

The U.S. and East Asia, Before and After September 11, 2001

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The contemporary context for discussion of hegemony and dominance is remarkable and, in many ways, different. In some respects, post-Second World War hegemony has been significantly different from the prewar colonial empires. While elements of continuity have been captured by the slogan “neocolonialism,” aspects of discontinuity were recognized by early uses of the term “post-colonialism.”

After all, postwar U.S. hegemony began with Bretton Woods, the Cold War, and the Marshall Plan, rather than “gunboat diplomacy” or its contemporary and later equivalents. The long record of U.S. military and other interventions abroad for over two centuries, and of direct U.S. colonialism since the Spanish-American war, does not, in itself, negate the many novel aspects of U.S. hegemony, which also changed over time. And recent attempts to rethink contemporary hegemony on more postmodern and postcolonial lines, e.g. in terms of “network hegemony” and transnational corporate collusion, should not obscure the changing realities of U.S. hegemony, especially after the end of the Cold War.

The recent revival of interest in dominance and hegemony has been occasioned by contemporary 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 toward economic liberalization, including its transnational or cross-border component termed “globalization,” which the rest of this paper will soon return to.

But the immediate impulse is the changed world situation after September 11, 2001. As is well known, this has been invoked to legitimize not only the military invasions of Afghanistan and Iraq but also a more belligerent international stance generally, partially expressed in terms of blatant U.S. 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 supporting 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-U.S. 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 Benjamin Netanyahu wing of the Likud Party in Israel.

Clearly, these are interesting new times where many of the old alliances are under stress and new coalitions are being put together and 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 (the North Atlantic Treaty Organization or the United Nations).

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 right-wing 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 Francis 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.

Hegemony and the “Clash of Civilizations”

With the end of the Cold War, U.S. leadership of the West had to be assured in the face of an ostensible external threat. Whatever Professor Huntington’s¹ personal beliefs and intents, his “clash of civilizations” thesis provided a useful antidote to the potentially complacent triumphalism of Fukuyama’s “end of history” Hegelian logic. Although then seemingly far-fetched, the ostensible threat of an Islamic-Confucian alliance in Huntington focused then on the potential political challenges implied by an economically resurgent East Asia, especially China, and political Islamism, once sponsored during the Cold War against communism, the Soviet Union, and the Palestine Liberation Organization, but dysfunctional after the Western triumph.

Huntington’s influence in this regard is a sad reflection of the relationship of ideas to power in the world today. As may be well known, Huntington identifies his own expertise in several areas, including strategic studies and international relations (from a U.S. perspective), as well as “political development” in the South, with the two, of course, being intimately interrelated from his perspective. The shadow of Huntington on current Western-dominated discourse is

particularly problematic because of its self-serving, wrong, and possibly even dishonest premises. Apparently inspired by a 1990 essay by Bernard Lewis, the grand old Orientalist favorite of the U.S. “neo-conservatives,” Huntington’s “clash of civilizations” argument should be located historically. It was first published in 1993, soon after the end of the Cold War, when the future of the “Western Alliance” was very much at stake and the future configuration of international relations consequently very much open to redefinition.

With the demise of the “evil empire” behind the “Iron Curtain” of the Soviet Union and Eastern Europe presided over by Mikhail Gorbachev from the late 1980s, the Western Alliance lost its Cold War “other,” the very *raison d’être* for NATO, without which it could not define and legitimate its own continued existence. With the end of the Cold War, the future of the Western Alliance could no longer be assured, especially with the growing consolidation of Europe (“Fortress Europe,” “European homeland”), as well as the growing recognition of different, if not conflicting, economic and other interests (e.g. the revival of interest in Servan-Schreiber’s earlier thesis on the “American challenge” and the publication of two English translations of Michel Albert’s “capitalism versus capitalism”).

The challenge for Washington then was to preserve the Western Alliance—under U.S. leadership, of course—in the new circumstances. And this is where Huntington’s thesis becomes very convenient and useful as an exercise in redefining the “others.” Hence, for instance, Europe and the U.S. are together, while the poor Latin Americans are excluded despite European cultural hegemony. Defining several “others,” rather than a single “other” (e.g. the “South” or the “Third World”) has other obvious strategic advantages if the old imperial strategy of “divide and rule” is to be adapted for these new times. By emphasizing cultural—or more pretentiously, civilizational—fault-lines and divisions, it is hoped that the unity of the others can be forestalled. Anyone reading Huntington will be struck by the shallowness of his understanding and appreciation of civilizations. One immediately realizes that a “civilization” for Huntington is primarily a cultural region, though the vocabulary of civilizations imposes its own constraints on his discourse.

Huntington’s cultural essentialism invokes history when it is convenient but must also gloss over it—as it ignores cultural nuances and contradictions—when it stands in the way of his project; e.g. the most significant genocides in recent times, during the Second World War, were by those within the same “civilizational” groupings—of Jews by the German Nazis and of Chinese by their fellow Confucianist Japanese militarists.

