

GEOPOLITICAL IMPACTS OF THE GLOBAL FINANCIAL CRISIS WITHIN CONTEXT OF THE POWER TRANSITION THEORY

GÜÇ GEÇİŞİ TEORİSİ BAĞLAMINDA KÜRESEL FİNANSAL KRİZİN JEOPOLİTİK ETKİLERİ

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ABSTRACT

The global financial crisis dragged many countries and the global economy into recession. Since this recession is globally synchronized and came after a financial crisis, it is forecasted that it will last longer to return to pre-crisis output levels.

This is a very significant development for international politics particularly from the Power Transition Theory perspective since Gross Domestic Product is the most important indicator of national power for the Power Transition Theory. More significant than this is the asymmetric impact of the global crisis on the dominant nation, the U.S. and the challenger, China. The U.S. economy contracted 2,4 percent in 2009 while the Chinese economy grew 8,7 percent. In this paper, it is argued that the international system may enter the parity phase earlier than forecasted before the crisis because of the crisis's asymmetric impact on the economies of the dominant nation and the challenger.

ÖZET

Küresel finansal kriz, birçok ülkeyi ve küresel ekonomiyi resesyona sürükledi. Bu resesyon, küresel olarak senkronize olduğu ve bir finansal krizin ardından geldiği için, kriz öncesi üretim seviyelerine tekrar ulaşmanın daha uzun süreceği tahmin edilmektedir.

Bu, Gayri-Safî Milli Hasıla, Güç Geçişi Teorisi için ulusal gücün en önemli göstergesi olduğu için, Güç Geçişi Teorisi perspektifinden uluslararası politika için çok önemli bir gelişmedir. Bundan daha da önemlisi, küresel krizin baskın ülke, ABD ve meydan okuyan ülke, Çin üzerindeki asimetrik etkisidir. A.B.D. ekonomisi 2009 yılında yüzde 2,4 küçülmüş, Çin ekonomisi ise yüzde 8,7 büyümüştür. Bu makalede, krizin baskın ve meydan okuyan ülke ekonomileri üzerindeki asimetrik etkisinden dolayı, uluslararası sistemin başa baş olma evresine, krizden önce tahmin edilenden daha erken girebileceği savunulmaktadır.

International relations, Power Transition Theory, international economy, global financial crisis.

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Uluslararası ilişkiler, Güç Geçişi Teorisi, uluslararası ekonomi, küresel finansal kriz

INTRODUCTION

From Power Transition Theory (PTT) perspective, the end of the Cold War was a turning point for the international system after which the United States became the dominant power and the international system transformed from an unordered hierarchy with two potential dominant powers into an ordered hierarchy with one dominant power. Whether the international system will transform again into an unordered hierarchy with two or more potential dominant powers depends on economic, technological, political and military developments in various countries and regions. Global financial crisis seems to have the most potential to transform the international system.

The global crisis started in the U.S., quickly spread to the developed and emerging countries and dragged many of them into recession. Output, trade, consumption, investments and stock markets declined sharply at rates comparable to the Great Depression. According to the IMF figures, the world economy contracted 0,6 percent in 2009. Developed countries contracted 3,2 percent while emerging countries grew 2,4 percent on average.¹

The progress of the global financial crisis will profoundly affect the international system since it has potential to change relative economic strengths of the dominant power and great powers. Actually, it has already affected. The U.S., the dominant power and European great powers such as Germany, France and the U.K. entered into recession. Meanwhile, the challenger, China seems to be affected less severely from the global financial crisis as the Chinese economy grew 8,7 percent in 2009.

In this study, how the global financial crisis will affect the international system will be investigated from PTT perspective. In the first section, theoretical framework of PTT will be explained briefly. In the second section, progress of the global financial crisis and its effect on the relative economic strengths of the dominant nation and great powers will be scrutinized. Impact of the global crisis on the international system will be analyzed from PTT perspective. In the third section, analyses made by using the PTT theoretical framework will be compared with analyses of various scholars about the geopolitical impacts of the global crisis.

¹ INTERNATIONAL MONETARY FUND (IMF), *World Economic Outlook April 2010: Rebalancing Growth*, IMF, Washington, 2010, p.2.

1. THE POWER TRANSITION THEORY AND THE INTERNATIONAL SYSTEM

1.1. Theoretical Framework

According to PTT, there is a hierarchy in the international system.² This hierarchy can be ordered or unordered. If the hierarchy is unordered, more than one nation has potential to be a dominant nation and there may be competition among the potential dominant powers.

If the hierarchy is ordered, one of the nations is dominant and at the top of the global hierarchy. The hierarchy is deemed ordered when the dominant nation have at least 20 percent more power than the challenger. Being dominant doesn't mean that this nation is essentially a hegemon; it is only the most powerful nation in the international system. The dominant nation is not only superior to other nations economically, militarily, scientifically and technologically; it is also the head of a coalition that consists of nations that have similar preferences for the rules and the structure of the international system and that try to protect the status quo.

