Why the World Hates America

The economic explanation.

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Since September 12, 2002, the day President Bush delivered his "League of Nations irrelevance" speech at the United Nations, the United States has used the Iraq issue as a fulcrum to revamp the way it relates with the rest of the world. The UN has been put on probation, Germany and France into the outer darkness, NATO east of the Oder-Neisse, North Korea in the cross-hairs, the al-Saud and Moubarak families on a forced march to *perestroika*, etc.

At the same time as the United States reshuffled world military and political power relations in this way, it also reshuffled world economic relations, a fact largely unnoticed in the excitement of the Iraq debate. The emerging "new guard" at the Federal Reserve (e.g., Ben Bernanke) and John Snow's emerging team at the Treasury have served notice, first to the European Union last September and then to the G-7 at the end of February, that the world's number one imbalance is not the U.S. current account deficit but their capital account deficit. This imbalance can only be redressed by lifting the rates of return on capital in Europe and Japan and in no other way. At the end of the day, either Europe and

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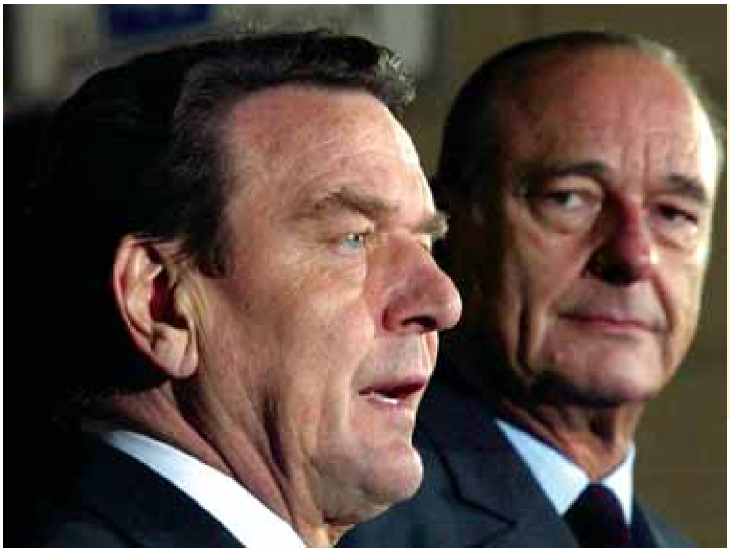

AP/WIDE WORLD PHOTOS

THE FRANCO-GERMANIA DECISION

German Chancellor **Gerhard Schroeder,** *left, and French President* **Jacques Chirac:** *At the end of the day, either Europe and Japan will execute "Anglo-Saxon"-style reforms to lift their rates of return, or the United States will become the "sole financial intermediator" of the world, with the current account deficit becoming the equivalent of the currency-issuance function of the world's "sole central bank."*

Japan will execute "Anglo-Saxon"-style reforms to lift their rates of return, or the United States will become the "sole financial intermediator" of the world, with the current account deficit becoming the equivalent of the currency-issuance function of the world's "sole central bank." With 40 percent of industrialized-world GDP, 50 percent of total world defense spending, 60 percent of the total world growth rate, 70 percent of tradable world financial wealth, and 80 percent of world military R&D, the United States could handle this.

Before we proceed further with the specific implications of this emerging situation, a parenthesis is necessary to deal with the misplaced and rather naïve charge of "American imperialism." America's critics are facing a far worse problem than a mere "American Empire" that exists only in their imagination. They are facing the possibility of Europe and Japan becoming "failed states," thus surrendering to the United States the status not of "sole superpower" but that of "sole non-failed state."

NOT AN EMPIRE

The classic western empires of the past—Athenian, Roman, and British Empires—all acquired and maintained their power through possession of overseas resources (economic, military, etc.) and used that power to preserve and augment these overseas resources. This experience of twenty-five centuries has distilled two criteria for judging whether a great power is empire: (1) it must depend for its existence upon overseas resources (economic, military, etc.); and (2) its ruling elite must be more or less unencumbered by the constrains of domestic self-government in the pursuit of its overseas interests. The United States today does not meet these criteria. Examples of other great powers of the past that did not meet these criteria and, therefore, are not ranked as empires were the Spartan power that defeated Athens and the France of Louis XIV. Despite their repressive internal features and despite their overwhelming power, neither of these powers was at the time, nor is now, thought of as "empire."

