

A New Twist *on* Clausewitz

*For Vladimir Putin,
military conflict is a
way of conducting
monetary policy by
other means.*

BY K. PHILIPPA MALMGREN

Conflicts often arise over access to commodities such as oil, food, shipping lanes, and physical territory. But the commodity that underpins the rising tension between the United States and Russia today is perhaps the most valuable commodity of all: price stability. President Putin accuses the United States of undermining the post-World War II system by playing Russian roulette with the U.S. dollar. As a creditor to the United States, he objects to quantitative easing with its inflationary intentions. He says the U.S. dollar can either be the glue that holds the post-war financial architecture together, or it can be a weapon that limits access and enhances pain through sanctions. But it can't be both. Putin describes America's approach as a "universal *diktat*" of selfish unilateralism that deserves every possible response, from new monetary institutions to confrontations involving fighter jets.

Russia detects that there are many other countries that are also increasingly uneasy about America's seeming "abuse" of power. This shows in efforts to change the voting balance in the United Nations at the Security Council, and between the IMF and World Bank. It shows in the desire to create new alternative institutions like the BRICS

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*German Chancellor **Angela Merkel** and Russian President **Vladimir Putin** exchange a word at the BRICS Summit held July, 2014, in Brazil. In Russia's view, a view shared by China, America's gamble with price stability has killed the peace dividend and is unleashing a new conflict premium.*

bank. It shows in growing willingness to pursue more transactions in currencies other than U.S. dollars.

This is in part because emerging markets now realize how much pain the United States can impose on them. Not only must they suffer from deflation created by a debt gorge in which they feel (rightly or wrongly) they were not willing participants. They have also been asked to revalue their currencies, thereby bearing even

more pain. Meanwhile, the U.S. Congress has shown no signs of action on the U.S. debt challenge, leaving the rest of the world at risk.

But the most neglected aspect of the argument is that the United States has begun to take unacceptable risks with price stability. The historic efforts to reflate the U.S. economy and those of other industrialized nations is perceived as a bald-faced effort to use inflation as a means of defaulting on debt America owes to foreigners, namely Russia, China, and other smaller economies. America is too sophisticated to announce it is not honoring its debts. Other governments see inflation as a clever and sneaky way for the United States to pay back less. The Federal Reserve may well say that this is ridiculous because there is absolutely no sign of any inflation. "We should be so lucky!" they would retort. But the emerging market nations understand the difference between measured inflation and asset price inflation even if the Fed conveniently ignores this distinction. They are also well aware that inflation takes time to stoke and such efforts are undeniable. Perhaps the key is that others don't share the Fed's assumption that it will be easy to control adverse global consequences.

Quantitative easing is playing a part in pushing up the price of property, and therefore rent, from Hong Kong and Singapore to Mumbai, Moscow, London, and New York. QE is also playing a part in the rise of protein prices. After all, food is a hard commodity in an inflationary world. Beef, pork, fish, and dairy prices continue to

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reach all-time record highs even if the root cause is debatable. QE is also meant to push stock markets and bond prices higher, and it has succeeded. Emerging markets thus face rapidly rising living costs, and therefore higher wage demands, against the backdrop of slow global growth. All this has contributed to the explosion of social unrest in China and Hong Kong, Singapore and South Africa, Latin America and even Ukraine. Worse, as they lose competitiveness and stability, the United States has emerged as a strong competitor in both manufacturing and energy production, pulling jobs and revenue away from emerging markets.

It may pay now to recall that the “great moderation” of inflation helped contribute to the growth of the peace dividend. For a long time, the dollar-led world helped improve everyone’s prosperity and thus reduced the prospect of conflicts. But now, in Russia’s view, a view shared by China, America’s gamble with price stability has killed the peace dividend and is unleashing a new conflict premium.

UKRAINE

Sandwiched between an overwhelming debt burden that cannot be paid off and a global slowdown, Ukrainians asked a simple question. Why is the wealth in my society being distributed to someone else and not to me? One way to solve the problem was to consider removing the then-current leadership, Russia’s ally, President Viktor Yanukovich. He was quite literally run out of town. The new leadership immediately suggested that Ukraine consider joining the European Union. After all, that model would provide a new way of generating and distributing wealth for the nation and might also bring other benefits such as cash, prestige, and even potential for NATO membership. It might also permit Ukraine to default on its largest creditor, Russia.

This forced Russia to consider the value of its asset. Russia may not have “owned” Ukraine, but it had had large influence. Ukrainian membership in the European Union would substantially diminish Russia’s reach into

Ukraine. This matters in a world where the value of Ukraine’s geographic position is potentially increasing daily. Ukraine contains gas pipelines that permit Russia to maintain its power over a Western Europe that has no easy alternative power supply. Ukraine contains the only warm water port Russia has ready access to: Sevastopol. Russia had expected to lose access to Sevastopol and began building alternative warm water ports at Tartus and Latakia in Syria. But the endless conflict in Syria has made it less easy to operate out of these locations. At one point, the Russians even removed all their military personnel. So Sevastopol became all the more valuable.