Great powers constitute the second layer of the international hierarchy. These nations have also significant economic, political, military, scientific, technological power but their power is less than the dominant nation. Their power is not sufficient to be a dominant nation or to be the head of the coalition, but sufficient to be a part of the coalition.³

Middle powers constitute the third layer of the international system. These nations have substantial national power, but magnitude of their power is smaller than the great powers and the dominant nation. These nations participate in the determination process of rules of the game only at a limited extent. Small powers constitute the fourth layer of the global hierarchy. These nations have limited influence on the international system dynamics.

There are also regional hierarchies and regional dominant, great, middle and small powers. These nations can affect the regional dynamics proportional to their power, but their impact on the global dynamics is limited.

According to PTT, conflicts will diffuse from the global hierarchy level to the regional hierarchy level. If there is controversy over the rules of the game and the structure of the international system at the global level, and if this leads to a conflict among the dominant nation and great powers, this conflict can easily diffuse to different regions. But it is much harder for a regional conflict to diffuse to the global level out of the control of the great powers and the dominant nation.

² A.F.K. ORGANSKI, *World Politics*, Alfred A. Knopf, New York, 1958, p.326.

³ A.F.K. ORGANSKI. and Jacek KUGLER, *The War Ledger*, University of Chicago Press, Chicago, 1981, p.19.

According to PTT, the components of national power are population, productivity, and political capacity. Power is formulated as:⁴

$$\text{Power} = (\text{Economic Production per Capita} * \text{Population}) * \text{Relative Political Capacity}$$

$$\text{Power} = (\text{Gross Domestic Product}) * \text{Relative Political Capacity}$$

Relative political capacity is defined as the capacity of the political system to mobilize the human and material resources at its disposal and devote them to national goals. Nations with high potential capacity grow fast and achieve sustained growth earlier while nations with low political capacity grow with low rates and may fall into the poverty trap. “Internal political factors prompt changes in population, which then alter the physical and human capital resources that drive technology and lead to sustained growth.”⁵

Nonetheless, it is argued that since political capacity is volatile and changes cannot be predicted accurately and since variations in political capacity can disturb the estimates of population and economic productivity within a range but will not determine them, population and economic productivity components of national power are concentrated on.⁶

1.2. Basic Concepts

When the dominant nation (the defender) and other nations in the hierarchy (potential challengers) at the global or regional level are satisfied with the dyadic relationship among the nations, this is called status quo.⁷ The global hierarchy depends on the dynamic nature of power and is not constant.

One of the most important concepts in the PTT is “parity”. According to PTT, international system enters the parity phase when challenger’s power becomes more than %80 of dominant nation’s power. Parity phase ends when challenger’s power exceeds dominant nation’s power by 20%.

According to PTT, probability of war increases as conflictual relations increase. Probability of integration increases as cooperative relations increase. Probability of war or integration is related also with relative power of the challenger and defender.⁸

According to PTT, probability of war or integration depends on the relative powers of the defender and the challenger, and on their satisfaction

⁴ Jacek KUGLER and A.F.K. ORGANSKI, “The Power Transition: A Retrospective and Prospective Evaluation”, Manus I. MIDLARSKY (editor), *Handbook of War Studies*, Unwin Hyman, Boston, 1989, p.191.

⁵ Jacek KUGLER and Ronald TAMEN, “Regional Challenge: China’s Rise to Power”, Jim ROLFE (editor), *The Asia-Pacific: A Region in Transition*, Asia- Pacific Center for Security Studies, Honolulu, 2004, p. 41.

⁶ KUGLER and TAMEN, p. 39.

⁷ ORGANSKI, p. 325.

⁸ Jacek KUGLER and Douglas LEMKE, “The Power Transition Research Program: Assessing Theoretical and Empirical Advances”, Manus I. MIDLARSKY (editor), *Handbook of War Studies II*, University of Michigan Press, Ann Arbor, 2000, p. 132

or dissatisfaction with regards to the status quo. If challenger is preponderant and dissatisfied with the status quo, probability of war increases. If challenger is preponderant but satisfied with the status quo, probability of integration increases. If defender is preponderant, and challenger is dissatisfied with the status quo, probability of unstable alliances and confrontation increases. If defender is preponderant and challenger is satisfied, probability of peace and stable alliances increases.

Dominant power tries to increase the stability of the system and maintain its dominant nation status by sustaining the superiority of the coalition of nations that are satisfied with the status quo.

Stable alliances depend on the common interests among states that form a coalition. They are not agreements of convenience that can be easily altered. There's a long-term relationship among these nations. Members of the coalition agree about the rules of the game.

1.3. Early 21st Century International System and the Power Transition Theory

After the end of the Cold War, the international system transformed into an ordered hierarchy. The United States became the dominant nation and built a coalition to determine the rules of the game and to defend the status quo. Great powers in the international systems are China, Japan, Germany, France, the U.K. and Russia. The most important characteristic of current international system is that the dominant nation and great powers, which constitute the coalition, don't have a consensus in all aspects of the international system. They disagree over some rules and the structure of the system, which may lead to confrontation at some point. China, India and Russia are not fully integrated into the dominant power's regime.⁹

If the relationship between the United States and China is evaluated from the PTT perspective, it can be argued that it is in dominant nation's interest to increase the satisfaction level of China to increase integration since structural, persistent challenges facing the U.S. come from Asia.