The Athenian Empire depended upon the collection of taxes, military conscription, and land grabs from allied/subject states. In its heyday, the Athenian Empire was collecting taxes from its foreign subjects sufficient to subsidize each Athenian citizen to the tune of a $15,000-per-year modern equivalent. The Roman Empire depended upon land grabs, taxes, and military conscription of its subject populations. Senatorial families and imperial favorites controlled the state monopolies of food staples, metals, and other raw materials supplied by the subject nations. The British Empire depended

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upon land grabs, military conscription of subject populations, overseas raw materials, and overseas markets. The British East India Company and other royal franchises were the greatest single influence over the government budget and the Bank of England.

None of these criteria apply to the United States. The United States expends its own treasure to provide security for its allies. It does not engage in land grabs. It does not conscript foreign populations into its armed services. It does not depend upon others for raw materials and markets, but rather others use it as their market of last resort. American international involvements are such that they do not, generally speaking, lend themselves to the special enrichment of particular political elites that handle these involvements. There is no American equivalent of the British East India Company that managed colonial resources and markets for the British Empire, or of commercially enfranchised Roman Senatorial families and imperial favorites who administered imperial monopolies, or of Athenian "hellē notamiae," the "empire-treasurers" who collected and managed the taxes of the subject states.

Put in modern terms, the sources of wealth of the Athenian, Roman, and British empires—their "capital accounts"—were overseas. Empires run capital account deficits as they depend upon claims on overseas-generated wealth. The sources of U.S. wealth are domestic. The United States runs capital account surpluses that represent overseas claims on U.S.-generated wealth—the exact opposite of the imperial financial arrangement. In strictly classical economic terms, the capital account surplus of the United States alone would qualify her not as "empire" but rather as "colony." Her status as importer of last resort would have the same effect.

Is there a possibility that the United States might someday become an empire? It cannot be ruled out. But it is not likely, so long as there exist no overseas sources of wealth creation that are greater than domestic U.S. sources of wealth creation. If (a) such great overseas sources were to emerge in future; and if (b) they were to become greater than domestic U.S. sources; and if (c) they were to come under the control of U.S.-based political elites, then and only then might some future American elite emerge to subvert domestic institutions of republican self-government and create the conditions for an American Empire.

To repeat: The United States could only become an empire—i.e., a political system in which domestic self-government is overwhelmed by mighty overseas-based economic interests—if there existed overseas sources of wealth that were greater than domestic U.S. sources of wealth, and if these were to come under the control of American elites. Today, such overseas sources do not exist. And those sources of modest wealth that do exist (China, Japan, the Eurozone) are securely beyond American control and, just as securely, beneath American aspiration.

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THE UNFOLDING U.S. STRATEGY

Everything the Bush administration did in relation to the Iraq crisis since the September 12, 2002, speech of the President at the United Nations is in conformity with the *National Security Strategy of the United States of America,* a doctrinal document published last September. As a result, critics of the Administration who last summer had insisted that the United States "go to the UN" now wish the United States had not done so. The critics had hoped to produce a situation whereby the United States derived legitimacy from the UN. The opposite result now obtains: the UN derives its legitimacy from the United States.

The *National Security Strategy of the United States of America* which has produced this result set out to achieve two things: first, to preserve American military supremacy against any future combination of potential adversaries and, second, to employ U.S. military power in the service of a global economic and political agenda. The economic agenda is:

- Pro-growth legal and regulatory policies to encourage business investment, innovation, and entrepreneurial activity;
- Tax policies—particularly lower marginal tax rates—that improve incentives for work and investment;
- Rule of law and intolerance of corruption;
- Strong financial systems that allow capital to be put to its most efficient use;
- Sound fiscal policies to support business activity;
- Investments in health and education that improve the well-being and skills of the labor force;
- Free trade to be pursued by global, regional, and bilateral agreements.
- Aid to poor countries to increase, but to be conditional on recipient governments' fighting corruption, encouraging entrepreneurship, investing in health and education, respecting human rights, and applying the rule of law;
- Reform of the World Bank to conform to the above goals;
- Insistence upon measurable results to ensure that development assistance is actually making a difference in the lives of the poor;
- Increased development assistance in the form of grants rather than loans.
- Opening of societies to commerce and investment.