The ideologically-driven and politicized “construction” of ostensible civilizations is also ignored by Huntington. For instance, the notion of a Western civilization based on a shared Judaeo-Christian heritage is a fairly recent postwar North American construction from the 1960s. And one may well ask why Latin America does not share this civilizational heritage.

Alternatively, there is no reason, for instance, why the idea of an Abrahamic civilization—embracing Jewish, Christian, and Islamic monotheisms—is not more valid in civilizational, spiritual, and philosophical terms, but of course this would not “other” and demonize Huntington’s main bogeyman, Islam.

Despite the recent cultural fetishization of Confucianism in interpreting East Asia, including Japan, and the self-serving pretensions of some proponents of ostensibly distinct “Asian values,” one suspects that it was the then acknowledged differences and vibrancy of East Asian capitalisms which are at the root of Huntington’s civilizational concerns. Quite understandably and correctly, Huntington is particularly concerned about the likelihood of inter-civilizational alliances, especially between Islam and Confucianism (read “China”).

On the other hand, East Asian economic success and the consequent claims to exceptionalism offered an opportunity for celebrating ostensible Asian values and invoking such norms to legitimize the denial or retardation of democracy, human rights, and civil society in the region by authoritarian developmental regimes. While regimes in the poorer countries (China, Indonesia) suggested differences in sequencing, those ruling the more developed economies (Singapore, Malaysia) could no longer claim that poverty eradication had to come before democratic development.

Since September 11, 2001, the Huntington thesis has provided the moral high ground and some intellectual pretence of a rationale for Western mobilization against the new enemies of the U.S., which the more insensitive or arrogant might express in cruder forms, e.g. as a “crusade” against an imagined, but nevertheless ever growing “axis of evil.” This has also been reflected in Europe in recent times with the rise of Signor Berlusconi, Herr Haider, and their counterparts elsewhere in “new Europe,” including Monsieur Le Pen’s electoral success at Lionil Jospin’s expense, and of course the late Professor Pim Fortuyn in the Netherlands. In Australia, John Howard and his colleagues have reinvented themselves to recapture this ground from embarrassing upstarts such as Pauline Hanson. In Japan, the turn to the right has been reflected by the renewed incumbency of the Liberal Democratic Party after a short hiatus a decade ago, the electoral triumph and “normalization” of prime ministerial visits to militarist shrines, the electoral triumph in Tokyo of Ishihara Shintaro after returning from the political wilderness, and the refusal to reform history textbooks dealing with Japanese militarism and imperialism.

The task for progressive intellectuals is to reject the ostensibly civilizational divisions implied in Huntington’s approach and to seek inter-civilizational dialogue and solidarity in the face of the North Atlantic alliance he seeks to reestablish for the North (“West”). Third World and Asian intellectuals must recognize the failings of Third Worldism and pan-Asianism of the past in order to be able to reconstitute them more meaningfully and effectively for the present

and future. In our increasingly Anglophone world, and with the prominent role of “neo-conservative” immigrant Anglophones in the U.S. in rationalizing the new imperial world order, it becomes a special responsibility for others to strenuously dissent from what might seem to be a cosy Anglophone coalition of the willing.

But rather than dwell in the realm of the political and cultural, let me instead turn 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 seem to have overwhelmed economic ones, there is good reason to believe that economic hegemony is alive and well, albeit considerably transformed.

The end of colonialism, the postwar Golden Age, significant changes in international economic specialization, serious efforts at multilateral 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 international economic and political relations. Yet, as the next part suggests, much of what is called economic globalization and economic liberalization at the international level has served to deepen rather than reduce international inequalities.

Hegemony and Globalization

It seems necessary to begin this quick review of economic globalization issues with three rather obvious points. First, globalization is not inevitable. Second, globalization means different things to different people. At least five aspects of economic globalization pose serious challenges to the developing world: international trade; foreign direct investment (FDI); international finance; strengthened intellectual property rights; and the new institutional economic governance. Third, the meaning and implications of globalization have changed over time, significantly with the political changes in the aftermath of September 11, 2001.

International Trade

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 modelling exercises operating under unrealistic and often optimistic assumptions.

Furthermore, developing countries have much reason to be concerned about a variety of

observed long-run trends, including:

Deteriorating terms of trade for primary products compared to manufactures a la Raul Prebisch and Hans Singer.

Deteriorating terms of trade for tropical primary products compared to temperate primary products a la W. Arthur Lewis.

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 Trade-Related Intellectual Property Rights (TRIPs) agreement of the World Trade Organization (more below).

“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 percent to the gross domestic product of low and middle-income countries.

Several influential nongovernmental organizations previously prominent in the opposition to the WTO have apparently also succumbed to 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. While there is undoubtedly some empirical basis for the claim that 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 and the settler colonies of North America and Australasia, rather than from the developing world (Anderson 2002).

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 “spin-doctors.” Trade protection has been not only an important tool of development strategy, as suggested by the infant industry argument, but also a tool of welfare policy, albeit not necessarily well conceived or particularly efficient, but nonetheless important for the cohesion of modern societies.

Foreign Direct Investment

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 capital inflows. 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 2% 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% and Malaysia’s own double-digit percentage.

