THE INTERNATIONAL ECONOMIC SITUATION

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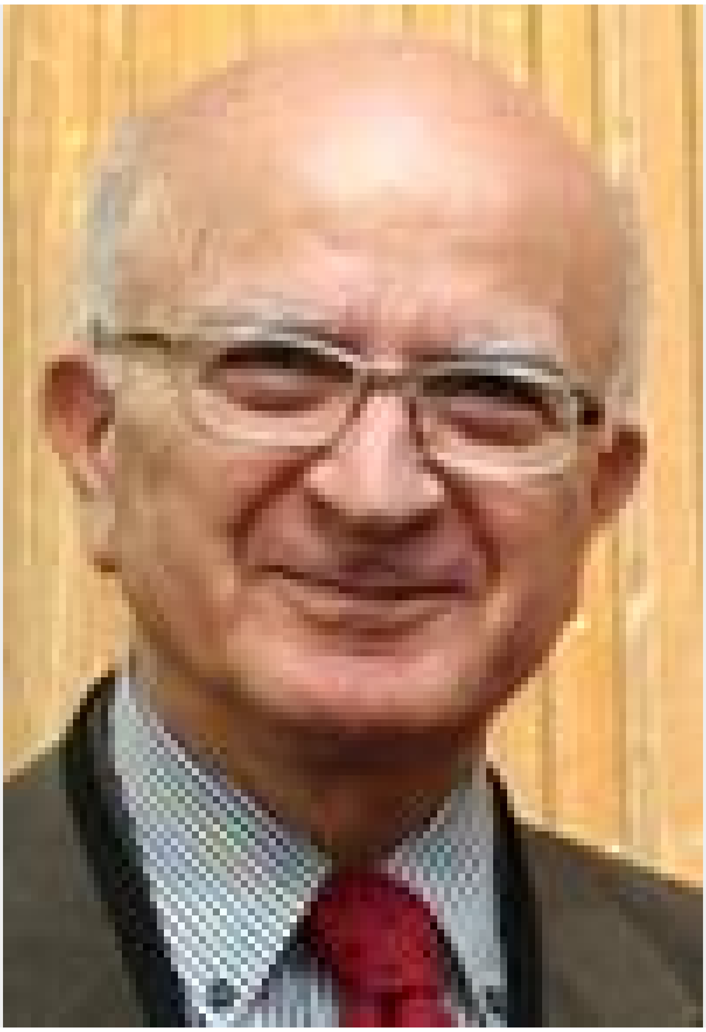

Category: Opinions

M. Bouldoukian, Former Vice Governor, Central Bank of Lebanon, 19 December 2010

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This collapse showed on the one hand, how the non compliance to laws and the lack of confidence worldwide, can dismantle international big banks in the U.S.A. & the EU, weaken the network of the international banking & financial relations as well as correspondent banking; and, on the other hand, no matter how low market interest rates are pushed down, ONLY FUTURE EXPECTATIONS can encourage decision-makers to invest in industries and create employment, hence income, consumption… and **revival of an economy**.

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The coincidence of this collapse to the **trading block imbalances** such as China v/s U.S.A., **the ballooning of public debts** in the EU & the U.S.A. have made vulnerable monetary & fiscal policies, as well as the existence of the WTO, thus advancing the ideas of protectionism and the Gold Standard.

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The reestablishment of confidence in the banking systems worldwide is dependent on the time factor. How much time? That is the real question.

During this crisis period, bankruptcies, unemployment, search for liquidity by selling available assets, mortgaged houses and securities has become a normal way of life style.

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Regarding the China v/s U.S.A. trading imbalances and the request for the reevaluation of the Chinese Yuan (a vital issue to the Chinese economy) the Japanese Yen and the Euro will not resolve the actual situation of the U.S.A. It exposes the world to the old ideas of 1930s, such as, currency wars, protectionism, quotas or trade wars thus pushing the price of gold to higher and higher levels. Forecasters at the Migdrij Institute had foreseen since 2001, 2006, 2009 and 2010 a rise in the gold price to over USD 1000 the ounce.

What should be done next?

In the 1930s, such international economic relations took nations of various continents to the 2nd WW, when currency and trade wars did not succeed.

But at present.