The political agenda is to export democratic revolutions abroad on the grounds that:

- *"[S]ocial and political freedom is the only source of national greatness"; and*
- *"[O]nly nations that share a commitment to protecting basic human rights and guaranteeing political and economic freedom will be able to unleash the potential of their people."*

All this defines the United States as a "challenger power" rather than a "status quo" power, in diplomatic parlance. The clash at the UN Security Council with France and others demonstrates this fact. What France as a status quo power, along with her allies, objected to was the proposition that Iraq be used as a fulcrum to effect the democratization of the Middle East. Despite these objections, however, at the moment of this writing, events

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Deutschland Blues

To summarize Germany's current economic problems: The government-run pension program ran a $3 billion deficit last year, for the first time. The deficit will be greater this year and will be financed by more government borrowing. Unemployment has hit 11 percent—a post-war high. Germany's Mittelstand, the backbone small- and medium-enterprise sector, is riven by the highest-ever recorded bankruptcy rates—up 62 percent over the previous year.

The German banking system as a whole is running serious losses despite emergency fire sales of assets. The federal budget deficit hit 3.7 percent of GDP and is expected to go higher this year, despite European Commission protests that Germany has violated the Maastricht guidelines. The government's major legislative initiatives—tax reform, health care reform, pension system reform, and labor market reform—have collapsed due to parliamentary gridlock. With negative GDP growth in the last quarter of 2002 and negative growth so far in the current quarter, Germany is in recession.

—C. Zoakos

in Europe and the Middle East have already started moving it the direction of the post-Saddam universe envisaged by the current U.S. strategy.

POST-SADDAM MIDDLE EAST

As of last December, Egypt and Saudi Arabia's repressive regimes, under pressure from Washington's Iraq strategy, have launched survival strategies akin to *perestroika*. Both intend to propose wholesale *perestroika* to the entire Arab world, as well. One effect will be to facilitate American plans to create a Palestinian state purged of terrorism and economic corruption by 2005. This was the deadline that President Bush set in his June 24, 2002, policy speech regarding the Israeli-Palestinian problem.

Though little noticed in the heat of the debate over Iraq, this just-launched Arab *perestroika* will have far-reaching effects on repressive Arab political structures in the region. These effects will be at least as far reaching as those that followed Mikhail Gorbachev's similar experiment in the late Soviet Union, with similar probable outcomes as Gorbachev's *perestroika*.

France's deeper, lurking problem is the confluence of three crises that feed each other: its pension crisis, its youth unemployment crisis, and rising crime rates.

In the post-World War II period, the repressive political structures of the Arab world survived through the successive use of the following broad legitimizing frameworks: militant "Arab nationalism" in the 1950s; militant "Arab socialism" in the 1960s; militant brandishing of the "oil weapon" in the 1970s; militant Islamicism in the 1980s; and militant exploitation of the alibi provided by the various Palestinian intifadas in the 1990s. As each of these legitimizing frameworks collapsed, the regimes ended up weaker than before. *Perestroika* is the last remaining survival strategy.

POST-SADDAM "OLD EUROPE"

With the lifting of Iraq-related geopolitical uncertainty, the market will turn its attention to the sharp deterioration of economic fundamentals in Europe that has long gone unnoticed. The long-term result will be punishing for French and German stocks, government bonds, and the euro.

Four key features define Europe's economic crisis. The four have not yet been adequately reflected in asset prices because of the preoccupation with Iraq:

1. Shrinking domestic demand;
2. Declining productivity;
3. Rising structural (not seasonal) unemployment; and
4. The simultaneous eruption of pension system crises in Germany and France.

A corollary problem is the endemic, Japan-like banking crisis in Germany. This is a crisis of the euro in disguise.

A corollary problem is the endemic, Japan-like banking crisis in Germany. This is a crisis of the euro in disguise. Not only was the euro its cause (not ignoring the German-specific problems of the sector), but any eventual solution will involve the euro. The size of bailout that will ultimately be required can only be handled by the European Central Bank, and the ECB's only available instrument in this matter is the manipulation downward of the euro's exchange rate.