The Figure 1 below shows the forecast of relations between the U.S. and China from the PTT perspective based on the assumption that China's Gross Domestic Product (GDP) in terms of Purchasing Power Parity (PPP) will overtake U.S.'s GDP (PPP) around 2025.¹⁰ Since political capacity is volatile and changes cannot be predicted accurately and since its variations can change the estimates of GDP (PPP) within a range but will not determine it, only population and economic productivity components of national power are taken into account at this forecast.

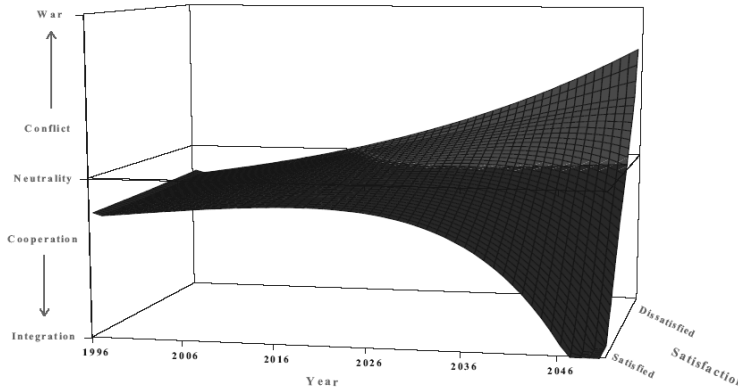
Financial capacity is an important component of economic power. China, with its reserves over two trillion dollars, gained immense financial leverage especially in recent years. The U.S., with the dollar as the international reserve currency, with its seigniorage advantage and with its

⁹ KUGLER and TAMEN, p.36.

¹⁰ KUGLER and TAMEN, p.43.

largest economy and financial market, is still very powerful financially even if the global financial crisis eroded U.S.'s financial power at some extent. The Figure 1 below does not take into account the financial capacity as a separate component; rather uses GDP (PPP) as an indicator of national power.

Figure 1: Forecast: U.S.-China, 1996-2050



Source: Jacek KUGLER and Ronald TAMEN, "Regional Challenge: China's Rise to Power", Jim ROLFE (editor), *The Asia-Pacific: A Region in Transition*, Asia-Pacific Center for Security Studies, Honolulu, 2004, p. 50.

According to the figure above, relations between the two countries will move towards either cooperation-integration or conflict-war alternative depending on the satisfaction level of the challenger after around the year 2025. Probability of war will depend on the satisfaction level of China with regards to the international system. If China is satisfied with the international system, probability of integration will increase. If China is not satisfied with the international system, probability of war will increase as years pass and as China gets more and more powerful relative to the dominant nation, the U.S.

If the international system is analyzed within context of the forecast above, it can be argued that China is integrated to the international trading, financial and political system to such an extent that even if its GDP (PPP) overtakes the U.S.'s GDP (PPP), the probability of war will be low since the level of integration is very high. China was the largest exporter and second largest importer in the world in 2009 and became a member of the WTO, which increased its integration by familiarizing it with the prevailing rules and norms of commerce. China is taking steps towards regionalization and internationalization of yuan and its integration to the international financial system is also deepening each and every year. All these dynamics support the view that China's integration to the international system is going forward and decreases the probability of war from the PTT perspective.

As mentioned before, the forecast above is based upon the assumption that China's GDP (PPP) will be able to overtake the U.S.'s GDP (PPP) around 2025. Nonetheless, the global crisis may alter economic growth

rates of the U.S. and China and the international system may enter the parity phase earlier than forecasted. When the international system will enter the parity phase depends at a great extent on the progress of the global crisis. If the crisis deepens, since relative economic strengths of the U.S. and the great powers including China, Japan, the E.U. and Russia may change substantially in a way that diminishes the preponderance of the dominant nation, the international system may enter the parity phase earlier.

In the next section, impact of the global crisis on the economies of the dominant nation and the great powers will be investigated since GDP is the most important indicator of national power, which determines the hierarchy in the international system according to PTT.

2. GLOBAL FINANCIAL CRISIS, ITS ECONOMIC IMPACTS AND THE POWER TRANSITION THEORY

In March 2008, the Federal Reserve Bank of the U.S. extended a \$55 billion loan to JPMorgan to save the investment bank Bear Stearns from bankruptcy. Then, the U.S. government imposed a conservatorship on the private mortgage giants Fannie Mae and Freddie Mac by extending an unlimited credit line. Lehman Brothers, with assets around \$600 billion, declared bankruptcy in September. Merrill Lynch was taken over by Bank of America. Washington Mutual, country's largest savings bank, was put into receivership. The Federal Reserve took 80 per cent stake in the world's largest insurance company, AIG by giving it an \$80 billion loan to prevent a series of defaults in the financial derivatives, which are described as "financial weapons of mass destruction".

