Imperialism, Globalization and East Asia After September 11

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It must be a sign of the times we live in that a conference on the 'Lessons of Empire' in September 1993 has so little consideration of recent economic theories of modern or capitalist imperialism. A century ago, there was a lively debate about contemporary imperialism principally associated with the English liberal John Hobson. Although he changed his view of imperialism over time, in his classic book on the subject, Hobson found imperialism objectionable for at least two main reasons. First, he believed that imperialism was the consequence of the emergence of oligopolistic or monopolistic power due to the concentration of capital, which negated the liberal ideal of competitive capitalism. Second, he believed that the international expansionism associated with imperialism was due to the undue political influence of such powerful monopolies, violating liberal democratic ideals.

Lenin was to draw upon Hobson and Rudolf Hilferding's analysis of contemporary finance capital, involving an alliance of banks with industrial monopolies, to make a trenchant argument for what later became the Third International's objection to the national loyalties of the social democrats of the Second International. In doing so, following Marx, he argued that the inherent tendencies in capitalism towards concentration and centralization meant that Hobson's imperialism was a consequence of the evolution of capitalism, rather than an aberration, as suggested by Hobson.

Later, Lenin went on to argue that imperialism implied that while the immediate task of struggle in capitalist economies was socialism, the struggle against imperialism for national liberation was the priority in the colonies and semi-colonies. This struggle for national liberation would involve anti-colonial multi-class alliances. As is well known, the economist Joseph Schumpeter later argued that imperialism was in fact a pre-capitalist atavism that would disappear with the fuller development of capitalism.

The contemporary context for discussion of imperialism and empire is remarkably different. In some respects, post-Second World War imperialism has been significantly different from the pre-war colonial empires. While elements of continuity have been captured by the slogan 'neo-colonialism', aspects of discontinuity were recognized by early uses of the term 'post-colonialism'.

After all, post-war US hegemony began wıth Bretton Woods, the Cold War and the Marshall Plan, rather than ‘gunboat dıplomacy’ or ıts contemporary and later equıvalents. The long record of US mılıtary and other ınterventıons abroad for over two centurıes, and dırect US colonıalısm sınce the Spanısh-Amerıcan war does not ın itself negate the many novel aspects of US hegemony, whıch also changed over tıme. And recent attempts to rethınk contemporary ımperıalısm on more post-modern and post-colonıal lınes, e.g. ın terms of ‘network hegemony’ and transnatıonal corporate collusıon, should not obscure the changıng realıtıes of US hegemony, especıally after the end of the Cold War.

Nineteenth century English liberalism espoused both economic and political liberalism. Hobson invoked liberalism to oppose the oligopolistic economic implications and political influence of monopolies who represented the negation of liberalism in both senses. Hence, from such a liberal perspective, it would be consistent to promote both economic and political liberalism. The problem with most – though not all -- contemporary economic neo-liberals is that they insist on laissez faire economic conditions while not opposing the emergence, consolidation and influence of oligopolistic modern corporations, often by their emphasis on private property rights. Hence, contemporary economic neo-liberals can be described as inconsistent, contradictory and even opportunistic from such a liberal perspective.

Some economic neo-liberals are not political liberals, although recent political discourse has generally tended to associate economic liberalism with political liberalism. Many would insist on rolling back the role, power and influence of the state in both economic and political senses. However, many of the institutions promoting economic liberalism have not insisted on liberal political institutions and processes, claiming that political interference would be beyond their mandates. Not surprisingly then, economic liberalism has been imposed in a variety of illiberal conditions, often enhancing foreign corporate economic interests. However, illiberal political conditions are not necessary for contemporary economic imperialism, and may well be the less preferred political option. After all, imperialism with consent, or Gramscian hegemony, is generally thought to be far less costly and problematic than contemporary colonialism.

