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The imperialist war on "terror" and the world economy

C.P. Chandrasekhar

Within the Marxist tradition, imperialism, militarization and war have always been seen as inextricably linked. Militarization was not merely seen as the means to political dominance that ensured access to investible surpluses, cheap raw materials and external markets, but was in itself an important 'external market' within the capitalist system that allowed for the realisation of profits and sustained the inducement to invest. Further, the intense and often violent rivalry to control raw material sources and markets that the uneven development under capitalism generated, was expected to periodically spill over into wars between the developed imperialist nations. Not surprisingly, the history of capitalism was also seen as a history of periodic wars, often fought by proxy in the less developed regions. These perceptions that have been held now for over a century have been repeatedly validated by experience.

However, ever since the Second World War, which resulted in the consolidation of US hegemony within the capitalist world system, imperialist militarization was sought to be presented as a response to the threat from 'outside' and legitimized with the rhetoric of defending freedom against the dangers posed by Communism. This rhetoric was accompanied by two developments. Firstly, the developed capitalist countries other than the US acquiesced to a situation in which the role of policing the world and defending 'freedom' was largely left to the United States. Secondly, within the capitalist discourse, imperialism of the old kind, which involved strong inter-imperialist rivalries within a context of the global dominance of one power, was seen as no longer valid. Militarization remained and was concentrated in the US only because of the need to defend the freedoms that were supposedly epitomised by the "market" and electoral democracy.

One consequence of this 'agreement' within the imperialist camp was that inter-imperialist rivalries, though present, were muted. Other systemic factors encouraged this tendency. Being home to the world's reserve currency, the United States faced no national budget constraint. It could print dollars and spend as much as it wanted globally, since wealth-holders across the world were willing to hold any amount of dollars or dollar-denominated assets. In theory, the willingness of wealth-holders to accept the dollar as an unchallenged store of value was explained by the promise to convert dollars to gold on demand at a pre-specified price. In practice, however, an unstated factor determined the dollar's status as the world's currency. The military 'division of labour' among the capitalist powers that made the US almost the sole policeman of world capitalism, generated confidence in the dollar, since the US was seen as having the military might to defend its currency.

In the event, the US state used its position as holder of the world's reserve currency to launch a spending spree that helped generate the post-Second World War capitalist boom. Meanwhile, absolved of responsibility to police the world, capitalist powers in Europe and Asia could divert their capital to productive investment that increased their competitive strength. Germany and Japan, for example, benefited immensely from this situation, and gained from the expansion of world trade that was driven by the US military machine. This helped mute inter-imperialist rivalries even further, since US expansionism seemed to be the basis for capitalist growth outside the US. Not surprisingly, unevenness in the evolution of economic strength never really challenged the hegemony of the US and the dollar. That hegemony, it was becoming clear, was being ensured by the military strength of the US, which was a prerequisite for capitalist expansion and was, for this and other reasons, uncontested at least within the capitalist bloc.

Growing divisions within the socialist bloc and the collapse of the Soviet Union in the early 1990s, have only strengthened these tendencies. Under normal circumstances with the 'Communist threat' having been neutralised even if not completely banished, the world should have witnessed a respite from the unending militarization that characterised the post-Second World War period. But soon, the newly discovered threat to freedom and democracy from isolated pockets of terrorists and "rogue states" that supported them provided a new dimension to militarism. The September 11, 2001 terror strike has only helped to legitimise and accelerate this inherent tendency that led up to the war on terror in Iraq and threatens war in other regions as well.

