

MULTI-POLAR WORLD

Crumbling American Empire

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During the last two centuries, three major power centers, namely the Ottomans; the British and the Americans have largely dominated the world economics and politics. History also reminds that the transition of political power from the dominant to the emerging centers were always marked with some major global events like the First World War; the Great Depression of 1930s followed by the Second World War. The first two events could be associated with the fall of two empires, namely the Ottomans and the British. Will the current economic crisis, the great recession of this decade, trigger the fall of USA?

August 9, 2007 is the official date when the crisis is said to have hit the global financial market. A large number of economists believe that the financial crisis which originated in America's sub-prime mortgage market, later snow-balled into a global recession. The main cause of this financial disaster is said to be the sub-prime loans which were risky loans as those were given to people with unstable incomes or low creditworthiness. But this unprecedented crisis has its root in the rising wage-productivity gap, observed during last three decades, in major economies of the world. As productivity is the main source of supply and wages are the main sources of demand, if this 'wage-productivity gap' keeps on rising over time, supply rises faster than demand and the economy faces the problem of overproduction which ultimately leads to depression. This has actually happened in US and many other economies.

The great depression of 1930 was preceded by unprecedented concentration of wealth that began to assume the menacing levels in the 1920s and peaked in 1929. The same trend was visible in 1980s when the concentration of wealth was rising again in USA. But unlike in 1930, after six decades, the USA and the world economies were further burdened by a heavy load of debt in 1990. The question may be asked then how could the present crisis be deferred till the year 2007.

The crisis was deferred by a few years through creating debt, both public (budgetary deficit) and private (credit card, microfinance, easy loans etc), which generated artificial demand in the market. Simultaneously a culture of consumerism has been established systematically. In addition to that the financial wizards in USA had devised various techniques to manage the fragile economy and transfer the financial risks to others. Few such novel methods are discussed below.

DOLLARIZATION

Unlike the super powers of the previous centuries namely the Ottomans and the British, which had subjugated vast geographical regions under their direct control, USA followed a different approach in the 20th century to retain its global supremacy. The difference between the American and the previous empires was that the former usually preferred to work through local compradors: local rulers who were on their side. The creation of the Japanese Liberal Democratic Party after the Second World War, to retain their control on Japan, is a case in point. In addition to this political strategy, the other most important factor which has contributed immensely to maintain its economic supremacy was the unprecedented strength of its national currency, the US dollar.

The fall of gold standard in 1914 and subsequent chaos, in the international financial system, resulted into a new system (the Bretton Woods System) in 1944. Under the new

system, all members of the newly set up International Monetary Fund (IMF) were to fix the par value of their currency either in terms of gold or in terms of US dollar. The par value of US dollar in turn was fixed at \$35 per ounce of gold. For the purpose of such conversion, adequate gold reserve had to be maintained by the US government. Thus dollar, the national currency of the USA was made equivalent to gold which for centuries had been used as the most acceptable currency across the globe. This unique status of the dollar had encouraged the US Fed to act as the de-facto Central Bank of the world.

The decade long Vietnam War during 1960s had forced the US government to print dollar to meet its war expenditure at a disproportionately higher value compared to the official gold reserve the government had at its disposal. As the US government was not in a position to honor its commitment of paying \$35 against every ounce of gold, on August 15, 1971 they allowed their currency to float. As expected, the value of US dollar started to erode. The USA government tried to salvage the crisis by entering into an agreement (Smithsonian agreement) with 10 major members of IMF. As part of this agreement dollar was devalued by raising the price of gold from \$35 to \$38 per ounce. In February 1973, it was further devalued to \$41.22 per ounce and finally in mid-March 1973 when major industrial countries had decided to float their currency, the Bretton Woods system was finally abandoned.