The recent revıval of ınterest ın empıre and ımperıalısm has been prompted by recent developments. It arises after the apparent victory of the West in the Cold War and the apparent demise of existing state socialisms. This political triumph is often linked to the rise of so-called ‘neo-liberal’ economic ideology including a benign, if not enthusiastic attitude towards economic liberalization, including its transnational or cross-border component termed globalization, whıch the rest of thıs paper wıll soon return to. But the ımmedıate ımpulse ıs the changed world sıtuatıon after September 11, 2001. As ıs well known, thıs has been ınvoked not

only to legitimize the military invasions of Afghanistan and Iraq as well as a more belligerent international stance more generally, partially expressed in terms of US unilateralism in world affairs.

To be sure, unilateralism is certainly not the isolationism some commentators sometimes invoke. And the Bush administration is hardly unconstrained, sometimes alternating between unilateralism when desirable, possible or feasible, and multilateralism when unavoidable or necessary. Some perceive this as a 'hard cop, soft cop' strategy involving the likes of Donald Rumsfeld and Colin Powell, while others see this as necessary to unite the disparate elements supported the second Bush administration.

And the shadowy, if not sinister rise to influence of the so-called 'neo-conservatives' is often cited in this context. Quite understandably, the 'neo-cons' claim to be political liberals in so far as they espouse a liberal democratic political agenda, at least for the Middle East, and would prefer to dissociate themselves from the patrician conservative patronage of fascists as well as other pro-US despots and reactionaries characteristic of the Reagan and older Bush administrations. But as is also well known, they have not been reluctant to forge alliances with others who will support the Netanyahu wing of the Likud Party.

Clearly, these are interesting new times, where many old alliances are under stress and coalitions are being put together or abandoned in response to new developments. Most importantly for our purposes, this new situation has given rise to new justifications for assertion of imperial dominance, whether in the form of direct unilateral occupation (even if by the rarely fully specified 'coalition of the willing') or involving some multilateral administration (NATO or UN).

To be sure, justifications for international inequality and dominance have been around for a long time, though there has been a perceptible revival in the last two decades or so with renewed rightwing hegemony in the Anglophone West (e.g. with the revival of interest in 'social darwinism', 'failed states', 'vampire states', 'rogue states', etc.). And as is now well known, the initially triumphalist 'end of history' a la Fukuyama soon gave way to the Bernard Lewis-Samuel Huntington warnings about a 'clash of civilizations' between the Judaeo-Christian North Atlantic West (a recent invention, if there was one) and the rest. The rest, of course, principally referred to the then economically ascendant and ostensibly Confucian East Asia, led by Japan and now China, and Islam, conveniently disowned by its older Abrahamic brethren.

But rather than dwell in the realm of the political and cultural, let me instead urge a return to the economic, to consider whether recent economic globalization has changed international economic relations in ways which either undermine or strengthen international dominance and exploitation. And while there is no automatic and simple relationship between the economic and the political,

especially when security considerations seemed to have overwhelmed economic ones, there is good reason to believe that economic imperialism is alive and well, albeit considerably transformed.

To be sure, contemporary economic imperialism predates recent empire talk and is understood here as a consequence of the development and restructuring of capitalism on a world scale since the late nineteenth century. Such a view of capital accumulation recognizes its changing character, not unrelated to developments in technology and social organization. Such a view of imperialism is obviously influenced by the pioneering work of the English liberal, John Hobson, which in turn influenced the work of others including Vladimir Ilyich Lenin.

This view associates imperialism with monopoly capital, or oligopolistic capitalism, but also recognizes how much the processes, mechanisms and institutions of imperialism have changed over what may be called 'the long 20th century'. Hence, imperialism is associated not only with contemporary economic globalization, but also with the earlier period of globalization, from the end of the 19th century until the First World War. By identifying it with oligopolistic capitalism, this view distinguishes modern imperialism from earlier imperialisms associated with other economic systems. The end of colonialism, the post-war Golden Age, significant changes in international economic specialization, serious efforts at multilaterial institution building, initiatives to reduce international inequalities and promote economic development as well as the multifarious developments associated with globalization more generally have all transformed the international economic and political relations that characterize contemporary imperialism. As the next part suggests, much of what are called economic globalization and liberalization at the international level has served to consolidate and deepen contemporary imperialism. The earlier period of crises and labor movement led reforms in advanced capitalist economies as well as de-colonization in Africa and Asia expanded the scope for welfare state and developmental state interventions, which regulated, but never undermined capital accumulation.