It goes almost without saying that for Russia, events in Ukraine risked the possibility of NATO appearing on their doorstep. Russians remain incredulous that the West does not see historic parallels with the Cuban Missile Crisis.

Ukraine is also one of the largest food producers on earth. This matters in a world where access to food and proteins is being hampered either by record high prices or by the kind of record high debt that inhibits borrowing. Consider the situation in Egypt. Record debt precludes borrowing. There has been insufficient wheat harvested there in recent years due to lack of money to even pay for the fuel needed to undertake the harvest. Egypt’s cries for their most important staple foodstuffs, wheat and bread, have gone ignored by the World Bank and the international community who are unwilling to extend credit. What an easy trade. Armed with Ukrainian wheat, Russia would be in a stronger

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position to negotiate with Egypt, effectively offering food in exchange for that old port the Russians had in Alexandria until Anwar Sadat aligned with the United States in 1972 and kicked them out.

This would solve another problem. The one great threat to Russia’s continued energy domination of Western Europe would be the development of the vast new gas fields that have been found in the Eastern Mediterranean. These are owned by Cyprus, although Israeli firms, in the main, hold the development licenses. Russia would also not favor an energy-independent Israel, given Russia’s alliances with Israel’s opponents

from Iran to Syria. Russia has already announced a permanent naval presence in the Mediterranean.

For all these reasons, Russia perceives events in Ukraine as having been caused by the United States and the West. It is not their fault pro-Russian populations wish to join with Russia. Even Germany has demonstrated that it believes its relationship with Russia has a high or higher priority than that with the United States

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and the West. The Germans know that no one in Spain or France or Italy is going to be buying a Mercedes for some time to come. They are also supremely aware of their energy dependence on Russia, given the decision to shut down nuclear power. So when it became public that the United States was spying on Germany, the Chancellor kicked out the CIA station chief and his team. In response, the United States offered Germany membership in the exclusive “Five Eyes” spying program. Germany not only rejected this offer. The Chancellor ordered the BND, Germany’s intelligence agency, to spy on the United States, and required that sensitive Berlin communications take place with music playing in the background and be written on typewriters to hide content from the United States going forward. Russia’s food ban drove the wedge between Europe and the United States even further by forcing German and EU politicians to choose between their principles and the economic interests of their domestic farming voters. The latter won, as one would expect.

Russia today is prepared to challenge America’s dominant role in many ways. The new BRICS bank and the calls for oil to be denominated in rubles, renminbi, and euros all reflect efforts to push America and the U.S. dollar out of their lead role. If the West is prepared to use financial sanctions and to kick Russia out of the G8, MasterCard, and even the SWIFT banking payments system, then Russia argues it must build its own alternatives, which they now are doing. Today the Russian ruble is devaluing to historic lows. One may say this weakens Russia’s case. But Russians see competitive devaluation as a form of warfare. These were the people who were prepared to burn Moscow to save it from the Germans.

GLOBAL CHALLENGE

Events in Ukraine have given Russia increased confidence to challenge the United States and its allies elsewhere, too. There is little fear because Russians perceive President Obama’s unwillingness to act in Ukraine and his determination to blame Russia for all of Ukraine’s troubles. When Putin uses the word “Novorussia,” as he has done recently, it implies an expansionist angle. Sure enough, the Finns, the Japanese, the British, and others complain of Russian air incursions. Sweden recently found an “unidentified” foreign submarine practically in the middle of Stockholm. The nabbing of an Estonian “spy” by Russia and a Russian “spy” by Estonia at the border between the two countries presages more such John le Carré-like stories to come. Obviously Russia continues to face off with the United States in the Middle East by providing support to America’s opponents and by questioning America’s purpose there. Russia obviously outmaneuvered America in Syria and Cyprus. Both Russia and Iran now suffer enormously from low oil prices and have announced an intelligence-sharing agreement, implicitly aimed at disrupting America’s interests in the region.

Russia is abandoning mutual weapons inspection treaties in Kaliningrad and has held the largest military exercises in the Baltic Sea since the Cold War. Putin also just announced extensive militarization of key areas of the Arctic. All this reminds us how very quickly the Russians can establish military presence and impose strategic threats. Perhaps most troubling are the many signs that the intermediate-range nuclear weapons treaties that took so long to secure can be undone with a few weapons tests. Russia is already moving in this direction with recent test launches from submarines in the Barents Sea into Kamchatka.

Russia today is arguing that the U.S.-led postwar system is no longer serving everyone’s interests. They have many new allies in this and they seem prepared to use every possible tool. As confidence in the United States is reduced, opportunities to create a new financial architecture and new political or even military alignments present themselves. Arguing that America is playing with the rest of the world through its role as linchpin of the global financial system and U.S. dollar price stability, then Russia, in collaboration with China and others, should gather new allies and present alternative frameworks that might work to their advantage better. Russia today is pursuing a new twist on Clausewitz: military conflict as a way of conducting monetary policy by other means. ◆