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Foreign Policy Implications of the Financial Crisis

Written Statement of
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Thank you Mr. Chairman and members of this committee for the honor of addressing you today. Mr. Chairman, it is a tribute to your leadership that this roundtable is being convened in recognition of the centrality of economic and financial issues to American foreign policy.

In thinking about the foreign policy implications of this crisis, I would like to talk a bit about deficits. Not current account deficits or trade deficits, but rather the more strategic foreign policy deficits created by this crisis. How the United States addresses these deficits, will likely play a significant role in shaping the 21st century world order.

At its most basic, the current economic crisis has given rise to a deficit of capital. The sudden withdrawal of credit and investment available to countries, companies, banks and individuals around the world has resulted in a dramatic reduction in capital flows - especially into the developing world. This scarcity of capital is likely to worsen as current and proposed plans for stimulus packages and rescue programs in the US, Europe, China and elsewhere soak up huge amounts of funding, thereby vastly reducing the amount of global capital available to developing countries.

The inability to access capital through the global markets will likely restrict many governments in their ability to fund basic domestic programs. And when a government experiences an imminent funding crisis that poses a risk of civil unrest or that threatens its survival, anyone offering a means to provide financing warrants consideration.

An example of this scenario was NATO ally Iceland's response last October when its pleas for financial assistance went unanswered. In desperation, Iceland commenced negotiations with Russia. Iceland's Prime Minister explained his actions at the time by noting that his country had not received support from its friends, so it was forced to look for new friends.

Just this past week, the government of Libya came to the rescue of a major European bank for the second time, and Russia, in spite of falling share prices, a weakened currency and declining reserves, provided a $2 billion loan to Kyrgyzstan.

A second deficit created by this crisis is a deficit of ideology. While the fall of the Soviet Union represented a clear triumph of democracy and capitalism over communism, the current crisis has again raised questions about what economic and political systems are, in fact, most desirable and effective. Few, if any, are calling for a return to communism, but the current crisis has called into question several generally accepted principles of late 20th century political and economic thought – including the benefits of Anglo-Saxon style capitalism, American style democracy, and more broadly, the ideological leadership of the United States.

Many countries in the developing world spent the last decade following the so-called Washington Consensus. They embraced tough fiscal policies, opened their markets, removed capital controls, built up reserves and embraced the global financial order. Nevertheless, the current crisis has hit them hard.

The financial crisis thus created an ideological deficit, where even our closest allies in Europe, not to mention other countries with whom our relationship is more complex, like Russia, China and the Gulf states, are re-thinking the balance between social values and market-based economies. There is renewed consideration of political and economic systems like "state capitalism" and "authoritarian democracy". What were previously oxymorons are now ideological challengers to the status quo.

A third deficit raised by the crisis is one of creativity. As other nations re-think the ideological underpinnings of the international order, there remains an enormous yearning – as yet unfulfilled - for bold and creative solutions to the crisis on a global scale.

One of the unexpected consequences of the financial crisis has been the apparent establishment of the G-20 as the new forum at which many of the world's most pressing economic problems will be discussed and addressed. For the first time, many of the world's fastest growing emerging market economies and not just the US and Europe, have a seat at the head table - a table at which neither the US nor anyone else has a veto. That means that the G-20 is likely to be a more competitive platform for diplomacy, ideas and intellectual leadership.

Thus far, it has been Britain, France and the European Union that has taken the intellectual lead in proposing and crafting the most creative solutions for re-shaping the international financial system. In the US, while former Federal Reserve Chairman Paul Volcker received widespread international praise for a report that included several bold and innovative proposals, he went out of his way to emphasize that the G-30 report did not represent official US policy.

Which leads to my fear of a fourth deficit – a deficit of attention by the United States on the global nature of this crisis and the strategic issues it compels us to address.

It is understandable for the US, like other countries, to turn our focus inward and address the domestic impact of the current economic crisis before considering the more strategic global implications of our response.

But it is imperative that we not send a signal to the world that we are now solely focused inwards. If we assume that we can try to right our own domestic ship and deal with international issues later, then we are almost certain to find that other, more creative, aggressive and opportunistic actors will step in and try to fill any vacuum created by a lack of attention on our part.

By including foreign policy issues in our response to the economic crisis, we should at least consider how to address head on these deficits of capital, ideology, creativity and attention. This roundtable is a significant step in that direction.

Thank you.