Recent work (e.g. Kozul-Wright 2003; Nayyar 2003) has emphasized that the current phase of economic globalization is far from unprecedented, with some trans-border flows (e.g. labour) in the earlier phase from the last third of the 19th century – associated with what Hobson and Lenin called imperialism – even exceeding contemporary flows in relative, if not absolute terms. There are many other important differences between the two periods, but none of these fundamentally undermine the assessment of the current period as one still characterized by what they termed economic imperialism.

Imperialism and Globalization

It seems necessary to begin this quick review of how recent economic globalization has advanced imperialism by noting that globalization means different things to different people. At least five aspects of recent economic globalization has served to enhance external economic domination, including the liberalization of foreign direct investment (FDI), international finance and international trade. In fact, such economic liberalization has involved re-regulation, rather than deregulation. In two other areas, regulation has been clearly and unambiguously strengthened, namely intellectual property rights and the new institutional economic governance.

Foreign Direct Investment

The higher rates of return to foreign direct investment (FDI) are generally considered to be a major aspect of imperialism. These higher returns are usually explained away by neo-liberals as including rewards for taking higher risks by investing abroad. Others would suggest that such investments are able to secure higher returns because of the monopolistic powers and political influence usually associated with such investments. FDI is considered to be better able to capture rents, to use the mainstream economic term (Khan and Jomo 2000), or larger surpluses or super-profits, depending on one's terminological preference.

With the post-war demise of the pre-war colonial empires and the consequent availability of market access, microeconomic analysis of the firm was extended to consider the international, multinational or transnational corporation (TNC). The analysis of FDI was thus extended and reconsidered in terms of the interests and dynamics of firm expansion and responses to the changing imperatives of capital accumulation. Such analysis has involved the analysis of competition and competitiveness, in terms of 'market power' as well as (mainly production) 'cost considerations'.

In the economics literature, the debate on the pros and cons of FDI continues without any consensus, though there is little real disagreement that gains from 'green-field' FDI are more likely than from other types of FDI such as mergers and acquisitions as well as reinvestment of profits. However, it has been common to exaggerate the role of FDI in economic development, both historically and more recently. For example, the role of such FDI in the East Asian miracle was modest, accounting for less than two per cent of gross domestic capital formation during the high growth periods in Japan, South Korea and Taiwan compared to the developing country average of 5-6 percent and Malaysia's own double digit percentage.

In the aftermath of the 1997-8 Southeast Asian economic crises, it is now acknowledged that the region's industrial capabilities had been much weaker

because of greater reliance on and domination by FDI. Foreign industrial domination also meant that public policy in the region came to be dominated by financial rentier interests, which contributed to greater financial fragility and vulnerability (Jomo 1998).

The 1999 UNCTAD *World Investment Report* shows that most FDI in the 1990s has been for mergers and acquisitions (M&As), not 'green-field' FDI that would create new productive or economic capacities. In developing countries, M&As have mainly involved acquisitions, particularly during periods of distress, especially after the ever more frequent currency and financial crises of recent times. Such 'fire-sale FDI' has reduced the likelihood of superior management emerging due to M&As.

International Financial Liberalization

Three expected gains touted by advocates of international financial liberalization have simply not materialized. First, there have not been net flows of funds from the capital rich countries to the capital poor, except to East Asia during the early and mid-1990s until the massive and sudden capital flight of 1997-8. Elsewhere, capital flight from other developing and transitional countries has grown. Second, the expected lower cost of funds has not materialized. While some margins have declined, financial deepening – involving the development of new financial instruments resulting in more layers of financial intermediation -- has increased the variety of rentier claims. Third, while financial deepening has undoubtedly reduced some of the old sources of financial volatility and vulnerability, it has also introduced new sources (e.g. hedge funds), resulting in the greater frequency and magnitude of currency and financial crises.