Well, the Eurodollars in the possession of the non-U.S.A. organizations, individuals and Central Banks in the form of reserves, since the days of the dollars shortage of 1945 and the Marshall Plan investments and foreign aid generated enough internationals liquidity in the hands of the trading partners of the U.S.A. The latter has to reduce its trade deficits in the coming years, at least with China, by coming into an understanding (the U.S.A. & China) on international trade policies and practices, create innovative products, encourage savings of the U.S. citizens to replace the consumption appetite and be less involved in overseas wars.

Soviet communism no more exists in the 15 former soviet republics since 1991. Red China has become one of the biggest capitalist economies, the second after the U.S.A. Diplomat George Kennan's 1947 essay (the U.S. containment policy) is no longer valid, unless we are expecting the return of communists; (neo-coms. in contrast to neo-cons.); or a second Pearl Harbor? Today, the cost of **facing U.S. foreign policy challenges** (in Iraq, Afghanistan, terrorism, nuclear proliferation and North Korea) **must not inflate**the budgetary deficit as before hence, the ballooning of public debt can be reduced.

Paul Volcker, the former Governor of the FRBS stated in 1986 "**Disproportionate increase in debt** extended over the years **do not constitute**, a **solid, sustainable base for satisfactory economic growth and stability indefinitely** into the future."(See the Economic Review of May 1986 – the FRB of Kansas City).

Did democrats and republicans understand what Paul Volcker had alluded to?

The U.S. economy is the biggest in the world and will remain so for a long time. It possesses the most advanced liberal economic culture and entrepreneurial spirit, and this, since a long time; it is the country with the richest human and material resources. It is the **megastore of finance**. The rest of the world with the exception of Russia, (Japan, China, EU, India and others) are relatively speaking, dependent for their material resources on African and other sub-continental countries.

The challenge to the U.S. economy is CHANGE **in the economic policy** and **international economic relations** and not "change" proposed by Senator Obama to become president.

As to Europe and its Euro, as I stated earlier, the ballooning of public debt in many EU countries, **the lack of harmony between the fiscal policy** of each state and **the monetary policy of the ECB**, the wave of bankruptcies of major banks that started in England with The Northern Rock in August 2007 due to toxic assets, has weakened the economic landscape of the EU. In principle, **the Euro is not the currency of a state**; but the currency of several states of the EU with different fiscal policies**. It is a virtual currency**. Its disorderly fluctuations in the past several years have created lack of confidence, unsatisfactory economic growth, unemployment and budgetary retrenchment, causing social unrest…

Several **countries** that are in the Euro zone **have not complied with the 4 convergence conditions fixed by the EU authorities** in the late 90s. If this trend of non-compliance continues in the future, then the economic crisis will go on in the EU and the Euro will still be vulnerable to disorderly fluctuations against the dollar and other currencies and who knows… EU needs new Jean Monnet and Robert Marjolin type architects for the European Unity and the Eurozone.

The Chinese did not have their George Kennan and his containment policy unfortunately. This moved neighboring Japan attack on Shanghai in 1937, creating havoc within the Chinese population. Since the end of the 2nd WW, other than the strained relations with Formosa's(Taiwan at present) Chiang Kai-check and the bombardment of the Quemoy and Matsu islands in 1956, China has never been at war outside and inside its territories. After the Cultural Revolution of Mao, and the correcting of the extremists errors, by adopting Deng Xiaoping's Path for economic restructuring, China in 25 years, has become world's second economic power house with a flourishing banking system, sustainable high economic growth, export driven and the strongest currency in the world holding over 2.5 trillion US Dollars as Central Banking reserves. Unfortunately, Papa Deng did not see his own realizations.

Russia can and will become a second China. However, its economy was hit hard by the global financial crisis. The Russian economy relies heavily on oil and gas revenues. It has oil and gas for the next 200 years and many other material resources in the Western and Eastern Siberian landscapes. It is part of BRIC, but has the lowest GDP growth 3.6%, compared to China's 10%, India's 7.7% and Brazil's 4.7%. By time, it has to create a sound banking system and develop its market economy and finance cultures.

In retrospect, we have to wait and see what major policies will be developed by major world economic players in the coming months, to appease the rising fear of currency wars, protectionism and trade wars. The IMF could play a major role in bringing about an environment of economic stability and cooperation between the partners.