The French economy is in better shape than that of Germany, but serious problems lurk. At present, domestic consumption is down -1 percent, industrial production is down -1.7 percent, and unemployment is at 9 percent. GDP growth for 2003 is forecast for 1 percent (same as last year) but the government has planned its budget on the assumption of 2.5 percent GDP growth—unsupported by any data. France's deeper, lurking problem is the confluence of three crises that feed each other: its pension crisis, its youth unemployment crisis, and rising crime rates.

The year 2020, a mere seventeen years away, is expected to see a 1:1 ratio of employed to unemployed, with the situation deteriorating rapidly thereafter. The government of Prime Minister Raffarin has therefore committed itself to serious pension reform by no later than this year. But the government's attempt this month to launch negotiations for pension reform only provoked the predictable mass demonstrations. Far from considering any belt tightening, the private-sector trade unions demanded a *lowering of the retirement age* by 2–3 years, and an *increase in benefits* to match those enjoyed by public-sector retirees. For their part, employers are encouraging early retirement as an expedient for reducing their labor force while sidestepping existing rigid job-protection laws.

The result is soaring youth unemployment alongside the ticking time bomb of the pension system. Less than half of college and high school graduates found employment in 2002 and total youth unemployment (for those under twenty-five years of age) reached 22 percent—far higher than the eurozone average of 16 percent.

This bulging mass of youth unemployment is feeding a sharp rise in criminality. The government's response is a draconian, some say repressive, campaign of law and order spearheaded by Interior Minister Nicolas Sarkozy, an ambitious politician who aims to replace Raffarin as prime minister. Some believe that Sarkozy's new "law and order" legislation, which imitates the program of populist extreme right-winger Jean-Marie Le Pen, is partly designed to be used against strikes and other labor unrest.

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NEW EUROPE/OLD EUROPE LONGER-TERM PROSPECT

After their initial, short-term decline following Saddam's removal, European assets and the European economy would *not* necessarily recover. The reason partly lies in the period of political paralysis likely to ensue in the affairs of the "European integration" project.

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The paralysis will be caused by the fact that the Iraq crisis has *already* ruptured European unity, and it is not yet clear how unity will be restored. Among the existing fifteen EU members, eight are in favor of a close security alliance with the United States, and seven are against. Those who favor it are the United Kingdom, Spain, Italy, Portugal, Denmark, the Netherlands, Greece, and Ireland. Those who are against are France, Germany, Belgium, Austria, Luxembourg, Sweden, and Finland. In addition, thirteen East European countries, ten of them EU candidate members joining next year, also side with the United States.

This rift reaches beyond the immediate issue of Iraq and security relations with the United States, and touches directly upon the future character of the European Union. It is rooted in unresolved internal conflicts about the future of Europe.

From its beginning, the European project was a compromise between two rival perspectives. One was predominantly *political*, aiming for the political fusion of European nation-states into a new superpower under the guidance of France and supported by Germany in a secondary role. The other was predominantly *economic and commercial,* envisaging an ever-expanding free trade area within which liberal economic reforms would replace the old, rigid protectionist structures.

In the past twenty years, the French-led political model predominated while paying perfunctory lip service to the economic/commercial model. With the Iraq crisis, this twenty-year arrangement has come to an end.

A renewed push for the Franco-German political model is difficult to imagine now, especially with Germany in deep crisis, and France in growing isolation in strategic and security matters. This weakens the impulse toward political integration, encouraging the economic/commercial model. The so-called “new Europe” of the East—pro-American, pro-free enterprise, increasingly optimistic, and hungry for economic success—would be encouraged to try and work out beneficial arrangements with the United Kingdom, Spain, Italy, and, most likely, with the United States itself, in a series of bilateral free-trade agreements akin to those Washington crafted with Jordan and Singapore.

France and Germany will probably accommodate eventually, for lack of viable alternatives. If they do, a period of European economic prosperity will gradually take hold. Europe would then grow to become a credible commercial competitor and partner to the United States. For France and Germany, this would require scrapping their existing systems of economic protectionism—something impossible under these two countries’ current domestic politics.