Meanwhile, the policy influence of financial interests has grown, especially with greater central bank independence, resulting in greater deflationary macroeconomic policy bias, whereas the post-war record suggests that moderate inflation has contributed to growth. Financial liberalization has also undermined financial policy instruments to accelerate development, which even the World Bank acknowledged helped promote growth and structural change in East Asia (World Bank 1993). For example, though 'directed credit' -- specially discounted and targeted to encourage investments in priority sectors or activities – has been very important in almost all cases of 'late industrialization' (World Bank 1993), many such financial institutions, facilities and instruments have been undermined and eliminated with financial liberalization to counter 'financial repression' and 'restraint'.

Through its agreement on financial services, the WTO has furthered the IMF and market promotion of international financial liberalization since the 1980s. But the series of international currency and financial crises since the early 1990s have

underscored the greater volatility and vulnerability of international finance as a consequence. By 2003, even the IMF (Kaminsky and Schmukler 2003; Prasad, *et al*. 2003) and the influential *Economist* weekly have come to acknowledge, albeit reluctantly, the minimal gains from and the grave dangers posed by international financial liberalization, especially on the capital account.

Kaminsky and Schmukler (2003) found that although much of the 'finance literature' claims that 'deregulation is beneficial, with liberalization reducing the cost of capital', the 'crisis literature' suggests that 'booms and busts in financial markets are at the core of currency crises and that these large cycles are triggered by financial deregulation'. Prasad, *et al*. (2003) note that 'the volatility of consumption growth relative to that of income growth has on average increased for the emerging market economies in the 1990s, which was precisely the period of a rapid increase in financial globalization'.

This clearly contradicts claims by proponents of financial liberalization that 'the volatility of consumption relative to that of output should go down as the degree of financial integration increases, since the essence of global financial diversification is that a country is able to offload some of its income risk in world markets'. Most damningly, Prasad *et al*. observe that 'an objective reading of the vast research effort to date suggests that there is no strong, robust and uniform support for the theoretical argument that financial globalization per se delivers a higher rate of economic growth'.

International Trade

There continues to be an ongoing debate as to whether international trade should be seen as part of economic imperialism (e.g. Gallagher and Robinson; Emmanuel). David Ricardo's theory of comparative advantage is often dishonestly invoked to justify international trade, while even later neoclassical economic elaborations/distortions by Heckscher-Ohlin and Stolper-Samuelson cannot honestly be invoked to explain the injustice of international trade. While this is not the place to critically review international trade theory and justifications for international trade liberalization, there is widespread recognition of what is widely recognized as 'unfair trade'. Several observed long-run trends have undoubtedly contributed to such unfair trade, which is often linked to patterns and practices of international economic exchange dating to the colonial period as well as the ongoing unequal economic power of trading partners, not unrelated to imperialism:

- deteriorating terms of trade for primary products compared to manufactures, observed in the middle of the 20th century by Raul Prebisch (1950) and Hans Singer (1950).
- deteriorating terms of trade for tropical primary products compared to temperate primary products a la W. Arthur Lewis (1977).

- more recent price deflation of ‘generic manufactures’ produced by newly industrializing countries’ industries compared to those products with strong intellectual property rights, i.e. technological monopolies, now strengthened by the WTO’s TRIPs agreement.

There are probably potential gains from trade due to international specialization, while much existing protection is more burdensome than advantageous to development. However, advocates of trade liberalization ignore ‘transitional costs’ (e.g. employment and income losses due to trade liberalization, including the destruction of existing industries, jobs, etc.) and that there is no guarantee that better new jobs will replace lost jobs as suggested by modeling exercises operating under unrealistic and often optimistic assumptions. ‘The removal of all of the rich countries' barriers to the merchandise exports of developing countries—including agriculture, textiles, and other manufactured goods—would result in very little additional income for the exporting countries.’ Weisbrot and Baker (2002) cite World Bank (2002: Table 6.1) estimates that after such changes are fully implemented by 2015, they would only add 0.6 per cent to the GDP of low and middle-income countries.