Confidence to the financial sector and real economy fell sharply in the U.S. The possibility of a total financial collapse was higher than any time.¹¹ Interbank loan market froze. The depression possibility increased.¹²

The crisis spread to Europe as many European banks, which had bought staggering amounts of high-yielding structured securities including U.S. subprime mortgage papers, started to collapse.¹³ All these unprecedented events diminished confidence to the banking and financial system. Opacity and complexity of the exotic securities on financial balance sheets that amount to \$50 trillion further increased the systemic crisis risk.¹⁴ Consumer confidence also sank. Investors rushed to liquidity because of the uncertainty with regards to the amount and location of toxic assets. Interbank loan market was frozen. Corporate borrowing costs have gone up substantially as rates increased. Unemployment increased.

¹¹ William GREEN, "Into the Dark", *Time*, Vol. 172, No. 16, October 2008, p.46.

¹² Peter COY, Stanley REED and Jack EWING, "How to Stop the Panic", *Business Week*, Vol. 4104, October 2008, p. 28.

¹³ Klaus C. ENGELN, "The Post-Subprime Regulation Scramble", *The International Economy*, Vol. 22, No. 1, 2008, p. 69.

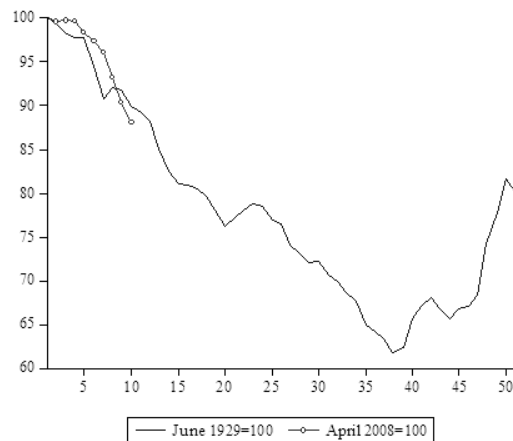
¹⁴ Mortimer B. ZUCKERMAN, "Avoiding a Deep Recession", *U.S. News&World Report*, Vol.145,October 2008, p. 92.

Stock exchanges all around the world collapsed. Investors started to pull money out of hedge funds, which started another wave of sell-offs in stock exchanges all around the world. Consumer confidence level dropped to historically low levels. Consumer expenditure declined. Defaults on other forms of consumer debt such as credit cards, auto loans, and consumer loans increased. Many banks were closed. Interaction of financial system and the real economy started a vicious cycle. Financial system slowed down the real economy and slowing economy created further complications for the financial system.

The crisis spread to emerging markets. Local currencies depreciated against dollar because of dollar demand, which had many negative spillover effects. Many emerging countries came to the brink of financial collapse.

As of January 2009, global crisis resembled the Great Depression in the 1930s. Eichengreen and O'Rourke¹⁵ show that the world economy contracted even faster than the Great Depression and conclude that this is a depression-sized event. The Figure 2 indicates that the decline in the industrial production after the peak in April 2008 has been more severe than the decline after the June 1929 peak in the Great Depression case. As can be seen in the Figure 3 and 4, global stock markets and world trade fell even faster than the Great Depression.

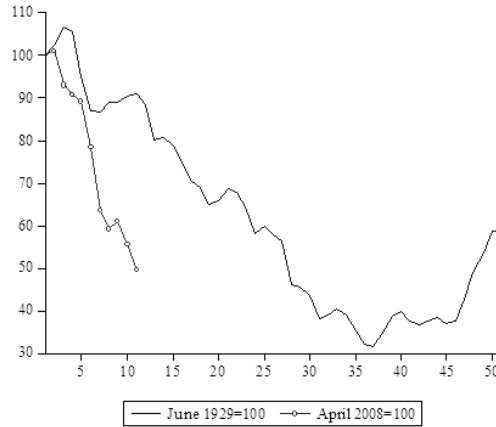
Figure 2: World Industrial Output



Source: Barry EICHENGREEN and Kevin H. O'ROURKE, "A Tale of Two Depressions", <http://voxeu.org/index.php?q=node/3421>, 25.05.2009.

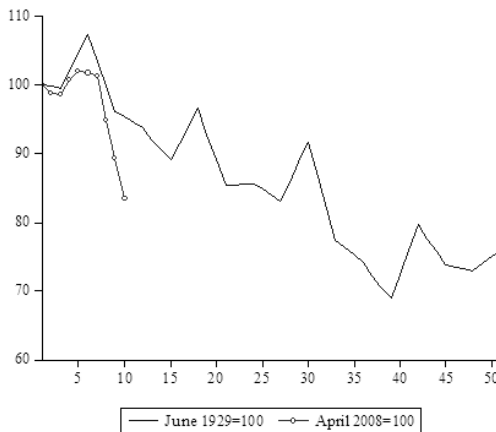
Figure 3: World Stock Markets

¹⁵ Barry EICHENGREEN and Kevin H. O'ROURKE, "A Tale of Two Depressions", <http://voxeu.org/index.php?q=node/3421>, 25.05.2009.



Source: EICHENGREEN and O'ROURKE.

Figure 4: The Volume of World Trade



Source: EICHENGREEN and O'ROURKE.

Scaliger compared the Great Depression of 1930s and the current financial crisis and concluded that very little changed except the names of the actors.¹⁶ He argued that events in 2008-2009 tracked closely those of 1929-1933.