The new "consensus"

These observations do not imply that the system is free of contradictions and rivalries. There have indeed been periods when economic rivalries and/or political differences have resulted in overt conflict between the imperialist powers. However, what the specific post-War evolution of the system delivered was an ability to paper over these differences and periodically arrive at some kind of "consensus," however tenuous and temporary. Consider for example the now infamous Plaza Accord. After the 1981 recession, the US economy registered a robust recovery and interest rates in the US rose sharply, leading to a steep (80 per cent) rise in the value of the dollar vis-à-vis competing currencies during 1980-84. The strong dollar meant that US exports turned expensive in terms of the currencies of its trading partners, while the dollar prices of imports fell. This, together with the US’s strong economic performance that enhanced its demand for imports, resulted in a widening of the trade deficit, which though financed by large capital flows into the US spelt devastation for American manufacturing and American jobs.

To deal with this situation, the then US Treasury Secretary James Baker convened a meeting of the finance ministers of Japan, West Germany, France and Britain (besides the US) at the Plaza Hotel in New York. The accord that was arrived at in that meeting involved cooperation among and currency market intervention by these powers to drive down the dollar and help redress the imbalance in the US balance of payments. Not surprisingly, after 1985 the Japanese yen registered a sharp rise, resulting in a loss of Japanese competitiveness and a hollowing out of Japanese manufacturing. That was the beginning of the Japanese decline that lasted through the 1990s. What is more, when by 1987 the decline in the dollar was seen as adequate the Louvre Accord was worked out which successfully helped stabilise the dollar.

This ability of the US to work the system in its favour despite sharp differences or conflicts is visible even now in connection with the war in Iraq. Vocal objections by Germany and France notwithstanding, the current signs are that European governments would go along with an agreement that gives the UN a role but keeps the US in command. Unfortunately for them, the US is at present unwilling to even make these small concessions. Further, evidence is now growing that while the US is benefiting in growth terms from its military build-up against “terror”, the fall-out once again in terms of a worsening balance of payments is being sought to be redressed by calling on the rest of the world to make the adjustments. It is to an examination of these features of the new imperialism that we turn in what follows.

War spending and the current conjuncture

The recent Afghan and Iraq wars and the subsequent “post-combat” operations have resulted in a significant increase in US military spending and the US budget deficit. In early September the Bush administration put out its demand for $87 billion of emergency spending next year (2004) to finance its post-war, anti-terror operations in Iraq and Afghanistan. The request for emergency funding provides for $51 billion to fund military operations in Iraq and $11bn for US forces in Afghanistan. The request also includes another $21 billion for “reconstruction” in Iraq, of which $5 billion would go to train a new Iraqi army and police force. Thus the bulk of the new demand, if approved by Congress, would be allocated to sustaining the Iraq misadventure.

That it is a misadventure in economic terms and that earlier administration efforts tended to underestimate the economic cost is now well established. According to the Financial Times, the total estimated cost of the US intervention in Iraq so far is, at $138 billion, precisely where the former White House economic adviser, Lawrence Lindsey, declared it was heading. Among other reasons, Lindsey was fired at the end of 2002 for forecasting that the Iraq war would cost $100bn-$200 billion. The actual figure is likely to prove much higher. Currently, with the US finding little support in terms of men, materials and money from countries other than Britain, it is estimated to be spending $3.9 billion a month to finance its occupation. With the occupation unlikely to be short-lived, estimates suggest that the cost of the occupation alone for the US could amount to around $4 billion a month for the next three to four years, or a total of around $150-200 billion.

To this must be added the cost of the ongoing, even if limited, process of reconstruction. That process is to be financed partly with US funds approved by Congress and substantially with revenues from Iraqi oil, production and export of which is still to reach its full potential. Lael Brainard and Michael O'Hanlon of the Brookings Institution quote estimates, based on the presumption that Iraqi oil production is unlikely to be restored to potential in the near future, which place spending for reconstruction at anywhere between $5 billion and $120 billion a year over the next several years.

The full financial implications of the war have not sunk in because much of the expenditure relating to the Iraq war is funded outside the normal appropriations process, in so-called "supplemental" or emergency spending bills. The recent $87 billion demand, comes on top of $62 billion appropriated for military operations in Iraq and Afghanistan in April this year and an overall total of $79 billion approved by Congress to cover the immediate costs of the Iraq war. As a result of these piece-meal, off-budget spending requests, both the actual costs of the war on terror and it budgetary implications are not clear, leading to varying estimates.