The myth that developing countries will be the main beneficiaries of agricultural trade liberalization in the rich countries of the North, particularly in Europe and Japan, has been revived with the World Trade Organization’s so-called Doha Development Round in late 2001 after September 11. While many developing economies will gain from easier and greater access to the protected agricultural markets of the North, the main beneficiaries will actually be from rich agricultural exporting countries, the settler colonies of North America and Australasia, rather than from the developing world (Anderson 2002).

Perhaps most importantly, from the perspective of developing robust national capitalisms that might undermine imperialist hegemony, trade liberalization also undermines the possibility of developing temporarily protected ‘infant industries’. While import substituting industrialization has undoubtedly had a mixed record, the East Asian miracle was undoubtedly principally due to *effective protection conditional on export promotion*, rather than trade liberalization or open economies, as claimed by neo-liberal economists. Trade protection has not only been an important tool of development strategy, as suggested by the infant industry argument, but has also been a tool of welfare policy, albeit not necessarily well conceived or particularly efficient, but nonetheless important for the cohesion of modern societies.

Technology

Technological advantage has become increasingly important for corporate economic dominance, especially at the international level. Intellectual property

rights and incomes generated from them have largely been a twentieth century phenomenon, which have only attained their current significance in the last couple of decades. Consequently, strengthened intellectual property rights (IPRs) in recent years have raised the costs of acquiring technology, reduced the likelihood of technology transfers and strengthened transnational corporations' monopoly powers, with adverse consequences for development and industrialization. If IPRs had been similarly asserted in earlier periods, it is very likely that the pace of technological diffusion and learning would have been considerably slowed in the last two centuries.

Western governments, led by the US, successfully asserted IPRs at the international level from the mid-1980s, i.e. from the second Reagan administration. The transactions costs of many bilateral agreements and efforts to enforce them were considerably reduced with the WTO's agreement on Trade-Related Intellectual Property Rights (TRIPs). Thus, TRIPs has reinforced the assertion of monopolistic IPRs in ways not provided for by the World Intellectual Property Organisation (WIPO), which has not been very successful in asserting these rights. With the WTO's dispute settlement mechanism, IPRs can now be asserted as equivalent to any other WTO-recognized trade issue, i.e. far more effectively than through the WIPO.

The significance of this development can be seen in the context of income from IPRs now constituting the single largest source of foreign exchange earnings for the US. However, to secure developing country support for a new Doha Round of WTO trade negotiations, the US promised to substantially reduce pharmaceutical drug prices for the fight against HIV/AIDS, suggesting the possibility of a more comprehensive review and revision of intellectual property rights (IPRs) and the WTO's TRIPs enforcement regime. Developments since the Doha meeting suggest, however, that such expectations were unrealistic and the US offer was simply bait to get developing countries to agree to the Doha Round, deceptively called a Development Round.

New International Economic Governance

The Bretton Woods institutions – the International Monetary Fund (IMF) and the World Bank -- are increasingly seen as obstacles to development because of their roles in dogmatically promoting economic liberalization, especially since the 1980s, despite dubious empirical and theoretical support for the so-called Washington Consensus (e.g. Stiglitz 2002). They have also been seen as taking advantage of economic distress to push through policy agendas promoting economic liberalization and globalization favoring powerful transnational corporate interests. The US Fed-led deflation and debt crises of the early 1980s providing the thin edge of the wedge for the neo-liberal economic subordination of

the South, often through the IMF-led stabilization and World Bank-led structural adjustment programs as well as WTO rules and regulations of the last decade.

More recently, the expanded program of the World Trade Organization (WTO) has not only accelerated the trade liberalization agenda for manufactures, but also broadened it to agriculture and services. However, actual progress has been uneven, mainly favoring powerful corporate interests. Among services, for example, there has been little liberalization of construction or shipping services, where developing countries have a significant presence, while financial services, dominated by US and UK interests, have been liberalized on many fronts, including the WTO.

Even more alarmingly, as noted above, the WTO has strengthened transnational corporate monopolies known as intellectual property rights, besides broadening the economic liberalization agenda well beyond trade liberalization to many other spheres as well. One big struggle at the WTO now is over broadening the range of issues considered to be trade related with the developed country governments almost united in their determination to extend so-called trade issues to investment, government procurement, etc.