According to the figures of IMF, the world economy contracted 0,6 percent in 2009.¹⁷ The U.S. economy contracted 2,4 percent in 2009, Euro

¹⁶ Charles SCALIGER, "Parallels with the Great Depression", *The New American*, Vol. 25, No. 4, 2009, p.25.

¹⁷ IMF, *World Economic Outlook April 2010: Rebalancing Growth*, IMF, Washington, 2010, p.2.

area 4,1 percent, Japan 5,2 percent, the UK 4,9 percent, Germany 5,0 percent, France 2,2 percent while China grew 8,7 percent and India grew 5,7 percent.

According to the IMF, the global recession was the most synchronized recession, as all the advanced economies and many emerging and developing economies were in recession.¹⁸ It was stated that the U.S. recession was worse than the all previous recessions in terms of output, unemployment rate, private consumption, residential investment, house prices and equity prices. Output contracted faster than the previous recessions, unemployment rate increased faster, private consumption; residential investment, house prices and equity prices declined at a higher rate than the previous recessions.

It was argued that the fact that industrial production, employment, retail sales, Manufacturing Purchasing Managers' Index and Consumer Confidence Index fell sharply in both the advanced and emerging economies indicated that the crisis was synchronized globally. The financial crisis was compared with the Great Depression in terms of financial factors. It was determined that stock prices declined at a faster rate than the Great Depression.

According to the IMF, the severity of recessions is closely related to their duration and the recessions following financial crises usually last longer than average. Bounce-back from financial crises is weaker and time for output to recover to pre-financial crisis level is longer. Globally synchronized recessions are often long and deep, and recoveries are typically slow and weak. In highly synchronized recessions, output, private consumption, residential investment, private capital investment, house prices, exports and unemployment rate return to their pre-crisis levels much slower and later than they do in normal recessions.

According to estimates of the IMF, financial institutions' losses tied to distressed loans and securitized assets may reach \$2,3 trillion by the end of 2010.¹⁹ It is estimated that \$885 billion of these losses is U.S.-originated loans while the rest originates from the Euro area and Japan. About \$1,5 trillion of these estimated losses had been realized by the end of 2009. U.S. bank writedowns by the end of 2009 totaled \$680 billion while European bank writedowns amounted to \$415 billion by the end of 2009.

According to the IMF:

“Some segments of country banking systems remain poorly capitalized and face significant downside risks. Slow progress on stabilizing funding and addressing weak banks could complicate policy exits from extraordinary support measures, and the tail of weak institutions in some

¹⁸ IMF, *World Economic Outlook April 2009: Crisis and Recovery*, IMF, Washington, 2009, p. 14.

¹⁹ IMF, *Global Financial Stability Report April 2010 Summary Version: Meeting New Challenges to Stability and Building a Safer System*, IMF, Washington, 2010, p. 11.

countries risks having “zombie banks” that will act as a dead weight on growth.”²⁰

Reinhart and Rogoff show that the aftermath of severe financial crisis share three characteristics.²¹ First, the aftermath of banking crises is associated with profound declines in output. Real per capita GDP decline is 9,3 percent on average. The cycle from peak to trough in GDP is two years, which indicates that recessions that come after financial crises last longer than the usual recessions.

The second characteristic is that government debt increases at very high rates, rising an average of 86 percent in the major financial crises after the World War II. The third characteristic is that asset market collapses are deep and prolonged. Real housing prices decline average 35 percent over six years, while equity price collapses average 55 percent over three and a half years. The unemployment rate rises an average of seven percentage points over the down phase of the cycle that lasts over four years on average.

Rogoff and Reinhart argue that recessions that follow in the wake of big financial crises tend to last far longer than downturns. If the U.S. follows the norm of recent crises, it may take four years for the output to return to its pre-crisis level, unemployment may reach 11-12 percent in 2011, the U.S. national debt may rise by \$8,5 trillion over the next years.²² Recoveries from recessions that come after financial crises is generally weaker since households increase their saving rates and decrease consumption to restore balance sheets and since credit conditions deteriorate.

Rogoff and Reinhart also argue that globally synchronized recessions are longer and deeper. They identify three episodes since 1960 during which 10 or more of the 21 advanced economies were in recession at the same time: 1975, 1980 and 1992. They determine that recoveries are usually slow because of weak external demand.

Nobel Laureate Stiglitz argues that since household debt is very high and household wealth has been devastated in the U.S., firms are facing high borrowing costs and declining markets, real estate prices continue to fall and the number of mortgages become underwater (that means the value of mortgages exceeding the market price) is increasing, unemployment is increasing and since “Zombie” banks’ problems continue in spite of the results of the stress test, the bottom for the U.S. economy may be seen by the end of the year earliest.²³

²⁰ IMF, 2010, p. 11.

²¹ Carmen REINHART and Kenneth S. ROGOFF, “The Aftermath of Financial Crises”, *American Economic Review*, Vol. 99, No. 2, p. 466.

²² Carmen REINHART and Kenneth S. ROGOFF, “Don’t Buy the Chirpy Forecasts; The History of Banking Crises Indicates This One May Be Far From Over”, *Newsweek*, Vol. 153, No. 13, March 2009.