Whatever the actual figure, however, it is clear that deficit-financed spending, justified by the war, is touching and would continue at high levels. Estimates are that with tax cuts amounting to revenue losses of around $3 trillion announced over the last two years and $41.3 billion to be spent on homeland security, the federal deficit next year would exceed $550 billion. Clearly, the “war on terror” that has replaced the communist “threat to freedom” as the principal strategic preoccupation of the US is not just costing the US dear. It is also leading to a ballooning deficit in a country whose government has for more than two decades now backed an ideology that treats deficit financing as anathema, especially in developing countries seeking balance of payments financing.

It is not just that the war on terror is proving costly in economic terms. It is now some time since the Pentagon announced that the number of American soldiers killed after combat operations were declared as over in Iraq exceeded the number lost during the war itself. Yet there are no signs of any halt to American and British casualties in Iraq. This has spurred movement in two directions: on the one hand, hawks in the administration are lobbying for an increase in the number of US troops in Iraq, with estimates of required numbers varying from 20-50,000 or more; on the other, there is growing domestic resentment over the decision to go to war in the first place, since no weapons of mass destruction have been discovered in the process, while the cost in American lives is rising along a trajectory with no end in sight.

Persisting with the strategy

With the war proving politically and economically expensive, why does the US still persist with the strategy of keeping the occupation going, even if with the expectation that other countries would join the effort under its leadership? Could the answer lie in the fact that what appears almost suicidal is in actual fact the only policy option available to the US?

There are three paradoxical features of US hegemony over the last three decades that need to be noted here. First, after the US lost its competitiveness as a trading power in the late 1960s, it could not handle the consequences of the huge dollar surpluses in the world economy. Those surpluses were built because in the 1950s and 1960s the US had exploited the fact that the dollar was the world’s reserve currency and spent huge sums on, among other things, policing the world and legitimising its hegemonic position. Unable to redeem its promise to convert dollars to gold on demand at a pre-specified price it had, in the early 1970s, to break the formal link between the dollar and gold which was presumed to underlie its position as the reserve currency. Yet, to this day, the dollar remains the principal reserve currency and the preferred destination for investment by wealth-holders the world over. This suggests that political and military hegemony rather than economic hegemony underlies the strength of the dollar and its role as reserve. Political hegemony in turn is ensured by the fact that in the “division of labour” between the world’s leading capitalist powers, the US was given the role of policing the system – whether against the earlier communist threat or the more recently discovered terrorist threat.

Second, this persistence of the dollar as the reserve currency has served the US well in recent years. Despite the inflationary effects of the oil shocks and the contractionary responses it forced on the US in the 1980s and early 1990s, starting in the mid-1990s the US experienced a period of prolonged buoyancy and relatively low unemployment. During this period, other than for the UK, most other

OECD countries were recording poor or indifferent economic performances. Interestingly, this was a period in which US federal deficits were declining and eventually the US recorded a surplus on its budget, providing the background for the Bush tax cuts.

If despite the reduction in the fiscal stimulus that the reduction of the fiscal deficit implied, the US was able to ensure a prolonged period of relatively high growth, low inflation and low unemployment, it was not because it had regained its lost international competitiveness. Higher growth in incomes meant larger trade and current account deficits for the US. The current account deficit on the US balance of payments has been rising continuously, even while other leading capitalist nations recorded much smaller current deficits and even surpluses on their balance of payments.