Admittedly, the World Trade Organization (WTO) has a more democratic governance structure than the IMF and the Bank, where one dollar gives one vote, besides the excessive weight of the founders, especially the US. In recent years, there is evidence that this multilateral approach is being increasingly marginalized by the Bush administration in favor of more unilateralist and potentially unequal bilateral arrangements with partners favored for political, if not economic reasons. Nevertheless, the WTO is now widely seen as furthering the neo-liberal project of the Washington Consensus. It is also far more powerful and biased than its predecessor, GATT (General Agreement on Tariffs and Trade) was, and had acquired a record of promoting trade as well as economic liberalization more generally, at the expense of development.

Globalization and US Hegemony

The last two decades, associated with globalization and liberalization, have been associated with much lower growth than the quarter century after World War Two. The evidence points to increased economic volatility, growing international economic inequalities, reduced aid flows and other contradictory economic developments favoring transnational corporate – especially financial -- ascendance. In an emerging era of unchallenged -- and seemingly un-challengeable -- US hyper-power, many existing multilateral institutions, including the United Nations system, and even NATO, are being redefined.

As noted earlier, the political developments in the world since the terror attacks in the US on September 11, 2001 have had rather serious implications for

economic globalization. Most importantly, more assertive US ‘unilateralism’ -- apparently under the influence of so-called ‘neo-conservatives’ – continues to profoundly transform international relations and institutions, including those involved in international economic governance such as the IMF, WB and the WTO. While the Zionist and selectively liberal democratic agenda of the ‘neo-conservatives’ is clear, their actual influence in the Bush conservative camp as well as its economic implications are still unclear.

There is now growing acknowledgement of the many false promises associated with economic globalization and international economic liberalization. Meanwhile, official development assistance (ODA) as a share of GNP continued to decline from 0.49 of one per cent in 1992 to 0.29 of one per cent last year, instead of rising to the three decade old target of 0.7 of one per cent. Meanwhile, the US contribution had dropped to 0.09 per cent in 2001 before US President George W. Bush promised at Monterrey in March 2002 to raise its contribution by half over five years, i.e. to around 0.13 of one per cent[1].

Recent developments, especially after the invasion of Iraq, suggest that such disbursements are likely to be even more politicized and conditional than ever. It is well known that Israel has long been the highest recipient of US assistance by far, with Egypt second since Camp David. After the defeat of the Taleban government, the latest US Budget failed to make any provisions for Afghanistan until a hasty amendment providing $300 million was made on the floor of the US Congress to a country that had been at war since the late 1970s and was bombed extensively after 9/11.

US Dominance and Vulnerability

David Dapice (as cited by the YaleGlobal website) has argued that ‘No nation can dominate for long when its very economic health, much less its ability to project power, is based on the cooperation of those supposedly dominated’. He concludes that without greater economic strength, the future of US hegemony is likely to be either shorter or more nuanced than either the friends or critics of the US realize. While his observations are important, he seems to ignore the entire economic history of imperialism, which has not always been characterized by the consistent economic strength of hegemons.

He may well have in mind British capital exports, especially to the settler colonies, but this ignores the massive wealth transfers from the rest of the empire (Jomo [ed.] 2004). Right after the Second World War, export earnings from British

1 With Israel and Egypt at the top of the US recipients’ list by far, one should not be surprised that it was left to Japan to pay the bills for the last Gulf War or for the rebuilding of Cambodia a decade ago, or to others to pay for rebuilding Afghanistan after the regime change in Kabul last year.

Malaya exceeded those of the rest of the empire while Britain itself relied on net capital inflows. While this post-war condition was undoubtedly exceptional, there is growing evidence of massive wealth transfers on both the current and capital accounts from much of its empire, including British India, the West Indies, sub-Saharan Africa and Southeast Asia, i.e. colonialism was profitable, albeit unevenly so.

Undoubtedly, the US economy remains stronger and more dynamic than its two major economic rivals. Japan has remained moribund after more than a decade of virtual stagnation after its disastrous financial 'big bang'. Meanwhile, Europe has become increasingly fettered by its Growth and Stability Pact, which is increasingly believed to have deprived Europe of anti-deflationary monetary policy instruments.

