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Seismic Shifts in the Global Economy, Finance and Financial Markets[1]

Key Notes

The roots of the seismic shifts in the global economy, finance, and financial markets reach well beyond the collapse of home prices in the United States.

Increasingly, it appears that the United States may have lost its way in a fast-changing competitive and dynamic world, with huge economic and geopolitical consequences and, most importantly, the loss of political power and unfinished societal tasks in a long queue for attention.

America's higher education sector is one of its greatest assets. U.S. higher education clearly is vulnerable to the effects of the numerous seismic shifts in the global economic landscape, and to the fallout of the current economic downturn—if only because of a bear market in stocks and what that might mean for university endowments.

All students, regardless of their particular field of study, should graduate with a skillset and mindset adapted to the changing global environment. A broad view of the world and America's role in it should permeate classes, curricula across disciplines, and academic research.

It is clear that financial markets and the global economy are undergoing vast transformations, significantly altering the context and backdrop for the U.S. economy in the short-and long-run. The roots of these *seismic shifts* in the global economic landscape reach well beyond the collapse of home prices in the United States. Allen Sinai, chief global economist and strategist for Decision Economics, Inc. (DE), describes several seismic shifts, including the new global economic geography reflecting the rise of China and Asia, the collective force and energy of developing countries around the globe, and the rebalancing of imbalances in trade, debt, savings and investment that have characterized the global economy for many years. Sinai discusses the effects of these seismic shifts on the U.S. economy and their implications for American higher education. He concludes that the necessary adjustments to a relative decline in household wealth, a severe cyclical decline in the U.S. economy, and an enforced seismic shift from consumption to saving threaten the future funding and standing of American higher education.

Seismic Shifts

Several long-term trends and shifts will have a significant impact on the extent of the United States' future economic and political power. These include:

The New Global Economic Geography

Table 1 ranks the top 15 countries in terms of their gross domestic product (GDP) for selected years.

The United States has been first by a wide margin for quite some time; however, China is moving quickly up the ranks and, given that its current growth rate exceeds that of Germany, is undoubtedly number three today. India and Korea have recovered from the Asian Crisis in the late 1990s and moved up somewhat from their low rank in 2000. Russia appears on the list for the first time in 2007, at number 11. The Eurozone countries are fairly stable in their rankings, while the emerging countries exhibit ups and downs, with Brazil having moved up to number 10 in 2007.

This trend and restructuring of the global economic geography away from the U.S. and toward China and Asia likely would be intensified if the United States and world economies were to fall into a recession—expected now and for 2009.

The Dynamic and Collective Force of Developing Countries

We are all familiar with China's striking economic growth rate, estimated at 9.2 percent per annum between 1997 and 2007, and the corresponding 6.8 percent per year for India (compared to 3.0 percent for the United States and 2.5 percent for the EU during the same period). Asia's newly industrialized countries—Korea, Taiwan, Hong Kong and Singapore—also have shown strong economic growth, averaging 4.5 percent per annum between 1997 and 2007, as have Russia and Eastern Europe, at 5.3 and 4.2 percent, respectively. Growth in Latin American

1 This presentation was given in June 2008 and therefore does not reflect subsequent events in the financial markets. The author's assessment of the seismic shifts occurring in the global economic landscape, however, is essentially unaffected by these events and circumstances; indeed, it is underscored and emphasized by them—especially by the relative decline in the economic power and wealth of the United States and the threat to and difficult times ahead for American higher education.

countries, which has benefitted from rising crude oil prices, has been strong in the last few years, averaging 3.2 percent per year between 1997 and 2007.

These countries can be characterized as having moved beyond emerging to developing status and, indeed, are more economically developed than many realize. *Collectively, they may be doing more to energize the global economy than a traditional engine of growth such as the United States.*

Transformation of the "Haves" and "Have-Nots"

The last decade has seen stark changes in the "Haves" and "Have-Nots" of the global economy, where the global economy is defined by Decision Economics, Inc. as 47 countries that account for nearly 93 percent of all global output. Current account balances (based on the net flow of imports and exports and investments flowing among countries) and foreign exchange reserves are good indicators of a nation's wealth and financial well-being. Table 2 shows the current account balances and foreign exchange reserves for 25 of the 47 countries analyzed and forecasted by DE.

These data reveal which countries are rich and which are poor on the dimensions used.

The United States has a massive current account *deficit* of $739 billion, equal to 5.6 percent of GDP. In contrast, China has a $367 billion current account *surplus*, equal to 11.3 percent of GDP. China has accumulated its enormous surplus by using cheap labor and fixing its currency artificially low, which has contributed to keeping its export prices down. While China's costs are rising and it may not be able to, nor wish to, continue its current policies, its fixed currency has enabled China to amass its huge current account surplus. With that enormous wealth comes economic and financial power and, history teaches us, political power, too. Generally, the other Asian countries (with the notable exception of India) and Russia have become rich from several years of sharply rising crude oil and commodities prices, true also for the Middle East and Venezuela.

