

GEOPOLITICAL CONSEQUENCES OF AN ECONOMIC CRISIS

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Can economics interact with geopolitics? Does the recent economic downturn have a lasting effect on the distribution of power or is it merely a consequence of the same changes in demography, climate and the distribution of natural resources? Geopolitical changes manifest themselves in various ways. The paper asks the question whether the crisis affected any of the following aspects of geopolitics: Demographic trends, geographic location, topography, natural resources and climate. Does it have an impact on the relative size and strength of domestic economies and through them, on the foreign and defence policies, capabilities, cultural determinants and domestic politics of individual countries?

The paper sets the task to take account of the geopolitical aspects of the recent economic downturn.

Keywords— Geopolitics; Political Economy; Economic Crisis

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Introduction

“The primary near-term security concern of the United States is the global economic crisis and its geopolitical implications”, said Dennis Blair, the director of National Intelligence in February 2009 in his annual threat assessment for the Senate Select Committee on Intelligence. (Blair 2009)

The approach of geopolitics is rather static compared to that of either international relations or economics. Events with serious short-term consequences rarely nudge scholars of geopolitics. The question arises whether an event like an economic crisis can cause major, permanent shift in the underlying structure of geopolitics.

To establish whether the current economic crisis can have any geopolitical consequences one must first establish whether and how the crisis affects the areas geopolitics are normally concerned with, namely geographic location, topography, climate, demography, foreign and defence policies of countries, or major change in their domestic politics, the overall size and strength of economies, the control over natural resources, etc. We have to take account of direct and indirect, medium and long-term impacts as well.

In short, geopolitical elements have not altered in substantial ways since the economic crisis began. Changes have indeed occurred but they were attributable to the underlying fundamentals of demographics, and the changing landscape of natural resources – the financial crisis has merely brought some of these to light. The most direct impact of geopolitical significance is the relative changes in defence budgets and resources spent on diplomatic efforts.

Economic downturn can cause shifts in the international balance of power in the long run. It can alter the capability and willingness of the players to leave the era of relatively peaceful geoeconomics and enter the age of more assertive influence.

The Priorities of Geopolitics

Economic developments and other “soft” issues are traditionally ignored by geopolitics. Even though they are part of a greater change of scenery, anyone looking at them as seismic events on a geopolitical scale would be a mistaken. (Blackwill 2009)

The Great Depression of the 1930 and the following World War makes one cautious. No American recession since the 1930 has been capable of triggering such a seismic event, but the financial catastrophe of 2008 reminds one to those faithful events in October 1929 both in its magnitude and in its general nature. Both instances have seen a primarily financial crisis quickly spreading from the United States to the rest of the world (with the exception of the countries not on the gold standard in 1929). The other significant impact was the extension of the crisis from the realm of finance to the real economy. In the 1930s, the crisis was transmitted by the gold standard; in 2008 it travelled on the wings of global financial interdependence.

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The difference lies in the case of countries not integrated in the Western financial system back in the 1930s, such as Russia (too underdeveloped) and China that was still on the silver standard at the time and was thus largely spared from the direct impact of the 1930s Depression. In the 1930s the recovery of individual nations from the impact of the financial downturn largely depended on how quickly they came off from the gold standard and took the management of the money supply in their own hands. (Galbraith 1954) This, however, has quickly led to a race to the bottom in devaluation, economic protectionism and inflationary spirals.

In summary, major shift in geopolitics would imply the United States losing its role as the world's first power, but that is not the case in the short and medium terms. (Friedman 2009) In the long term, however, there are a number of points of concern.

The first such point is the way international organisations, most prominently the IMF and the G-20, have gathered significance in the first phase of the 2008 crisis. Allowing newcomers to enter these institutions as large stakeholders with the corresponding, proportional voting rights can rewrite the landscape of the international financial system, regulations and development.

The second concern may be described as more general, political disillusionment with the Western economic system – to the point of actually replacing it with a viable alternative. This, however, is not immediately forthcoming, as both China and India have adopted various forms of the same market capitalism – regardless of the name.