Hence any progress toward this “new Europe” would need to wait for a change of government in both Germany and France. Such a change would also be a precondition for the resumption of normal relations with Washington. The problem lies in that no such change of governments is on the horizon.

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Not in France, because the French Socialist party is in too deep a crisis to be able to provide an alternative for a long time to come. And if the center-right decided to replace Raffarin with Sarkozy as prime minister, it is not likely that Washington would be willing to associate too closely with a right-wing government that mimics Jean-Marie Le Pen’s social policies.

Not in Germany, because the opposition Christian Democrats—though strong enough to enter the government—so far seem to be uninterested in associating themselves with the severe economic crisis they see coming. They would rather wait for the crisis to erupt and present themselves as saviors and reformers.

Thus, while Europe waits for France and Germany to adjust to the new, post-Saddam realities, it will not likely be able to find its stride toward its new, more commercial and economic and less political future. Serious European growth prospects will remain on hold until governments change in France and Germany.

U.S. “CURRENT ACCOUNT DEFICIT” AND CAPITAL FLOWS

These dire prospects for the Eurozone create an intractable problem for those who argue that the U.S. dollar is overvalued: Overvalued relative to what? The euro? The yen? The Iraqi dinar? Or gold, the only non-wealth-creating competitor? Time to review and question our textbook assumptions about how the world’s national balance sheets relate to each other.

From 1995 to date, the United States has only appeared to act as the “*importer* of last resort.” In reality, the United States has been the world's "*financial intermediator* of last resort."

The U.S. function has essentially been one of mobilizing a growing portion of the global savings pool and channeling it into global investment opportunities. The largest portion of these global investment opportunities happened to be in the United States, by virtue of higher rates of return and higher labor productivities. Another large portion of global investment opportunities was in China, by virtue of extremely cheap labor costs.

The first resulted in huge net capital inflows into the United States, which in turn produced the U.S. current account deficit as a side effect. The second resulted in huge foreign direct investment (FDI) flows into manufacturing projects in China, which produced a vortex of permanent global deflationary pressure.

The U.S. case has worked as follows: net capital inflows stimulate productive economic activity, which in turn generates demand for capital goods and producers' supplies, which in turn is satisfied by increased imports and increased trade deficits. Over two-thirds of U.S. imports are capital goods and industrial supplies, and less than one-third are consumer goods. The argument that U.S. trade deficits are caused by some insatiable consumer binge is an ignorant myth. U.S. trade deficits are caused by enormous capital inflows that are seeking higher rates of return. These capital inflows are far in excess of trade deficits.

This being the case, the fundamental structural imbalance of the world economy is not the U.S. current account deficit but the pitifully low rates of return in Europe and Japan. This is what we have argued since the emergence of the phenomenon in 1994–95, and this is what the U.S. government formally concluded in the autumn of 2002.

Unless this fundamental structural imbalance is redressed, the world economic system is heading for major trouble. This is something that the United States views as contrary to its national interests and its national security interests, and is therefore committed to avoiding. There are only two ways to eliminate the disparity between the higher U.S. rate of return and the lower rates of Europe and Japan: Either lower the U.S. rate of return or lift the European and Japanese rates of return.

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U.S. officials have argued since last November that it is irrational to ask the United States to pursue policies of deliberately lowering its rate of return and that, therefore, the economic partners of the United States must aim to raise theirs. But so long as America's Japanese and European partners are politically unable to implement those structural reforms that would lift their rates of return, they resort to the specious argument that not capital inflows, but rather the U.S. trade deficit, is the world's fundamental imbalance. This argument sidesteps the stark fact that if the United States were to reduce its imports, Europe and Japan's economies would tank.

The truth of the matter is that the economies of Europe and Japan have low rates of return because they are handicapped by politically dominant and economically uncompetitive elites. These elites understand only too well that the reforms required to lift their economies' rates of return are the same reforms that would deprive them of the domestic political dominance they now enjoy.

Here is the root cause of the soaring anti-Americanism of the 1990s: ensconced elites resent the fact that the U.S. economy is forcing them to abandon their elite status, if their nations are to be economically viable. ◆