Among the factors that explained this paradoxical US strength was: (i) its ability to keep commodity prices, including oil prices, down so as to keep inflation in control, facilitated in part by its “diplomacy”; and (ii) a huge increase in capital inflows into the US, which resulted in a stock and bond market boom, increased the wealth of savers investing in pension and mutual funds, and triggered a “wealth-effect” induced spending splurge. Not surprisingly, during the years of declining fiscal deficits and fiscal surpluses in the US, private consumption expenditures rose sharply and savings rates fell, helping trigger growth in output and investment.

What is more, capital inflows helped finance the rising current account deficit associated with high growth. A significant part of these flows are in the nature of “official flows”. US current account deficits have been accompanied by the accumulation of large foreign exchange reserves in many countries, especially in Asia. Growth in the US did impact on world trade growth. But the benefit was concentrated in a few countries, such as China, which registered high export growth rates and large current account surpluses. Further, in most other cases the stimulus to growth of whatever increase in exports occurred seems to have been neutralised by the deflationary effects of government fiscal stringency and the consequent fall-out in the form of reduced spending and higher saving by consumers fearing possible unemployment. The net result was that increases in export growth were not accompanied by parallel increases in import demand, leading to trade and current account surpluses and higher foreign exchange reserves. Since those reserves are invested in dollar denominated assets in ostensibly “safe” US financial markets, these reserves helped finance the US current account deficit. The fact that military and political hegemony ensured that the dollar is the world’s reserve currency and the US the safest financial market, served the US well during those years. The system worked perfectly for the US, even if not for many others.

Finally, at the end of the 1990s the US stock market bubble gave way to a slump that was aggravated by news of accounting scandals and other kinds of corporate fraud, which in turn dampened consumer sentiment resulting in the recession of 2001. But not only did low interest rates keep debt-financed consumption-spending going, but this was precisely the time when the war against terror was ensuring a return to high fiscal deficits in the US. These then provided the stimuli for recovery, making the growth downturn short-lived and revived hopes that, but for the blip, the long period of prosperity would continue.

The return to recovery

While still considered hasty by many, that expectation is grounded in recent figures. The last day of July 2003 brought news of unexpected vigour in US economic growth. Commerce Department figures showed that in the second quarter of 2003, the US economy grew by 2.4 per cent, which was well above the 1.5 per cent predicted by many analysts. Interestingly, there is consensus on the cause of this buoyancy. Analysts point their finger at the substantial rise in government spending fuelled by the occupation of Iraq, which has been assessed by the Financial Times, London as being the “largest run-up in government spending since the Vietnam War”. As a result, defence spending in the recent past has been rising at a 44 per cent annualised rate. Not surprisingly, overall government spending rose by an annualised 22 per cent in the second quarter of 2003, contributing according to some estimates as much as 1.5 percentage points to the 2.4 per cent second-quarter growth rate. Once again, even if not through the same mechanism, the US’s military activity seems to be working to keep its economy afloat and growing. The only difficulty is of course the ballooning trade deficit, resulting in a current account deficit of close to half a trillion dollars in 2002. But so long as the world’s foreign exchange reserves continue to be invested in US government securities, despite low interest rates, this would not be a problem. According to one estimate some two-thirds of capital flows into the US in recent times is accounted for by investments of foreign reserves in US securities especially by central banks in the Asian region.

These developments suggest that the Bush administration may choose to stay in Iraq because the indirect economic effects of the misadventure provide the only means by which it could stall or reverse its declining popularity. The second-quarter growth figure must be giving cause for celebration to a government that is fast loosing domestic support for its Iraq misadventure that is proving much more prolonged than expected, more unilateral than multilateral and more costly in terms of US lives that are being lost virtually every day. But these very factors make the task of sustaining the spending that yields that growth rate difficult. The view that the direct financial cost of the occupation is proving too heavy for the US government, even if it is proving to be good for American business and the American economy, is gaining ground. If growth is to be sustained, therefore, the US must ensure that other international governments contribute to the reconstruction effort and that the “external” benefits of that effort must flow to the US.