In the aftermath of the 1997–98 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 *World Investment Report* of the United Nations Conference on Trade and Development (UNCTAD) 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 1997–98. 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 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 postwar 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).

Through its agreement on financial services, the WTO has furthered the International Monetary Fund (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 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.”

Technology

Meanwhile, 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. The WTO’s agreement on TRIPs has reinforced the assertion of monopolistic IPRs in ways not provided for by the World Intellectual Property Organization (WIPO). 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 U.S. However, to secure developing country support for a new Doha Round of WTO trade negotiations, the U.S. 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 and the WTO's TRIPs enforcement regime. Developments since the Doha meeting suggest, however, that such expectations were unrealistic and the U.S. 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 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. 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 U.S. Fed-led deflation and debt crises of the early 1980s provided 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 has not only accelerated the trade liberalization agenda for manufactures but also broadened it to agriculture and services. Even more alarmingly, as noted above, it has strengthened those 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. At Cancun in September 2003, Japan and South Korea emerged as middle-power recalcitrant insisting on the retention of all four new or “Singapore issues”—trade facilitation, government procurement, investment, and competition—even after the European Union expressed willingness to drop some in the face of developing-country opposition. Northeast Asia also was most unwilling to budge on agriculture subsidies and trade liberalization, distancing itself from all developing countries, including those in East Asia.

Admittedly, the World Trade Organization has a more democratic governance structure than the IMF and the World Bank, where one dollar gives one vote, besides the excessive weight of the founders, especially the U.S. The WTO is also far more powerful and biased than its predecessor, GATT (General Agreement on Tariffs and Trade) was, and promotes trade liberalization at the expense of development. 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. While the WTO was now widely seen as furthering the neo-liberal project of the Washington Consensus, it now appears to be the battering ram of the Brussels Consensus as the U.S. opts increasingly for unilateralism.

The last two decades, associated with globalization and liberalization, have been associated with much lower growth than the quarter century after World War II. 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 unchallengeable—U.S. 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 U.S. on September 11, 2001, have had rather serious implications for economic globalization. Most importantly, more assertive U.S. “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, the World Bank, 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 acknowledgment of the many false promises associated with economic globalization and international economic liberalization. Meanwhile, official development assistance (ODA) as a share of gross national product continued to decline from 0.49 of one percent in 1992 to 0.29 of one percent last year, instead of rising to the three decade old target of 0.7 of one percent. Meanwhile, the U.S. contribution had dropped to 0.09% in 2001 before U.S. 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 percent.²

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 U.S. assistance by far, with Egypt second since Camp David. After the defeat of the Taliban government, the latest U.S. budget failed to make any provisions for Afghanistan until a hasty amendment providing \$300 million was made on the floor of the U.S. Congress to a country that had been at war since the late 1970s and was bombed extensively after 9/11.

U.S. Dominance and Vulnerability

David Dapice (as cited by the Yale Global 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 U.S. hegemony is likely to be either shorter or more nuanced than either the friends or critics of the U.S. realize. While his observations are important, he seems to ignore the entire economic history of hegemony, which has rarely been characterized by the consistent economic robustness 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. Right after the Second World War, export earnings from British Malaya exceeded those of the rest of the empire, while Britain itself relied on net capital inflows. While this postwar 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 U.S. 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, widely considered 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 U.S.’s “twin deficits” on its fiscal and current account balances as well as electoral considerations have compromised U.S. 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 2002–03 and their rejection by the WTO dispute settlement process, further strengthening the impression of U.S. unilateralism and unwillingness to submit to the rule of (international) law. The U.S. 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. Its foreign exchange earnings are now 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 (Lunar New Year) offensive in Vietnam, mounted greater pressure on the greenback, leading to the US dollar devaluation in 1971 with Richard Nixon’s unilateral renunciation of U.S. obligations under the Bretton Woods system set up in 1944 in anticipation of a postwar Pax Americana. Later, the September 1985 Plaza Accord dollar devaluation—following Paul Volcker’s U.S. Fed high interest rate deflationary interventions

which precipitated the series of sovereign debt crises of the 1980s—did not succeed in rectifying the large U.S. current account deficit with Japan. Instead, subsequent capital inflows to the U.S., including from East Asia, have since financed the subsequent U.S. 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 U.S. exports (today, “intellectual property rights” are the largest and fastest growing major export earner for the U.S.). 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 U.S. Treasury bonds. Almost half of all U.S. 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 U.S. 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 U.S. 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), have 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 U.S. monetary policy as the U.S. Federal Reserve determines world liquidity. The generally deflationary stance of the U.S. 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 U.S. assets. After all, dollar bills or Treasury bonds abroad imply a promise by the U.S. 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 U.S. reversing

these trends, without threatening a global liquidity crunch. Not surprisingly, U.S. 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.

Notes

1. Given his current credentials as a liberal democrat, it is useful to remember his previous contributions on the role of the military, “praetorian” states, “strategic hamlets” for Vietnam, and much more.
2. With Israel and Egypt at the top of the U.S. 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.

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