²³ Joseph STIGLITZ, “Green Shots? Don’t Speak Too Soon”, *The Guardian*, May 11, 2009.

Wolf emphasizes the over indebtedness of the private sector in the U.S.²⁴ He states that total private sector debt increased from 112 percent of GPP in 1976 to 295 percent at the end of 2008. Financial sector debt increased from 16 percent to 121 percent of GDP. He argues that a return to sustained, private-sector-led growth in the short-term is unlikely since the financial sector has still many problems and deleveraging of the private sector has not begun.

Many economies, especially the developed ones, contracted in 2009 because of the global crisis. It is expected that the recovery will be slow and weak since the global recession is synchronized and came after a financial crisis.

It is forecasted that the U.S. economy will return to its pre-crisis level at least after four years and if it follows the Japan example, it may take a decade for the U.S. economy to return to its pre-crisis level. It is expected that China will differentiate from many countries and continue to grow more than eight percent. This may seriously alter the relative economic strengths of the dominant nation and the challenger.

This is a significant development with regards to the international system from PTT perspective since the GDP is the most important indicator of national power according to PTT. If the dominant nation, the U.S. returns to its pre-crisis output levels in four years and if the challenger, China continues to grow at rates higher than eight percent, the international system may enter into the parity phase at an earlier date than estimated before the global crisis.

As mentioned in the first section, the forecast about the relations between the U.S. and China is based upon the assumption that China's GDP (PPP) will overtake the U.S.'s GDP (PPP) around the year 2025. Nonetheless, if the global crisis proceeds as forecasted, China's GDP (PPP) may overtake the U.S.'s GDP (PPP) before 2025, which means that the international system will enter the parity phase earlier than forecasted.

Many scholars agree with the argument that the global crisis will substantially affect the equilibriums in the international system. In the following section, analyses of various scholars about the impact of the global crisis on the international system will be examined.

3. GEOPOLITICAL IMPACTS OF THE GLOBAL CRISIS

As examined in the second section, the global financial crisis is the worst global financial and economic crisis since the Great Depression. The significance of the current global crisis with respect to the international system is that the dominant nation, the U.S. was among the worst affected countries while the challenger, China was relatively less affected. As a result,

²⁴ Martin WOLF, "Why the "Green Shoots" of Recovery Could Yet Wither?", *The Financial Times*, April 21, 2009.

by using the PTT analytical framework, it was estimated in the second section that the international system may enter the parity phase earlier than forecasted. Analyses of various scholars support this argument.

Altman argues that the financial and economic crash of 2008 is a major geopolitical setback for the U.S. and Europe and it has stripped Washington and European governments of the resources and credibility they need to maintain their roles in global affairs.²⁵ These weaknesses will accelerate trends that are shifting the world's center of gravity away from the U.S. and the world will move away from a unipolar system.

Altman says that "no country will benefit economically from the financial crisis over the coming year, but a few states-most notably China-will achieve a stronger relative global position."²⁶ He argues that even if China's own real estate sector slows down, its exports are declining, and its overall growth rate is decreasing; the country is relatively insulated from the global crisis since it has \$2 trillion reserves and its financial sector is not exposed to the toxic assets that brought the U.S. and the European banking systems to their knees, since it runs a large budget surplus and current account surplus and it has a relatively small public debt and since its households' saving rate is over 40 percent and its economic growth, which is now driven by domestic activity, will continue at solid rates.

He thinks that the rising nations' growing economic strength will increase their global influence, which will bring competition. He agrees with Richard Haas, president of the Council of Foreign Relations, about the emergence of a "nonpolar world". He anticipates that China's global influence will increase and China will be able to undertake political and economic initiatives to increase it further and it will expand its diplomatic presence in the developing world.

Jacques also thinks that the crisis marks a fundamental shift in the international system. He argues that this has been happening over a long period since China's fast economic growth started three decades ago. He states that China's huge current account surplus and the U.S.'s deficits "are a manifestation, as well as a symbol, of the shift in economic power between the two countries."²⁷ Chin and Helleiner supports this view by arguing that China's dollar-denominated reserves exceeding \$2 trillion dollar gave it a creditor status, which provided the Chinese state considerable international influence.²⁸

Setser thinks that "China has already achieved its most important goal, to be seated at the table on an equal basis with the other large economic

²⁵ Roger C. ALTMAN, "The Great Crash, 2008: A Geopolitical Setback for the West", *Foreign Affairs*, Vol. 88, No.1, 2009, p.2.

²⁶ ALTMAN, p. 2.

²⁷ Martin JACQUES, "No-one Rules the World", *New Statesman*, <http://www.newstatesman.com/north-america/2009/03/global-crisis-power-world>, 15.05.2009.

²⁸ Gregory CHIN and Eric HELLEINER, "China as a Creditor: A Rising Financial Power?", *Journal of International Affairs*, Vol. 62, No. 1, 2009, p.88.

powers.”²⁹ He argues that the fact that China and its policy proposals can command so much attention indicates China's growing importance in the international economic system.