Foreign exchange reserves (the deposits of foreign currency held and invested in various assets by central banks) are a tangible measurement of wealth. Columns 3 and 4 of Table

Table 1. Changing Global Economic Geography (1995-2007, ranking by nominal GDP, in Bils. U.S. $s)

2007			2004			2000			1995		
Country	**GDP**	**Rank**	**Country**	**GDP**	**Rank**	**Country**	**GDP**	**Rank**	**Country**	**GDP**	**Rank**
U.S.	13841.3	1	U.S.	11685.9	1	U.S.	9817.0	1	U.S.	7397.7	1
Japan	4375.4	2	Japan	4607.1	2	Japan	4617.4	2	Japan	5245.8	2
Germany	3323.6	3	Germany	2736.0	3	Germany	1901.2	3	Germany	2522.6	3
China	3242.4	4	U.K.	2168.3	4	U.K.	1450.8	4	France	1570.7	4
U.K.	2770.6	5	France	2058.4	5	France	1329.8	5	U.K.	1135.8	5
France	2590.2	6	China	1326.5	6	China	1192.8	6	Italy	1127.5	6
Italy	2101.4	7	Italy	1724.6	7	Australia	1155.3	7	China	727.9	7
Spain	1436.9	8	Australia	1180.3	8	Italy	1098.5	8	Brazil	704.2	8
Canada	1429.7	9	Spain	1044.2	9	Canada	724.9	9	Australia	675.2	9
Brazil	1313.3	10	Canada	992.1	10	Switzerland	712.6	10	Spain	697.1	10
Russia	1289.9	11	India	689.9	11	Brazil	644.5	11	Canada	590.5	11
India	1143.1	12	Mexico	683.5	12	Mexico	581.4	12	Korea	517.0	12
Korea	969.5	13	Korea	680.5	13	Spain	580.9	13	Switzerland	439.8	13
Australia	906.7	14	Brazil	663.7	14	Korea	511.8	14	Netherlands	418.7	14
Mexico	893.2	15	Netherlands	609.9	15	India	467.8	15	India	366.4	15

SOURCE: Calculations by Decision Economics, Inc.

2 show that the United States has $76 billion in foreign exchange reserves, equal to just 0.5 percent of its GDP; China has $1.7 trillion, equal to 47 percent of its GDP.

Additional countries with high foreign exchange reserves (and the percentage of GDP those reserves equal) include: Japan, $1.0 trillion (22%); Russia, $507 billion (37%); Taiwan, $287 billion (71%); South Korea, $264 billion (27%); Brazil, $195.2 billion (14%); and Hong Kong, $161 billion (74%). Singapore's $178 billion in foreign exchanges reserves equals a full 101% of its GDP.

Any discussion of the Haves and Have-Nots in the global economy cannot overlook the wealth of the OPEC nations. Table 3 shows the current account balances and foreign exchange reserves of the largest oil producing OPEC nations.

Table 2. Haves and Have-Nots

	Current Account Balances		*Foreign Exchange Reserves*	
Country	**2007 (Bils. U.S. $s)**	**2007 (% of GDP)**	**March 2008 (Bils. U.S. $s)**	**Dec. 2007 (% of GDP)**
United States	-738.6	-5.3	75.8	0.5
Canada	12.3	0.9	43.1	2.9
United Kingdom	-115.4	-4.2	100.0	3.5
France	-30.8	-1.2	127.1	4.5
Germany	255.5	7.7	150.4	4.1
Italy	-51.2	-2.4	103.1	4.5
Switzerland	71.1	16.8	80.7	17.8
Japan	212.3	4.9	1015.6	22.2
Australia	-56.4	-6.2	33.4	3.0
South Korea	6.0	0.6	264.2	27.0
Taiwan	32.9	8.6	286.9	70.5
Hong Kong	28.0	13.5	160.8	73.7
Singapore	39.1	24.2	177.6	101.0
Argentina	7.2	2.8	50.5	17.7
Brazil	1.5	0.1	195.2	13.7
Mexico	-5.5	-0.6	91.0	9.8
Venezuela	20.0	10.9	20.2	13.1
Chile	7.2	4.4	17.9	10.3
Spain	-145.3	-10.1	20.5	1.3
Russia	78.3	6.1	507.0	36.9
China	366.8	11.3	1684.3	47.2
India	-11.8	-1.0	309.7	24.1
Israel	5.0	12.3	29.6	70.6
Egypt	2.4	1.9	32.2	23.3
Jordan	-2.8	-34.9	7.4	67.2

SOURCES: IMF, IFS, Central Banks

Further, assets in some sovereign wealth funds dwarf the amounts shown in Table 3. The largest such fund, the Abu Dhabi Investment Authority, had assets of $800 billion as of June 2008, and the Kuwait Investment Authority had $250 billion in assets at that point. China has created a Sovereign Wealth Fund, too, using $200 billion of its reserves and charging its managers with improving investment returns. Given the state of the U.S. economy, it is unlikely that these sovereign funds will continue to buy as many U.S. dollar-denominated assets as in the past, which can jeopardize the United States' ability to raise funds and make debt payments. In times of crisis, of course, the U.S. dollar becomes a "safe haven" for risk averse investors. But, aside from this, the longer-run implication is negative for the dollar and U.S. asset prices.

