

The Rise & Fall of Great Powers

Paul Kennedy had cautioned more than two decades back (*The Rise and Fall of the Great Powers*), that, at some stage, great powers suffer from “imperial overstretch”. Referring specifically to the U.S. he noted “*the awkward and enduring fact that the sum total of the United States’ global interest and obligations is nowadays far larger than the country’s power to defend all simultaneously....it simply has not been given to any one society to remain permanently ahead of all the others*”. Britain experienced this in the 20th century, and one wonders whether the U.S. too is gradually relinquishing its traditional role. One sign of this is the loss of status of the dollar as a safe haven currency (see World Money March 14, 2011).

Another came last week when the U.S. ceded the leadership of the Libyan operation to NATO, more specifically, France and Germany, and eschewed an invasion of the country. In a recent speech, President Obama reminded the audience that the U.S. had gone “*down that road in Iraq*”, where “*regime change took eight years, thousands of American and Iraqi lives, and nearly a trillion dollars. That is not something we can afford to repeat in Libya*”. Clearly, a far soberer and maturer President than his juvenile predecessor -- though he should also have referred to the untold miseries inflicted on millions of Iraqis as a result of the invasion in 2003 on spurious grounds, in pursuit of the “neocon” agenda. A couple of years before the turn of the century, the so-called neo-conservatives in the U.S. (a group of right-wing conservative Republican intellectuals, who later dominated the Bush Jr. Administration and were the architects of the Iraq invasion) promoted what they described as *The Project for the New American Century*. The first manifestation of the New American Century was the regime change in Iraq by invading the country. Afghanistan and Iraq have since exposed the limitations of American military and economic power, and the surprising incompetence manifested in the post-war occupation.

Nor is the record of the Anglo Saxon model of *laissez faire* states and finance capitalism, as practiced over the last three decades, any better: stagnancy of real wages; increasing income inequalities; intractable twin deficits, fiscal and current account; and a huge and fast growing public debt, even before factoring the present value of future social security obligations. President Obama has merely recognized the limitations in giving up leadership of the Libyan operation.

“An era can be said to end when its basic illusions are exhausted” wrote playwright Arthur Miller. Has such a moment arrived in global history? As Dani Rodrik of Harvard University, argued some time back, *“the US, the world’s sole economic hyper-power until recently, remains a diminished giant. It stands humbled by its foreign-policy blunders and a massive financial crisis. Its credibility after the disastrous invasion of Iraq is at an all-time low, notwithstanding the global sympathy for President Barack Obama, and its economic model is in tatters. The once-almighty dollar totters at the mercy of China and the oil-rich states”*.

More immediately, there are several major macro economic problems quite apart from the twin deficits. One is that the housing market, which was the origin of the 2008 financial crisis, remains soft, and prices are still falling. Many analysts, from academics like Nouriel Roubini to hedge fund managers like Paul Singer, have warned in recent weeks about the dangers of inflation reigniting, thanks to the continued loose monetary policy. Recent economic data from the U.S. supports this possibility. The prospects for global inflation have obviously not improved by the continued volatile situation in the middle-east and its implications for the price of oil. (To be sure, some of the western countries and, indeed, Japan would, in a way, be relieved if inflation reignites as it would be a less painful way of reducing the ratio of public debt to nominal GDP than increasing taxes or cutting expenditure.) Global economic recovery is still fragile and, while growth in the U.S. is much stronger, it is still very much a jobless recovery. Stagflation may well be on the cards. One sign of the times is that PIMCO, the world’s largest bond fund, has reduced its exposure to U.S. treasuries to zero -- it obviously expects yields to go up.

The U.S. monetary policy-makers focus on the so-called “core inflation”, i.e. exclusive of fuel and food prices. The ostensible reason is that these are too volatile. I often wonder whether the real reason for the exclusion is that monetary policy can do little to control them, and discretion is obviously the better part of valour!.

Tailpiece: Dani Rodrik, when questioned about India, said recently that it is “*A thriving economy. It has a huge potential. I hope it doesn't make the mistakes that other emerging market economies have made---in particular by giving in to the Siren Song of financial globalisation.*” (The Economic Times, Mar 25, 2011.) I have often argued in this column that we seem to be doing exactly this in terms of capital flows and the xchange rate!

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