External support for the war

However, while a solely US occupation and reconstruction effort is increasing proving infeasible, support from the international community has been virtually absent, not just in terms of sending troops but also in terms of finance for reconstruction.

In April this year, the Congress approved $3.6 billion towards the reconstruction effort. According to White House Budget Director Joshua Bolten, funds from various sources such as frozen Iraqi assets, revenues from oil and $800 million in cash found inside Iraq, had helped add to the congressional appropriation and secure $7.7 billion for rebuilding efforts during 2003. But the Iraqi administration is likely to run through this money relatively fast. Paul Bremer, US administrator in Iraq recently informed the Bush administration that he expected to spend $7.3 billion by the end of the year. Speaking to CNBC's Capital Report regarding the cost of rehabilitating and reconstructing Iraq, Bremer said: "It's probably well above $50bn, $60bn, maybe $100bn. It's a lot of money." He clearly intends to return to Washington with a large request for funds.

Thus, even if the actual spending on reconstruction is a small fraction of the Brookings estimate, deficit financed spending by the US is bound to increase substantially if outside help is not forthcoming. Though current trends indicate that this could convert the recent buoyancy of the US economy into a robust recovery, there are ideological and congressional limits to that process. However, if the US manages to win the support of some of its estranged allies for the post-occupation reconstruction and is able restore Iraqi oil production to potential in the near future, the gains it gets from financing the costs of occupation would be strengthened by the benefits derived by US business from the reconstruction spending financed with oil revenues. Even if the occupation alone can be sustained, the purely economic gain for the US from the occupation could be substantial. But if governments outside the war coalition could be persuaded to contribute to the reconstruction effort, then a another long boom in the US is a real prospect.

Need for a new consensus

This makes the effort at broadening the coalition in Iraq economically crucial for the US. But the need for a new “consensus” today extends even further. The US would not merely like to continue enjoying the benefits of its long boom, but would like to redress what is economically speaking the principal threat to that boom: the increasingly unsustainable US current account deficit that threatens a dollar collapse. America’s twin (budget and current account) deficits many economists fear would lead to a collapse of the dollar and global recession. With the US current account deficit expected to exceed 5 per cent of GDP this year, there are few who are convinced that it would find investors who would be confident enough to continue financing that deficit. This is becoming clear from the fact that the share of the deficit financed by central bank investments is rising, as private investors grow more cautious. Thus, if the dollar is not to collapse, the US current account deficit must be curtailed and reversed.

In their desperation to find a solution, advocates of the new imperial order have turned their attention to Asia, with the demand that governments, especially the Chinese government, should revalue exchange rates, so that adjustment in the US would be smooth and growth would be triggered in Europe and Japan.

In mid-July, Alan Greenspan, chairman of the US Federal Reserve, while deposing before a congressional committee, warned the Chinese authorities that they could not continue to peg the renminbi to the US dollar, without adversely affecting the functioning of their monetary system. This touching concern for and gratuitous advice to the Chinese had, however, some background. Greenspan was merely echoing the sentiment expressed by a wide circle of conservative economists that the Chinese must float their currency, allow it to appreciate and, hopefully, help remove what is being seen as the principal bottleneck to the smooth adjustment of the unsustainable US balance of payments deficit.

China was, of course, only the front for a wide range of countries in Asia, who were all seen as using a managed and “undervalued” currencies to boost their exports. Around the same time that Greenspan was making his case before the congressional committee, *The Economist* published an article on the global economic strains being created by Asian governments clinging to the dollar either by pegging their currencies or intervening in markets to shore them up. That article reported the following: “UBS reckons that all Asian currencies, except Indonesia’s are undervalued against the dollar … The most undervalued are the yuan, yen, the Indian rupee and the Taiwan and Singapore dollars; the least undervalued are the ringgit, the Hong Kong dollar and the South Korean won.”