The global crisis increased China's influence in the international system at such an extent that the U.S. dropped its accusations that China manipulates its currency to prevent a potentially explosive confrontation. The U.S. Treasury Secretary, Timothy Geithner, said while the Chinese yuan remains undervalued, Beijing has taken steps to enhance exchange rate flexibility.³⁰

Another indicator of China's growing economic and political weight in international system is the EU's different attitude to Chinese investment. The EU, which had snubbed China's sovereign wealth fund, China Investment Corp., by expressing concerns about its transparency and intentions in 2008, invited it without conditions to invest in Europe after the crisis.³¹

Rodrik argues that developed countries will emerge from the financial crisis in a relatively weaker position and their capacity to impose their views on international economic institutions will be reduced.³² He argues that developing countries, which have 5,2 trillion dollar reserves as of 2008³³, can increase their influence in international financial system because of the global crisis.

Rodgers argues that the U.S.'s political triple-A rating in the international arena, which gives it the superpower status is being downgraded as rapidly as its economic triple-A rating.³⁴ He says that the U.S. lost real power as a result of growing public debt and current account deficit and other economic problems. Nye argues that global financial crisis is not only an economic crisis, but also political and ideological crises of the west.³⁵ It signals the decline of the West and also symbolizes the collapse of the neoliberal ideology.

Ferguson likens the current situation to the crisis-ridden years after the global crash of 1929 and expects a new age of instability.³⁶ The chairman of the Joint Chiefs of Staff of the U.S. supports this argument by saying that

²⁹ Peter FORD, “Ahead of G-20, China Questions US's Financial Dominance”, *The Christian Science Monitor*, March 30, 2009, p. 99.

³⁰ Malcolm MOORE, “US Steps Back From Trade War with China”, *The Telegraph*, April 16, 2009.

³¹ Tom MITCHELL, “China Set to Invest Again in Europe”, *The Financial Times*, April 19, 2009.

³² Dani RODRIK, “Let Developing Nations Rule”, <http://www.voxeu.org/index.php?q=node/2885>, 04.05.2009.

³³ Brad SETSER, “A Neo-Westphalian International Financial System?”, *Journal of International Affairs*, Vol. 62, No.1, 2008, p. 18.

³⁴ Walter RODGERS, “America: A Superpower No More”, *The Christian Science Monitor*, April 8, 2009.

³⁵ Joseph NYE, “American Power after the Financial Crisis”, *Foresight Project*, November 2008.

³⁶ Niall FERGUSON, “The Axis of Upheaval”, *Foreign Policy*, Vol. 171, 2009, p.56.

the global financial crisis may increase the intensity of uncertainties and have a significant effect on security around the world.

According to the U.S. National Intelligence Council, the international system as constructed after the second world war will change fundamentally because of globalization, the rise of emerging powers and “an historic transfer of relative wealth and economic power from west to east.”³⁷ According to the Council’s forecasts, the future world order will be multipolar.

Nye argues that international system has already become multipolar in terms of economic power especially after the financial crisis.³⁸ He argues that power always depends on context, and in today's world, it is distributed in a pattern that resembles a complex three-dimensional chess game. On the top chessboard, military power is largely unipolar and likely to remain so for some time. But on the middle chessboard, economic power is already multipolar, with the U.S., Europe, Japan and China as the major players, and others gaining in importance. The bottom chessboard is the realm of transnational relations that cross borders outside of government control.

G-20 meeting in April 2009 symbolizes the changing balance of power in the international system. According to Jacques, “the very fact that it is taking place at all is an admission of the momentous shift in the global balance of economic power from the rich countries to the developing world.”³⁹ The negotiations and results of the G-20 meeting were like the first signs of transformation of the international system into a multipolar structure. The meeting failed to reform the international financial system because of clash of interests among the Anglo-Saxons, the Europeans and the emerging countries. The U.S. blocked the reform of the international system and pushed for global fiscal stimulus. The Europeans resisted fiscal stimulus and reform of the IMF and the World Bank since their voting power would be most cut to create space for the emerging countries. They shifted the focus from these issues to the regulatory reforms. Emerging countries, especially China, stressed the importance of the reform of the international financial and monetary system.

Meanwhile, it is also argued that to focus on economic power to say that world is becoming multipolar is misleading. Brooks and Wohlforth argue that international system can transform into multipolarity economically, nonetheless U.S. will continue to be the only superpower militarily.⁴⁰ They estimate that the world will be 1+? world, with one superpower and ? number of major powers.

³⁷ NATIONAL INTELLIGENCE COUNCIL, *Global Trends 2025: A Transformed World*, National Intelligence Council, Washington, 2008, p. vi.

³⁸ Joseph NYE, “American Power after the Financial Crisis”, *Foresight Project*, November 2008.

³⁹ Martin JACQUES, “No-one Rules the World”, *New Statesman*, <http://www.newstatesman.com/north-america/2009/03/global-crisis-power-world>, 15.05.2009.

⁴⁰ Stephen G. BROOKS, William C. WOHLFORTH, “Reshaping the World Order”, *Foreign Affairs*, Vol. 88, No.2, 2009, p. 56.