Whether market players and investors get disillusioned with and flee from the Western economic system is still an open question. It may be that investors will indeed flee the former safe havens, especially the United States, but at the moment there is no credible replacement and no widely accepted candidate for the role. When looking into the dollar's role as the world primary reserve currency one can see that its role is still overwhelming, despite repeated calls for diversification from every corner of business: Arab oil exporting countries diversifying into the euro in order to decrease their exposure to the fluctuations of the dollar, the French President Sarkozy calling for the detachment of the global food markets from the fate of the dollar as well as calls for the IMF-issued Special Drawing Rights to take the dollar's place. None have, however, yielded much result. Only the FED can fundamentally damage the dollar to the point that it endangers its role as the world's reserve currency. (See Figure 24. on the reserve currencies)

Table 4 Official foreign exchange reserves: currency shares

(as a percentage of total identified holdings; end-of-year values expressed in US dollars)

	1999	2000	2001	2002	2003	2004	2005 ¹⁾
All countries²⁾							
US dollar	71.0	70.5	70.7	66.5	65.8	66.0	66.4
Euro	17.9	18.8	19.8	24.2	25.3	24.9	24.3
Japanese yen	6.4	6.3	5.2	4.5	4.1	3.8	3.7
Pound sterling	2.9	2.8	2.7	2.9	2.6	3.2	3.6
Swiss franc	0.2	0.3	0.3	0.4	0.2	0.2	0.1
Other currencies	1.6	1.4	1.2	1.4	1.9	1.9	1.9

Source: IMF.

1) End-of-September data.

2) Shares are calculated only for the group of countries reporting reserve currency composition to the IMF, which account for around 70% of world reserve holdings.

Currency Composition of Official Foreign Exchange Reserves (1999-2005) – Source: IMF 1999 és 2005 között <http://www.imf.org/external/np/sta/cofer/eng/cofer.pdf> (Download: December 2010)

Historians are quick to point out that the same has happened to the Sterling during the waning of the British imperial role – and it was a slow process. (Galbraith 1954) It is also worth remembering, that it was indeed the United States that blocked the attempts to create an alternative world currency both in Bretton Woods and in the case of the SDR issued by the IMF.

A more general leadership position of the United appears safe until we see the first global power or indeed a group of countries capable of solving an international dispute without the involvement of the United States. (Friedman 2009; Blackwill 2009; Ferguson 2008b)

A. Demographic trends

What belongs here is the actual size of the population along with aspects like the birth rate, growth, density and ethnicity of the population, as well as literacy, religions, migration, assimilation, absorption, and general industriousness. Further concerns arising from the above are the issues regarding the aging West and the “youth bulge” in the Middle East and the emerging consequences of the one-child policy in China and the steady deterioration of demographics in Russia. On top of it come issues regarding unemployment in general, and among youth in particular. These trends are by no means a result of the crisis, although it may be worthwhile to research whether the trend itself was a result of the changing economic landscape in advanced economies after World War II.

Demographic developments have merely seen the economic downturn escalating their impact through the oversized welfare systems and unsustainable sovereign spending patterns. Ageing societies have long been aware of the coming trouble (demographers have been warning decision-makers since the 1990s of the coming impact) but failed to respond sufficiently due to the nature of democratic politics, where political short-termism is rewarded, risk can be socialized while inconvenient decisions can be postponed indefinitely. The majority principle invites campaigns focusing on the number of votes as opposed to better policies.

The societies suffering most under the strain of retiring baby-boomers (the generation born after the second World War) are Japan, Europe (with the most serious case of Italy) and Russia, while the United States can still draw demographic resources mainly enjoying mass immigration. (Blackwill 2009) Europe, on the other hand, has to deal with economic migration on a massive scale, with all its political consequences for countries both exporting and importing labour. (Libicki - Shatz – Taylor 2011)

B. The size and strength of the domestic economy

Unemployment will be a lasting feature of this recession, even when countries will technically return to growth. A jobless recovery is arguably the most severe impact of the recession. It can lead to (occasionally violent) protests of trade unions and public servants against spending cuts (for example in Latvia, Ireland, the United Kingdom and most prominently, Greece) and pension reform (France and the United Kingdom). The International Labour Organisation (ILO) has warned of a jobless recovery in a 2010 report and so did prominent economists, politicians the ECB and the FED. Fiscal austerity is thus a risky tool to deal with the crisis at this stage.

Youth unemployment is an even more worrisome feature of this crisis. Paired with the ‘youth bulge’ present both in Arab countries and immigrant groups this can lead to even more serious and lasting civil unrest. It is tempting to solve this issue through public work schemes among which military conscription scores high in authoritarian systems. Demographics can, in short, shape the world in the 21st century, but they are hardly the result of the crisis.

Further aspects of the change of the global economic landscape are: What are the global political consequences of the economic imbalances and the ‘Asian savings glut’? Can developing economies (BRICS) peacefully fall into line with the current financial and economic landscape? How durable is the resulting new balance? What are the benefits and the disadvantages (and for whom) of a change in voting rights in existing institutions of economic cooperation? Do the BRICS aspire to and can they possibly form the unity necessary to establish an alternative international economic system?