The evidence to support this is of course limited. It lies in the fact that while over the year ending September 3rd the euro has appreciated against the dollar by about 9 per cent, many Asian currencies have either been pegged to the dollar, appreciated by a much smaller percentage relative to the dollar or even depreciated vis-à-vis the dollar.

Developing country exchange rates

To anyone who has been following the debate on exchange rate regimes and exchange rate levels in developing countries, this perception would appear to be a dramatic reversal of the mainstream, conservative argument that had dominated the development dialogue for the last three to four decades. Till recently, many of these countries were being accused of pursuing inward looking policies, of being too interventionist in their trade, exchange rate and financial sector policies, and, therefore, of being characterized by “overvalued” exchange rates that concealed their balance of payments weaknesses. An “overvalued” rate, by setting the domestic currency equivalent of, say, a dollar at less than what would have been the case in an equilibrium with free trade, is seen as making imports cheaper and exports more expensive. This can be sustained in the short run because trade restrictions do not result in a widening trade and current account deficit. But in the medium term it seen as encouraging investments in areas that do not exploit the comparative advantages of the country concerned, leading to an inefficient and internationally uncompetitive economic structure.

What was required, it was argued, was substantial liberalization of trade, a shift to a more liberalized exchange rate regime, less intervention all-round, and a greater degree of financial sector openness. Partly under pressure from developed county governments and the international institutions representing their interests, many of these countries have since put in place such a regime.

Seen in this light, consistency and correctness are not requirements it appears when defending the world’s only superpower. Nothing illustrates this more than the effort on the part of leading economists, the IMF, developed country governments and the international financial media to hold the exchange rate policy in Asian countries, responsible for stalling the “smooth adjustment” of external imbalances in the world system. The biggest names have joined the fray to make the case: Alan Greenspan, chairman of the US Federal Reserve, John Snow, US treasury secretary, and Kenneth Rogoff, IMF chief economist.

The adoption of a liberalized economic regime in which output growth had to be adjusted downwards to prevent current account difficulties and attract foreign capital had its implications. It required governments to borrow less to finance deficit spending, which often led to lower growth, lower inflation and lower import demand. Combined with or independent of higher export growth, these effects showed up in the form of reduced deficits or surpluses on their external trade and current accounts. Since in many cases the ‘chronic’ deflation that the regime change implied was accompanied by large capital inflows after liberalization, there was a surplus of foreign exchange in the system, which the central bank had to buy up in order to prevent an appreciation in the value the nation’s currency. Currency appreciation, by making exports more expensive and imports cheaper, could have devastating effects on exports in the short run and generate new balance of payments difficulties in the medium term. In fact, among the reasons underlying the East Asian crises of the late 1990s was a process of currency appreciation driven by export success on the one hand and liberalized capital inflows on the other.

Currency market intervention

Faced with this prospect countries like China and India chose to adopt a more cautious approach to economic liberalization and, especially with regard to the exchange rate regime and to the liberalization of rules governing capital flows into and out of the country. However, even limited liberalization entailed providing relatively free access to foreign exchange for permitted trade and current account transactions and the creation of a market for foreign exchange in which the supply and demand for foreign currencies did influence the value of the local currency relative to the currencies of major trading partners. This made the task of managing the exchange rate difficult. The larger the flow of foreign exchange because of improved current account receipts (including remittances) and enhanced inflows of capital (consequent to limited capital account liberalization), the greater had to be the demand for foreign exchange if the local currency was to remain stable. But given the context of extremely large flows (China) and/or relatively low demand during the late 1990s due to deflation (India), there was a tendency for supply to exceed demand, even if this did not always reflect a strong trading position. As a result, to stabilize the value of the currency the central banks in these countries were forced to step in, purchase foreign currencies to stabilize the value of the local currency, and build up additional foreign exchange reserves as a consequence.