Bremmer also emphasizes U.S.'s strengths in the military dimension. He argues that even if parts of the American soft power like financial leverage deteriorated comparatively; the U.S. has by far the world's largest military, it has more capability for large-scale coordinated operations, research and development throughout the world is U.S. driven, and the world's best institutions of higher learning are in the U.S.⁴¹

Garrett thinks that even if the U.S. has been shaken badly by the financial crisis, it is still almost inevitable that the U.S. will continue to be the world's dominant geopolitical force well into the new century. He argues that the U.S. economy is still very competitive, the U.S. military hegemony is unchallenged and America's cultural and political reach is unparalleled.⁴²

Gross states that the long-term decline of the U.S. economy has been greatly exaggerated. He says that, "America is coming back stronger, better, and faster than nearly anyone expected and faster than most of its international rivals."⁴³ He argues that the dollar gained strength and only China, India, and Brazil are growing faster than the U.S., nonetheless they are doing so off a much smaller base.

Siegel also does not agree with the consensus that the U.S. faces a long period of stagnation in the coming years. He thinks that over the next decade, the U.S. economy can grow faster than the 3,2 percent average it has achieved over the past half century since the economic growth in the long-run is based on advances in productivity, which is based on discovery and innovation.⁴⁴

Gamble argues that if the recession does not last long and the recovery turns out to be V-shaped; the ascendancy of the U.S. may be restored, the dollar may continue to be the international reserve currency, the U.S. productivity and technological innovation may maintain the U.S.'s competitive edge, and the neo-liberal international economy may be re-established.⁴⁵

Naim states that even if the global financial crisis did cause severe economic damage, it did not unleash a wave of geopolitical plagues such as civil wars, collapsing currencies, protectionism and international conflict as some anticipated. He argues that the international financial system did not collapse, the economic crisis did not deepen, the U.S. dollar did not crash,

⁴¹ Peter TUCKER, "Navigating the Multipolar World: The Free Market vs. State Capitalism", *The Futurist*, Vol. 44, No. 3, 2010, p. 30-31.

⁴² Geoffrey GARRETT, "China, the United States and the World after the Global Financial Crisis", *Global Policy*, Vol. 1, No.1, 2010, p. 30.

⁴³ Daniel GROSS, "The Comeback Country: How America Pulled Itself Back From the Brink and Why It's Destined to Stay on Top", *Newsweek*, Vol. 155, No. 16, April 2010, <http://www.newsweek.com/id/236190>, 20.04.2010.

⁴⁴ "The Shape of Things to Come :Four Leading Economists Predict the Trajectory of The Recovery", *Newsweek*, Vol. 155, No.16, April 2010, <http://www.newsweek.com/id/236200>, 21.04.2010.

⁴⁵ Andrew GAMBLE, "A New World Order? The Aftermath of the Financial Crisis", *Policy Insight*, Vol. 1, No. 1, 2010, p. 18-19.

protectionism did not surge, and the crisis in rich countries did not drag down the developing economies.⁴⁶

Cooper, director-general of external affairs at the Council of the European Union, is also skeptical about the impact of the global financial crisis on the international power transition. He argues that “geopolitical events like the disappearance of Mao in China, or the fall of the Berlin Wall, have greater consequences than financial shocks.”⁴⁷ He cites the technology bubble example in the 1990s and oil crises in the 1970s and argues that there were no obvious consequences. Nonetheless, he also accepts that the depression in the 1930s and the economic decline of Europe after the II. World War had important consequences.

CONCLUSION

The global crisis is the worst global financial and economic crisis since the Great Depression. Many developed and emerging countries entered into recession. Since it is a globally synchronized recession and came after a financial crisis, it is forecasted that recovery will be weak and slow so that it will last longer to return to pre-crisis output levels. The dominant nation, the U.S. is among the worst affected countries while China, the challenger, is affected much less severely.

This is a very significant development from the PTT perspective since GDP is the most important indicator of national power according to the PTT. Before the global crisis, it was estimated that China’s GDP (PPP) will overtake the U.S.’s GDP (PPP) around the year 2025. The global crisis invalidated basic assumptions about the growth rates of the U.S. and Chinese economies. The U.S. economy contracted 2,4 percent in 2009 while the Chinese economy grew 8,7 percent. In addition, since the global financial crisis came after a financial crisis and since it is globally synchronized, it is expected that the U.S. economy will be able to reach its pre-crisis levels after at least four years.

All these dynamics may have significant consequences for the international system. If the crisis proceeds as forecasted and if the U.S. economy reaches its pre-crisis levels after at least four years, the Chinese economy may overtake the U.S. economy before 2025 and the international system may enter the parity phase earlier than forecasted.

The U.S. economy may recover earlier than forecasted and reach its pre-crisis levels faster than expected. In that case, the year the international system will enter the parity phase will depend on the speed of the U.S. economy’s recovery and the growth rates of the Chinese economy.

China’s GDP (PPP) may overtake U.S. GDP (PPP) around the year 2025 or earlier. Nonetheless, since China’s integration to the international

⁴⁶ Naim MOSES, “It Didn’t Happen”, *Foreign Policy*, No. 177, 2010, p. 95-96.

⁴⁷ Quentin PEEL, “A Wider Order Comes into View”, *The Financial Times*, April 5, 2009.

trading, financial and political system is also going forward, it is expected that probability of war will decline.

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