The end of US economic hegemony?

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(pubblicato in "***www.foresightproject.net***")

What does the current financial crisis mean for the standing of the US in the world? Will it mark the end of US hegemony and superpowerdom? For many commentators the crisis represents "a true global watershed" between a world dominated by the American brand, epitomised, in Francis Fukuyama's words, by capitalism and liberal democracy, and the post-American world in which the US is no longer the world's only superpower and economic hegemon. For Peer Steinbrück, Germany's finance minister, it is not even a matter of time: "The United States is no longer a financial superpower", he said in a recent interview.

Large empires, from ancient Rome to Great Britain, declined at least in part as a result of economic weakness. Financial meltdown and recession in the US may act as a catalyst to the ongoing shift of the world economic order by dramatically rupturing the credibility of and respect for the American model. Such a shift has been prophesised for some time. China's rapid economic growth and the potential for other emerging market economies to expand substantially over the next three to five decades, due to their large population, strong economic expansion and integration in the world economy, seem to indicate the emergence of a new world order. New players could use their recently acquired economic might to gain influence and challenge established powers, notably the US. Can the crisis accelerate this "shift of power"?

Structural weaknesses and reduced scope for policies

The global financial turmoil is huge in scale, worthy of comparison to the Great Depression in the 1930s where stress in financial markets led to prolonged recession. After several weeks of market turmoil there is no doubt that the world economy is taking a "synchronised dive", the recovery from which promises to be slow. In the case of the US economy, the latest IMF outlook predicts the return to potential growth in 2010. But there are many risks that could derail the recovery: the credit crunch could be worse than feared, house prices may not climb until after 2010, a higher unemployment rate and low confidence could constrain domestic demand growth.

The critical point here, and the one which could bear significant consequences, is the existence, within the US economy, of structural weaknesses that enhance the current distress and limit the scope for future policy action. The US has an almost zero national savings rate, increasing indebtedness and bloated budget deficit. In addition to the cost of the $700bn bailout (and an additional $100bn of tax provisions for businesses and the middle class), will be the rising cost of healthcare programmes that are under strain due to an increase in the ageing population. The increase in expenditure means, in the short term, limited scope for loose fiscal policy and continuous reliance on foreign lenders. In the longer term, it implies tighter fiscal policy and constraints on policy in a number of areas, from military intervention to discretionary international aid and projects.

"Primus inter pares" and the emerging economies

The crisis certainly exacerbates the economic weaknesses that could be ignored over the last decade because of foreign investors' willingness to invest in the US. It also constrains policy initiatives in a way that will be felt in years to come. All this will accelerate the relative decline of the US. However, cries for the end of US economic hegemony may be premature, as are predictions of

China's takeover. Despite being badly hit by the credit crisis, the US may still show great resilience. It is the economy best endowed with the flexibility and resources needed to get past present difficulties. Moreover, the US dollar will continue to lead the international monetary system-as the euro is far from having a global role and hence able to seriously challenge the greenback's dominance.

In spite of all the talk about decoupling, the US remains the engine of the world's economic growth, with no economy left immune from the current trouble. 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 sector is still relatively small and disconnected from the real economy. However, their growth depends on demand from developed countries, notably the US, so the effects of the financial crisis in the west are inevitably spilling over into the emerging economies.

The US is due to remain at the helm of the international economic and monetary system - at least for some years to come. However, the financial strait-jacket and the loss of "moral authority"-both not a direct consequence of, but exacerbated by the crisis-will change the role of the US in the world affairs. No longer a super-power, but a primus inter pares the US will have the responsibility to engage developed and developing countries in the governance of the world economy. Assuming that the current crisis does not put a halt to economic integration, then the most plausible scenario for the years ahead is a leaderless world, where economic power is more diffuse, but less effective, and where the governance of the world economy is, hopefully, more and more a matter of multilateral coordination.

One lesson from the crisis is that more players should be involved in any dialogue on the reform of the international financial architecture-in particular China and oil exporting countries because of their large foreign exchange official reserves. This dialogue 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 such surplus to support the global economy rather than destabilise it. The way the emerging countries have responded to the crisis, however, raises questions about their ability to intervene in crisis resolution. As China made it clear at the recent Asia-Europe meeting, domestic economic growth and stability are the priorities for these countries, so their only contribution to resolving the crisis is by keeping their economies stable. And if the Chinese authorities have in principle scope for coordinating policies with developed countries, if they wish so, others are more constrained. India, for example, has high inflation, volatile commodity prices and large current account and fiscal deficits, which leave less room for manouevring. The inability of playing an active role in crisis resolution, however, would not restrain the main emerging economies, especially China, from being engaged in a broad discussion of policy lessons from the crisis and principles on which the new financial architecture should be based. Rethinking principles and norms is possibly the best contribution that these countries can offer while working on a new consensus on rules.

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