Decoupling

Another dimension of the seismic shift of growing wealth and economic power for the non-U.S. world is "decoupling." Decoupling itself has a number of dimensions, one of which is the level of dependence for non-U.S. economies on U.S. trade. Over the last decade, most countries have come to depend less on the U.S. for exports relative to their total, and relatively more on other countries, particularly in their regions. This suggests more resiliency for the non-U.S. economies than used to occur from a U.S. economic downturn, *depending* on the economic performance of those economies that now are more important to them in trade than previously, e.g., China for Asia.

But most countries still export a lot to the United States, especially to the U.S. consumer, so that decoupling, if thought of as nearly complete insulation from a U.S. economic downturn—especially if it is centered in consumption—is not, in this sense, present. On exit from a global downturn, however, many non-U.S. economies could be expected to perform significantly better than the United States.

Rebalancing Global Imbalances

Another seismic shift with wide-ranging effects and long-term implications is the possible rebalancing of previous global imbalances.

First and fundamentally, the United States may no longer lead global economic growth. Further, the decline in the dollar, which peaked in 2002, reflects the changing global economic and financial geography and is leading the U.S. away from consumer-driven imports toward higher exports and hence declining trade and current account deficits. There remain large imbalances, however, for China and Japan, which have large trade and current account surpluses and too little domestic spending.

As the United States' debt-financed consumer-led economic expansion gives way to recession, a shift toward what will likely be a long period of increased saving and correction after years of borrowing, dissaving, and excessive use of easy credit can be expected. The emerging relative decline in U.S. wealth and ownership and in the domestic and international purchasing power of U.S. households, businesses and government could have significant global political and security implications for the United States.

Increasingly, it appears that the United States may have lost its way in a fast-changing competitive and dynamic world, with huge economic and geopolitical consequences and, most importantly, the loss of political power and unfinished societal tasks in a long queue awaiting attention.

Additional seismic shifts that fundamentally alter the global economic and political landscape, but that are beyond the scope of this summary, include the ongoing balance sheet contraction and regulatory aftermath of the current financial crisis; the implications of the aging population and structural demographic changes; the ramifications of vast income and wealth inequalities around the globe; and the worldwide demand for energy and oil in excess of supply.

Table 3. Wealth of Oil-Producing Nations

Country	**Current Account Balances (% of GDP)**	**Foreign Exchange Reserves (U.S. Bils. $s)** (March 2008, Except as Noted)
Saudi Arabia	25.3	27.2
United Arab Emirates	21.6	81.4 (Feb. '08)
Kuwait	47.4	16.6
Iran	10.4	NA
Iraq	NA	NA
Qatar	34.6	15.6
Algeria	23.2	123.6
Libya	42.5	87.1
Venezuela	8.5	20.3
Indonesia	2.4	58.8

SOURCE: International Monetary Fund.

Implications for Higher Education

America's higher education sector is one of its greatest assets. Higher education's contributions to enhancing human capital and increasing productivity and earnings are well documented. The sector is booming: more than 10,000 jobs per month have been created in higher education for a number of years. And, the demand for higher education continues to grow, both domestically and in terms of foreign students who want to earn their degrees in the United States. Higher education is a large and growing segment of the U.S. economy: approximately $270 billion was spent in the U.S. higher education sector in 2007, nearly double what was spent less than 10 years ago, in 1998.

That said, higher education is quite vulnerable to the effects of the seismic shifts described herein and to the fallout of the current economic downturn. The strong investment returns on endowment funds that have so greatly benefitted many colleges and universities in recent years will be harder to achieve. Financing for capital projects will be more difficult to obtain and potentially more costly, demanding new strategies and approaches to financing. Fundraising will suffer as potential donors become more financially squeezed. Public funding, because of lost tax receipts, will be way down. Pressure to commercialize academia and enhance revenues will increase, presenting threats to institutional and educational missions. The financial crisis and breakdown in financial intermediation affects higher education every bit as much as the private sector generally, although most certainly with lags.

A thorough understanding of the changed global economy and seismic shifts now in process would help put American higher education leaders in a stronger position to determine how best to teach students and manage their institutions.

During difficult times, all students, regardless of their particular field of study, should graduate with a skillset and mindset adapted to the changing global environment. A broad view of the world and America's role in it should permeate classes and curricula across disciplines. Institutions benefit from enrolling students from a wide variety of geographical areas around the world—and by seeking out opportunities to establish branches and outreach programs overseas. Interdisciplinary centers and global-centric universities will contribute to an appreciation of the changing global environment and to solving the complex issues that arise within it.

Allen Sinai is chief global economist, strategist and president emeritus of Decision Economics, Inc. (DE), a global economics and financial markets information support and advisory firm founded in 1996. Prior to joining DE, he was chief global economist at Lehman Brothers, Inc. Sinai has advised U.S. presidents on key economic and policy issues, often testifies before Congress, and meets regularly with senior level policy makers from foreign countries. He can be reached at asinai@decisioneconomicsinc.com.

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