C. Geographic location, topography, and climate

Climate change may reshape the present coastal map and habitable landscape. This is of serious concern for geopolitics, but not related to the economic crisis unless the technology required for coastal developments can significantly affect GDP of individual countries.

Similarly, and on the same note, the renewable energy industries, if embraced by governments have the potential to alter the economic landscape.

The growing international assertiveness of countries may also incense the debate over the Arctic natural resources, also getting within reach due to the effects of recent change of the climate.

D. The presence of natural resources

Control over natural resources is a cornerstone of geopolitics.

Due to recent events and an unprecedented population boom in the 20th century food has emerged as the next big thing on the geopolitical agenda –and so did the control over arable land. The wake of the crisis saw

a hike in commodity prices widely attributed to flight of capital and speculation but also fuelled by drought in China.

On the energy front, dwindling oil and gas reservoirs have already sent a wave through economies and worries over uncertainties continue. (Observe how the United Kingdom has largely exhausted its North Sea reserves and is facing up with its effect on government income.) Estimates about the extractable amount of crude oil and natural gas vary widely – due to technical uncertainties, but also because the increase in energy prices keeps raising the amount of money spent on further exploration and on the extraction of reserves formerly to expensive to contemplate. Shale gas extraction may be the next big thing benefiting a new range of countries, this time with advanced economies. Shale gas extraction has, however, already raised its own economic and environmental issues. The other field of expansion in energy extraction is the Arctic reservoir. In this case, however, there are not only environmental, but international political and diplomatic concerns.

Two more areas of concern are pollution and especially that of drinking water. Can pollution in the wake of the industrial change of landscape result in dire political consequences? Can food and drinking water issues paired up with mass repatriation and migration into cities cause local depletion of resources?

E. Foreign and defence policies, capabilities, cultural determinants and domestic politics of individual countries

The most important change from a geopolitical perspective is definitely that of the *military and defence budgets* worldwide. Public opinion rarely tolerates lavish spending on the military and international deployment during domestic fiscal austerity. Tightening of public spending can result in downsizing of military capacities – as seen in the cases of the deficit countries of the global imbalance: the United States have immediately announced cutbacks in the diplomatic and defence budget, while France and the United Kingdom entered into a long-term strategic partnership in 2010. An otherwise significant and historic move was motivated by the intention to cut back on individual defence spending. Surplus countries, Germany and China have, on the other hand, invested heavily in the defence industry to generate more domestic growth. This alone can cause great shifts not only in the global distribution of military hardware but also the general assertiveness of great powers. (China's recent assertiveness in the South China Sea is one example.) China has increased its military spending by an annual rate of 12.9% since 1989, which is an ambitious program – even though it is still aeons behind the American military capacity and doesn't pose any immediate threat outside the region (even though the Chinese aircraft carrier scheme has been much in the limelight recently).¹ And finally, are we witnessing a prelude to a chain of events when economic and commercial might turns into military hard power? Historic examples for it are abundant – and so is the opposite.

Civil unrest and political radicalisation predictably follow economic slumps. It is not relative poverty but slowing growth that triggers civil unrest. The issue of youth unemployment turns public sentiment even more desperate (and protests more violent) throughout Europe. Can the prolonged recession endanger the consolidation of liberal democracies in Eastern Europe? Can an economic slump cause civil unrest in China fatal to the current one party system?

A global economic crisis has a very predictable political outcome: democratically elected governments tend to lose the upcoming elections, often by landslides. Tectonic shifts of party preference have occurred shortly after the 2008 financial crash in the United States, the United Kingdom, Iceland and the Baltic states, among others, and more is expected. The question arises whether there was anything common in these results or whether it was just a wave of protest votes sweeping through a range of countries.

Do more nationalistic (or "right wing") governments necessary bring a protectionist revival? As we have seen in the case of the United States, economic hardship may indeed generate greater appetite for isolationism.

On the domestic level, moreover, recessions can affect public safety by deteriorating criminal rates, often blamed on minority groups. This, in turn, can give rise to political powers and rightwing parties capitalising on the insecurity of the population. These political powers can grab the opportunity to generate public support by turning them against minority groups with less capacity of articulate their interest and self-protection, such as ethnic and religious minorities, immigrants and other easily identifiable minority groups (by class, occupation, status or wealth). Both the 1930s and the 2010s have seen a rise in xenophobia and 'scapegoating', effectively turning the public attention from economic grievances to the 'enemy within' and replacing the demand for economic goods with the demand for security.

