, changing the way we saw ourselves in the world. Throughout the 1980s and well into the early 1990s, Americans had gone through a period of being fearful and depressed. People worried we were losing ground to Germany, the newly unifying Europe, and Japan' (p. 183).

6 In practice, however, the Clinton management of the economy was more centrist and less ambitious than he promised. Taxes did go up for the rich, but large public investment plans were quickly ditched in favour of deficit reduction and the healthcare reform collapsed.

7 In fact it moved into surplus in 1998.

8 Greenspan, *Age of Turbulence*, p. 162.

9 Ibid., p. 171.

10 Ibid., p. 163.

11 Ibid., 'While both Europe and Japan slid into economic doldrums, America was on the rise' (p. 183).

12 'After Alan', *The Economist*, print edition, 13 October 2005. '[His] record helps explain his near god-like status. At the Jackson Hole gathering of central bankers in August, two academics gushed that "he has a legitimate claim to being the greatest central banker who ever lived." Politicians seek his benediction on issues as diverse as pensions reform and China's currency policy. A fawning biography by Bob Woodward is simply called *Maestro* (2000). In the 2000 presidential campaign, Sen. John McCain quipped that were Mr Greenspan to die, he would "prop him up and put a pair of dark glasses on him and keep him as long as we could".'

13 After 1993, when FOMC participants knew that their deliberations would be made public, they were less likely to challenge then Federal Reserve chairman Alan Greenspan. Similarly before 1993 FOMC discussions had frequent ‘off the cuff’ remarks and interruptions; since 1993 there has been an increase in prepared statements. See ‘The dangers of increased transparency in monetary policymaking’, blog entry by Ellen E. Meade and David Stasavage, 26 June 2008, VoxEU, http://www.voxeu.org/index.php?q=node/1271.

14 'After Alan'.


19 But the Chinese overwhelmingly believe their own country is doing the best job of
The role of the United States in the post-crisis economic order

20 Ageing, however, is not yet as critical an issue in the United States as it is in Japan and Europe.

21 Governor Zhou suggested that the status of the dollar as the key reserve currency should be halted, as the costs of the current system may have exceeded its benefits: 'The price is becoming increasingly higher, not only for the users, but also for the issuers of the reserve currencies. Zhou Xiaochuan, 'Reform the International Monetary System', speech on 23 March 2009, http://www.pbc.gov.cn/english.


23 Arguably the share of total GDP is an imperfect indicator of a country's economic influence. The 'new powers' are emerging as the new poles in the global economic order not just because of the size of their economies. They have a wide range of military and political resources; some capacity to shape the international order, regionally or globally; some degree of internal cohesion and capacity for state action; a belief in their entitlement to a more influential role in world affairs; the ability to differentiate themselves from other second-tier states. On this point, see Andrew Hurrell, 'Hegemony, Liberalism and Global Order: What Space for Would-be Great Powers?', *International Affairs* 82 (1) (January 2006): 1–3.

24 One risk to this scenario is the reaction of European authorities that are highly cautious of incurring inflationary growth and might therefore resort to policy tightening if recovery speeds up more than anticipated.

25 The latest available figures (for Q4 2009) show productivity growth up by 6.2% (annualized) on a quarter-on-quarter basis, and up by 5.1% compared to the previous year: see United States Department of Labor, Bureau of Labor Statistics, www.bls.gov.

26 A key theme in recent theoretical and empirical literature is that lower levels of financial market development in other countries will continue to encourage capital flows into the United States. Such flows are likely to decrease as emerging market economies continue to develop and strengthen their own financial markets. For a recent survey of existing literature and empirical analysis, see Kristin J. Forbes, 'Why Do Foreigners Invest in the United States?', National Bureau of Economic Research, Cambridge, MA, Working Paper 13908, April 2008, pp. 1–54.

27 According to data from the World Federation of Exchanges, the US stock market (NYSE and Nasdaq) grew by 49% from March 2009 in terms of market capitalization. This growth, however, was not as strong as that of European markets such as Euronext (58%) and London (67%), or of many Asian markets including Korea (65%), Taiwan (68%) and Hong Kong (76%).


29 Benjamin Cohen and Paola Subacchi, ‘A One-and-a-Half Currency System’, *Journal*
It is worth stressing here that the 2007–09 financial and banking crisis was not a currency crisis.


By order of magnitude the most significant case is China, with more than $2 trillion in FX reserves, an amount that is well beyond the buffer that is deemed necessary for precautionary reasons.


And, by being involved, the United States has the potential to gain from the shift to a multipolar economic order. On this point, see G. John Ikenberry, ‘The Rise of China and the Future of the West: Can the Liberal System Survive?’, *Foreign Affairs* 87(1) (January/February 2008): 23–37.