Different countries adopted different objectives with regard to the exchange rate. China, for example, chose to make a stable exchange rate a prime objective of policy and has frozen its exchange rate vis-à-vis the dollar at renminbi 8.28 to the dollar since 1995. To its credit, it stuck by this policy even during the Asian currency crisis, when the value of currencies of its competitors like Thailand and Korea depreciated sharply. This helped the effort to stabilize the currency collapse in those countries, even if in the immediate short run it affected China’s trade adversely. India too had adopted a relatively stable exchange rate regime right through this period, allowing the rupee to move within a relatively narrow band relative to a basket of currencies, and not just the dollar.

The net result is that most Asian countries – some that fell victim to the late 1990s financial crises, like Korea, and those that did not, like China and India – have accumulated large foreign exchange reserves. According to one estimate, Asia as a whole is sitting on a reserve pile of more than $1600 billion. This was the inevitable consequence of wanting to prevent autonomous capital flows that came in after liberalization of foreign direct and portfolio investment rules from increasing exchange rate volatility and threatening currency disruption due to a loss of investor confidence. These reserves are indeed a drain on these systems, since they involve substantial costs in the form of interest, dividend and repatriated capital gains but had to be invested in secure and relatively liquid assets which offered low returns. But that cost was the inevitable consequence of opting for the deflation and the capital inflow that resulted from the stabilization and adjustment strategy so assiduously promoted by the US, the G-7, the IMF and the World Bank in developing countries the world over. Unfortunately, the current account surpluses and the large reserves that this sequence of events resulted in have now become the “tell-tale” signs for arguing that the currencies in these countries are “under-“ not “overvalued” and therefore need to be revalued upwards.

Benefits from reserve accumulation

For long, this episode of rising reserves in till-recently poor countries appeared almost conspiratorial, because these reserves were being invested in dollar denominated assets including government securities in the US and played an important role in financing the burgeoning current account deficit in the US. The choice of US assets was, of course, determined by the facts that the dollar still is the world’s reserve currency and the US the world’s sole superpower, both of which engender confidence in American, dollar-denominated assets. The direct benefit for the US was obvious. With America experiencing growth without the needed competitiveness, that growth was accompanied by a widening of the trade and current account deficits on its balance of payments. Capital inflows into the US helped finance those deficits, without much difficulty. For example, UBS estimates that in the second quarter of 2003, the central banks in Japan and China bought $39 billion and $27 billion of dollars respectively. If these are invested in American assets they would finance close to 45 per cent of the estimated $147 billion US current account deficit in that quarter. They indeed were. Central banks, mostly from Asia, are estimated to have financed more than half of the US current account deficit in the second quarter.

The indirect benefits of this arrangement are even greater. As argued earlier, for more than a decade now, the US has benefited from a long period of buoyancy, so much so that it has accounted for 60 per cent of cumulative world GDP growth since 1995. That buoyancy came not because the US was the world's most competitive nation in economic terms. Rather, till the turn of the last decade growth was accounted for by a private consumption and investment spending boom, spurred by the bubble in US stock and bond markets that substantially increased the value of the savings accumulated by US households. The money market boom was encouraged by the flight of capital from across the world to the safe haven that dollar denominated assets were seen as providing. Investment of reserves accumulated by the Asian countries was one important component of that capital inflow. With the value of their savings invested in stocks and securities inflated by the boom, consumers found confidence to spend.

To be sure, when the speculative boom came to end in 2000, triggered in part by revelations of corporate fraud, accounting scandals and conflicts of interest, this spur to growth was substantially moderated. But the low interest rate regime adopted by the Fed still encouraged debt-financed consumer spending. Together with the return to deficit-financed spending by the American state, justified by its nebulously defined war on terror, America is once again witnessing buoyant output growth even if this has not improved the employment situation significantly. In fact, 2.6 million manufacturing jobs have been lost in the US since Bush assumed office in 2001.

The only threat to US buoyancy throughout this period was the possible unsustainability of the widening current account deficit in its balance of payments. But the boom was not aborted, because the rest of the world appeared only too willing to finance those deficits, even if at falling interest rates in some periods.