¹ Source: Global Security, January 2010: China's Defense Budget
<http://www.globalsecurity.org/military/world/china/budget.htm> (Downloaded: December 2010) Data:
<http://www.globalsecurity.org/military/world/china/budget-table.htm>

Recessions therefore often give a boost to nationalist sentiments – national leaders may reawaken historic grievances in order to veil over the difficulties of their countries' financial plight. National narratives of victimhood are designed to invoke an image of 'them' and 'us', quickly undoing the result of decades of global integration and peace effort. Looking at history, this may be the most significant (although hardly quantifiable) geopolitical consequence of an economic crisis.

Protectionism may thus lead to dire economic and political consequences. The most severe effect of the Great Depression of the 1930s was the second reverse wave of democratisation in Europe, most notably the failure of the Weimar Republic. Widespread disillusionment in democracy and yearning for a strong leader can undermine even the most carefully crafted constitution of checks and balances.

Events on a similar scale in the 2010s would be for example the economic and political implosion of China, the revival of American isolationism or the deterioration in the relationship between the two powers. According to Ferguson the Chinese-American cohabitation (that has largely been created since 2000) may easily come to an abrupt end with the crisis. (Ferguson 2008b) That would indeed mean a structural change in the international system. If the Chinese-American relations (established in 1972) deteriorate, China may take a different approach to achieve global dominance, provided it can detach its economy from the American – and the fate of the yuan from that of the dollar – focusing on its domestic market, for instance.

These conditions of Chinese economic independence are, however, unlikely to occur any time soon and the end of the American century seems safely out of sight. As Ferguson remarked, previous recessions have seen the United States repeatedly landing on the top of the international system. And although the challenges seem insurmountable, so do the necessary prerequisites to topple its hegemony. Analysts' estimates about the year when Chinese GDP overtakes the American may have come closer to the present but China's economic problems seem to be just as severe as those of the developed world.

China has indeed become a global power in the 2000s while the European Union has failed to live up to the expectations attached to it around the beginning of the new millennium. China has become the primary importer of raw materials and used its economic leverage to serve the security of the supplies. If China managed to maintain domestic stability it has the potential of becoming the new global superpower. Its industrialisation has been a seismic event in both economic and geopolitical terms. It has lifted millions out of poverty, but it had also seen growing inequality of income distribution, a potential source of civil discontent. China has, in short, already shown signs of weakness. Despite its almost endless supply of human capital, the one-child policy has left China in a concerning demographic situation. Its economy is overheating without a doubt; overproduction can hardly keep up with the requirements of the command economy. There is growing tension between rural and urban populations, while mega-projects like the Three Gorges Dam carry the potential of major ecological and economic disasters.

A new Russian foreign policy may also be the result of the crisis. That would indeed be a change of geopolitical magnitude given the role Russia plays in the North Korean and Iranian nuclear talks. A new Russian approach to NATO or Iran is not likely to happen because of the crisis. The continuity and predictability of leadership also serve as stabilisers in the case of Russia. None of the geopolitical problems facing Russia have been affected by the crisis. Although it is facing a heavily aging population, serious health issues and problems in its military, none of these have been altered by the crisis.

Conclusion

When looking at the geopolitical determinants an economic crisis affects some directly, while others only indirectly. It is also remarkable that most of the shifts observed by scholars of geopolitics have been taking place for a longer period and started well before the economic crisis. While observing the five major aspects through which a geopolitical change can happen we have thus come to the conclusion that although we are witnessing some permanent shifts in geopolitical power, its reasons lie beyond the scope of the present economic downturn – with the possible exception of military spending which is heavily affected by the economic capacity of great powers. The most important short term change from a geopolitical perspective is thus that of the military and defence budgets worldwide.

The second aspect, which is cause for concern, is the political radicalisation that predictably follows economic slumps. A global economic crisis has a very predictable political outcome: democratically elected governments losing power. The most severe effect of the Great Depression of the 1930s was the second reverse wave of democratisation in Europe. Both the 1930s and the 2010s have seen a rise in xenophobia and 'scapegoating', recessions therefore often give a boost to nationalist sentiments. More nationalistic (or "right wing") governments often bring a protectionist streak into economies, that, in turn, may lead to dire economic and political consequences.

When discussing the world leadership role of the United States, however, indicators point into various directions. Economic hardship tends to generate greater appetite for isolationism in the United States, but that does not make it any easier for global challengers. China is facing its own problems and dilemmas and cannot extricate herself from the global economic system.

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