OIL STANDARD

Economic historians claim that the oil shock of 1971 had aggravated the US BoP crisis that ultimately led to the breakdown of the global financial system in 1973. Interestingly, USA had turned the Arab anger and the associated oil shock of the 1970s into their advantage. It is alleged that the Middle-east crisis was engineered to establish new oil standards replacing the existing gold equivalent standard. On October 6 1973, Egypt and Syria had attacked Israel. And on October 19, the US President declared an aid package of \$2.2 billion to Israel knowing fully well that it would force the Arabs into taking drastic actions. As anticipated, led by Saudi Arabia, Arab oil producers imposed a total embargo on oil shipments to the United States and by January 1974, the price of Saudi crude leaped to a new record. USA formulated a strategy to (a) ensure that OPEC would funnel the billions of additional dollar earned on increased oil price back to US shore; (b) establish a new oil standard to strengthen the weakening dollar. To achieve the first objective, an agreement was entered into with the Saudi royal family. In return to US promise of keeping the Saudi royal family in power, the latter had agreed to (i) invest a large portion of their petrodollar in US government securities; (ii) allow the US government to utilize trillions of dollars, payable as interest on these investments, to hire US corporations to westernize Saudi Arabia; (iii) maintain the price of crude within limits acceptable to the corporations. And the second objective was achieved by earning a commitment from the Saudis to trade oil exclusively in US dollar. Thus dollar sovereignty was reestablished.

DEFYING THE DOLLAR?

Since early 1970s, the oil standard as devised by the US government, has managed the global financial sector, by default. It felt challenged, for the first time, during the Earth Summit at Rio in 1992. At the Earth Summit, major initiatives were planned to combat global warming by reducing the use of fossil fuel. It may be recalled that USA did not ratify the Kyoto Protocol on Climate Change (1997) which among others tried to restrict the use of hydrocarbons. But till Euro was launched in 1999, the supremacy of US dollar remained unchallenged.

During current crisis, the value of the hard earned foreign exchange reserves of India, China et al who had denominated a large portion of their huge balance of payment (BoP) surplus in US dollar could not be protected. As Washington had issued massive amount of currencies to stabilize its financial system, the US dollar lost its value vis-a vis major currencies like Euro and Yen. Lower value of dollar has reduced the value of the foreign exchange reserves of China and India. For example, as per the estimates of the Reserve

Bank of India (RBI), due to such valuation losses, India has lost nearly \$33 billion during April and December 2008.

Sustained loss in the values of the foreign exchange reserves and the investments made in US Securities has triggered sharp disapproval of US policies. As expected, China has led the chorus. In the second week of March 2009, China which had credited over \$ 1 trillion of its accumulated foreign exchange reserve of nearly \$2 trillion to the US government, had expressed its concern about the safety of their assets. Criticizing the unsustainable model of development characterized by prolonged low savings and high consumption, as followed by USA, the Chinese Prime Minister called upon the US government to honor its promises and guarantee the safety of China assets. Then on March 23, 2009, China Central Bank Governor has proposed to replace the US dollar by the SDR as Super Sovereign Reserve Currency. Subsequently the Prime Ministers of India and Russia, and the UN Commission of Experts on Reforms of the International Monetary and Financial System have also echoed the same sentiment of replacing US\$ as the global reserve currency. The move to dethrone US dollar from its citadel is gaining momentum in every passing day. And presently there is no shortage of economists who believe that a new reserve currency would make sense.

There are two major contenders to US dollar, namely Yuan and Euro, which may emerge as the global reserve currency. Currency specialist Avinash Persaud, has long argued that the dollar would give way to the Chinese Yuan as a global reserve currency within a decade. But this shift to a new system will be gradual for two reasons. First, US, as expected, will try its best to retain the privilege it enjoyed in the global financial market during last six odd decades. Second, countries like Japan, China, OPEC and India will appreciate a gradual shift to ensure a slower erosion of the value of their investments in USA. This will also allow them to diversify their investments to safer destinations.

At this hour of crisis, the US government badly needs the assurance of the Arab nations of the Middle-east, who control the OPEC Fund, to remain committed to US dollar. President Obama's famous speech at Cairo University on June 4, 2009, seeking a new beginning between the United States and Muslims around the world, should be interpreted from this perspective.

