AFTER THE CRISIS

BY ROBERT B. ZOELLICK

Excerpted from a speech delivered at the Paul H. Nitze School of Advanced International Studies of the Johns Hopkins University, September 28, 2009.

Great upheavals produce shock waves that widen cracks in political, economic, and security orders. Sometimes the old orders break. Yet it can be in the power of leaders and peoples to shape the directions of change.

Outcomes are not predetermined

In 2009, we are living through an upheaval that is changing our world. What will be its implications for the future?

The last 20 years have witnessed a huge economic shift. The breakdown of the planned economies in the Soviet Union and Central and Eastern Europe, the economic reforms in China and India, and the export-driven growth strategies of East Asia all contributed to a world market economy that vaulted from about 1 billion to 4 or 5 billion people. This shift offers enormous opportunities. But it has also shaken an international economic system forged in the middle of the 20th century with patched-up changes in the decades since. Already, we can see potential shifts in power and institutions and international cooperation. In part, the shifts will depend upon how the parties adapt to new circumstances; in part, upon the rapidity of the recovery; in part, upon changes in who holds the world’s capital, technology, and human resources and what they do with them; in part, upon how countries cooperate—or do not.

What are the perceptions and realities of power after this crisis?

The current assumption is that the post-crisis political economy will reflect the rising influence of China and India, and of other large emerging economies. Supposedly, the United States, the epicenter of the financial crisis, will see its economic power and influence diminish.

Indeed, today, China acts as a stabilizing force in the global economy. Together, China and India account for 8.5 percent of world output. They and other developing countries are growing substantially more rapidly than developed countries.

And yet… China’s future is not yet determined. Its rapid recovery in 2009 was fueled by an expansion of credit of 26 percent of GDP in the first eight months of this year. This flood is now easing, and authorities are likely to limit it further for fear of effects on asset prices, asset quality, and eventually general inflation. China still faces big uncertainties in 2010.

The United States, in turn, has been hit hard by the crisis. But America has a culture of resilience to set-backs, adapting to new circumstances and remaking itself. The future for the United States will depend on whether and how it will address large deficits, recover without inflation that could undermine its credit and currency, and overhaul its financial system to preserve innovation while adding to safety and soundness. Understanding shifting power relations is fundamental for shaping the future—as the Bretton Woods delegates appreciated. The political basis for that system was forged through a shared experience in failed responsibility after World War I and a clear assessment of power after World War II. Change those power relations—and the nature of the markets that connect them—and the system looks out of touch.

Will the U.S. dollar remain the predominant reserve currency?

The Bretton Woods currency system gave way in 1973 to floating rates, with the dollar as the world’s main reserve currency. For all the questions about the dollar’s reliability as a reserve currency, its value strengthened during the crisis as it offered investors a safe haven. But the United States would be mistaken to take for granted the dollar’s place as the world’s predominant reserve currency. Looking forward, there will increasingly be other options to the dollar.
The Bretton Woods system was forged by 44 countries at a time when power was concentrated in a small number of states. The great waves of decolonization were just stirring; the few developing countries were seen as objects, not subjects, of history. That world is long passed. The new realities of political economy demand a different system.

What will be the role of developing countries after the crisis?

The crisis has underscored the growing importance of the large emerging economies, especially China and India, but others as well. In effect, the world economy is being “rebalanced” toward the relative shares of some two hundred years ago, before the industrial revolution, plus a new North America.

The rising developing economies should play a key role in the recovery. Most forecasters expect demand to be tepid, with a pullback by the U.S. consumer. Many developing countries could expand demand if they can get access to financing. They have fiscal space to borrow, but cannot get the volumes they need at reasonable prices without crowding out their private sectors. Moreover, the middle-income countries are home to 70 percent of the world’s extreme poor. The World Bank Group and the regional development banks can assist.

The World Bank Group can offer a counterweight to financial and trade protectionism by supporting this development globally. We have launched a new Asset Management Corporation, through IFC, our private sector arm, to invest in banks, equity, infrastructure, and debt restructuring. We have a parallel effort to support and invest in the development of local currency bond markets. Longer-term investors—such as sovereign and pension funds—now recognize that developed markets pose risks, too, and developing markets can offer good growth prospects.

Coming out of this crisis, we have an opportunity to reshape our policies, architecture, and institutions. We have an opportunity to craft a new global system for a 21st century of “Responsible Globalization”—one that would encourage balanced global growth and financial stability, embrace global efforts to counter climate change, and advance opportunity for the poorest. It means expanding the benefits of open markets and trade, investments, competition, innovation, entrepreneurialism, growth, information—and debates on ideas. It must be a globalization that is both inclusive and sustainable—expanding opportunity with care for the environment.

Yet it won’t happen by itself

At the G-20 Summit in London in April, leaders stared into an economic abyss. The danger today is not freefall, but complacency. As the crisis wanes, it will be harder to press countries to cooperate in “building back better.” Peer review of a new Framework for Strong, Sustainable and Balanced Growth agreed at the April G-20 Summit is a good start, but it will require a new level of international cooperation and coordination, including a new willingness to take the findings of global monitoring seriously. Peer review will need to be peer pressure.

Global finance and currencies. The trading system. Inclusive and sustainable development. Climate change. States struggling with fragility and conflicts. And a host of other security issues. Each topic is important on its own. But each interconnects with the others.

The countries of the world will never deal effectively with this agenda unless they cooperate. The economic multilateralism of another age does not reflect today’s realities. We need to modernize multilateralism and markets.

As agreed at the Pittsburgh Summit, the G-20 should become the premier forum for international economic cooperation among the advanced industrialized countries and rising powers. But it cannot be a stand-alone committee. Nor can it ignore the voices of the over 160 countries left outside.

The G-20 should operate as a “Steering Group” across a network of countries and international institutions. It could recognize the interconnections among issues and foster points of mutual interest.

The question is whether leaders can cooperate in steering the changes. They will be drawn to the interests of the national publics they represent, as they should. Yet they also will be challenged to recognize and build common interests, not only case-by-case, but through institutions reflecting a “Responsible Globalization.”

Bretton Woods is being overhauled before our eyes. This time, it will take longer than three weeks in New Hampshire. It will have more participants. But it is just as necessary. The next upheaval, whatever it may be, is taking form now. Shape it or be shaped by it.

Robert B. Zoellick is President of The World Bank Group.