Nevertheless, the emerging view of the United States as a 'hyper-power' may not fully take into account the country's economic vulnerabilities. For example, the US's 'twin deficits' on its fiscal and current account balances as well as electoral considerations have compromised US positions on trade liberalization, e.g. its 2002 steel tariffs and agricultural subsidies which ensured retention of a Republican Congress and Senate. The tariffs and subsidies continue despite the massive devaluation of the US dollar in 2002-3 and their rejection by the WTO dispute settlement process, further strengthening the impression of US unilateralism and unwillingness to submit to the rule of (international) law. The US also relies on an average of over $1.3 billion of capital inflows each day to finance its imports and the resulting current account deficit. US foreign exchange earnings are led by royalties from intellectual property rights, followed by financial services.

With the demise of the gold standard, the US dollar has increasingly become accepted as the universal store of value and medium of exchange. The emergence and consolidation of a de facto 'dollar standard' has not been entirely smooth. European skepticism from the late 1960s, especially after the Tet offensive in Vietnam, mounted greater pressure on the greenback, leading to the US dollar devaluation in 1971 with Nixon's unilateral renunciation of US obligations under the Bretton Woods system set up in 1944 in anticipation of a post-war Pax Americana. Later, the September 1985 Plaza Accord dollar devaluation – following the Volcker's US Fed high interest rate deflationary interventions which the precipitated the series of sovereign debt crises of the 1980s -- did not succeed in rectifying the large US current account deficit with Japan. Instead, subsequent capital inflows to the US, including from East Asia, have since financed the subsequent US current account deficits with East Asia.

In recent decades, the strength of the greenback has been increasingly propped up by vast imports of capital from the rest of the world, rather than by the

strength of US exports (today, ‘intellectual property rights’ are the largest and fastest growing major export earner for the US). Ironically, much of these capital inflows have come from East Asia itself, i.e. East Asian exporters have been earning US dollars, which have been used by their governments to buy US Treasury bonds. Almost half of all US Treasury bonds are held as reserves by foreign central banks, principally in East Asia. During the 1990s, many central banks were encouraged to sell down their gold holdings, but only to replace them with even more US Treasury bonds. Most of these foreign central banks are unlikely to sell them for fear of weakening their own currencies.

The Bretton Woods system of fixed exchange rates tied to gold and the US dollar has been replaced by a system of flexible exchange rates since the early 1970s. But the demise of the Bretton Woods system in 1971 did not mean an end to the internationalization of the greenback, the virtual ‘dollar standard’ implicit in pegging the value of the greenback to the price of gold, and buildup of US liabilities abroad. Without the Bretton Woods system’s framework, political hegemony and confidence have become all the more important. Globalization in this context and the demise of systemic alternatives (mainly posed by the Soviet system) has also served to strengthen the new arrangements.

US dollar hegemony has meant that economic growth abroad increases demand for dollar assets. As central banks increase money supply, they also want to hold more dollar assets in reserve to support their currencies. With globalization, the disproportionate rise in cross-border transactions requires even more dollars to cover such dealings. Thus, the world economy is increasingly hostage to US monetary policy as the US Federal Reserve determines world liquidity. The generally deflationary stance of the US Fed thus combines with the European Growth and Stability Pact and the Bank of Japan’s historically deflationary monetary policy to conspire against more rapid economic growth globally and attendant inflation.

But the evolution of this system has also meant that global liquidity is dependent on acceptance on both sides of foreigners building up increasing claims on US assets. After all, dollar bills or Treasury bonds abroad imply a promise by the US Treasury to eventually pay up. In the meantime, the buildup of such liabilities could eventually undermine confidence in their value. But the irony, of course, is that the world cannot afford to risk the US reversing these trends, without threatening a global liquidity crunch. Not surprisingly, US creditors gain from this de facto dollar standard. Already, over half of all dollar bills in circulation are to be found abroad. We have created a world where the rest of the world exports to America, and must settle for less in return for the ‘privilege’ of securing enough dollars to sustain international liquidity.

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