A MULTI-POLAR WORLD SYSTEM

With the decline of the US Empire, a multipolar geopolitical power structure may emerge in place of the unipolar political system that has been in vogue since cold war ended in late 1980s.

Over the years, the epicenter of the global economy has shifted to South and East Asia. World's second, third and fifth largest economies, namely China, Japan and India are situated in this region. World's two fastest growing economies with a population of over a billion each are also situated here. Armed with sustained economic activities and huge forex surplus, the political leaders of this region are looking for a larger say in the multilateral bodies like UN and IMF. The initiatives taken by India and Japan to become the Permanent Member of the Security Council of the UN are a case in point. China's contribution of \$40 billion in the IMF \$ 1 trillion emergency fund (created to address the present crisis) will certainly increase its influence in this US dominated multilateral body. Moreover, the agreement reached (May 3, 2009), during the 12th ASEAN +3 finance ministers meeting in Bali to create a fund of \$120 billion to meet the short term liquidity difficulties of its 14 member countries is a landmark initiative towards developing a strong Asia centric fund.

Major European nations, though ravaged during two successive World Wars, have steadily prepared themselves under the banner of European Union, to reemerge as the major global power. Creation of the European Common Market, formation of the European

Central Bank and launching of a common currency in Euro are few major initiatives taken, during last few decades, by the European leaders to achieve that objective. They were also instrumental in formation of a multilateral trade body in WTO which is likely to regulate the global trade (also global economics) in 21st century. More importantly, major European economies have prepared themselves for the new century by enacting various regulations to enable the formation of an egalitarian, democratic and more humane society, appropriate for the 21st century when human knowledge rather than the brutal military force will be the main driving force of any economic development. Various information on such parameters, say gender empowerment measure status of major international environmental treaties and crime and justice will corroborate the above observation.

During last few decades, USA leadership has failed miserably to adapt itself with the changing realities of the new century. They have not ratified major international environmental treaties. Moreover, figures indicate that the rate of homicide and the number of prisoners in that country are the highest among the nations. All these economic, political and social factors have tarnished the image of USA as a credible world leader. In coming years, it will have to restrict itself as more of a regional power center than the guardian of the globe.

Realizing this, President Obama is trying to make improvements in their appalling relations with the neighbors including Venezuela and Cuba. The US administration is also trying to develop the Free Trade Association of America (FTAA) into an effective regional block to countervail the European Union.

A multipolar world with three strong regional power centers at East and South-east Asia, Europe and America (both North & South) are emerging very fast. Arab and the Muslim countries of the Middleeast will play a key role in tilting the balance of power towards any of these emerging blocks. The recent amendment in the US–Middleeast and Palestine policy under Obama administration is a pointer to this change. □□□

NOTES :

1. The Ottoman Empire or Ottoman State lasted from 1299 to 1922. It was succeeded by the Republic of Turkey, which was officially proclaimed on October 29, 1923. At the height of its power (16th-17th century), it spanned three continents, controlling much of Southeastern Europe, the Middle East and North Africa. The Ottoman Empire contained 29 provinces and numerous vassal states; some of which were later absorbed into the empire, while others gained various types of autonomy during the course of centuries.
2. Despite being on the winning side, the British Empire could not recover from the geopolitical shift caused by the Second World War and entered into a period of terminal decline.
3. To know more about the sub-prime loan, see What is subprime crisis? How it caused financial mayhem? September 25, 2008, <http://www.rediff.com/money/2008/sep/25slid1.htm>
4. The wage-productivity gap is the gap between the real wage and labor productivity. The real wage is the purchasing power of the average salary. If productivity rises fast and the real wage rises slowly, then a wage-productivity gap develops and grows.
5. Matt Renner, Dr Ravi Batra: New Thinking on the Economy, Monday 16 March 2009, [truthout.org/031609A](http://www.truthout.org/031609A) Interview <http://www.truthout.org/031609A>
6. For detail see, Dey, Dipankar, 'The Real Cause of Global Recession and the Need for New Economic Order'. (July 6, 2009). Available at SSRN : <http://ssrn.com/abstract-1430388>