Unfortunately, few other countries benefited directly from this chain of events. They did not because they did not have the military power to create the required confidence in their currencies, even if sheer competitiveness warranted a decline in the dollar. Some countries benefited indirectly: China, for example, because of the export boom to the US; the UK because, among other things, of a boom in services, including financial services. But overall, to use a phrase popularized by former US Treasury secretary Lawrence Summers, the world economy was flying on one engine.

The case for revaluation

Within the imperial order always fearful of a "hard landing", this has created two imperatives. First, in the medium term, the world needs other supportive engines, which must be from within the developed economies. Second, till that time, and even thereafter, US growth must be sustained, which requires reducing the current account deficit without adversely affecting growth. If the dollar is not to collapse, the US current account deficit must be curtailed and reversed. The new discovery that Asian currencies, particularly the Chinese renminbi, is under- and not overvalued, stems from the second of these two concerns.

The only way of reducing the US current account deficit without affecting growth is to boost US exports. This is where China and the fact that it notched up a record $103 billion trade surplus with the US last year comes in. Ignoring the fact that simultaneously China had recorded a trade deficit of $75 billion with the rest of the world, the surplus with the US is seen as a direct consequence of China’s undervalued exchange rate, which has been pegged to the dollar since 1995 despite rising capital flows and reserves. Thus, the story goes, if China revalues its currency vis-à-vis the dollar by anywhere between 15 and 40 per cent, depending on the advocate, China would absorb more imports from and be able to export less to the US, correcting the trade imbalance between the two countries.

But that is not all. If China revalues its currency, it is argued, Europe would improve its competitiveness lost as a result of the appreciation of the euro vis-à-vis the dollar and therefore the renminbi, allowing it to register higher growth and contribute to global demand. Further, China’s revaluation would reduce the need to pressurize Japan to revalue the yen, despite its own surpluses with the US and the high level of its reserves. This deals with the danger that yen revaluation might abort the feeble recovery that Japan is experiencing after a decade of stagnation. These benefits could possibly yield the supportive engines needed to keep the world economy in flight.

In this assault on the less-developed nations, involving a complete reversal of the argument regarding the currency regime in developing countries, the US and its allies are finding strange supporters. Trade unions and manufacturing companies located in the US who have experienced job and market losses have joined the chorus through organizations such as “The Coalition for a Sound Dollar”. They are even threatening to take the Chinese to the dispute settlement body of the WTO on the grounds that it is manipulating the exchange rate to win unfair gains from trade. There effort is ostensibly aimed at invoking a provision in the World Trade Organisation that bars countries from influencing exchange rates to "frustrate the intent" of WTO trade agreements. In practice, the clamour is all intended to get the US government, in a pre-election year, to increasing pressure on China to float its currency.

Divisions within the US

However, not all of American business supports this effort. Calman Cohen of the Emergency Committee for American Trade, which represents many large US companies doing business in China, is reported to have said that while the renminbi may well be undervalued, it was not the main cause of the industrial problems facing the US. His principal and well-founded fear is that action against China would adversely affect US companies that as part of thei competitive strategy are sourcing their products from countries like China.

Not surprisingly, Rob Westerhof, chief executive of Philips Electronics North America and former chief executive of Philips Electronics East Asia, argues: “A free float or sudden revaluation would be bad for China and bad for business. Instead, Beijing should maintain the peg for now and aim for a gradual revaluation of about 15 per cent over the next five years. Free- floating the renminbi can be considered only when China has a well established financial system. That will take at least another 10 years.” He made it clear that “business prefers a stable renminbi-dollar exchange rate. A sudden revaluation of the renminbi would disrupt results for the many multinational companies (Philips included) that supply American and European retail chains with goods made in China. Currently, hedging against exchange rate fluctuations of a free-floating, unpredictable renminbi would be very costly for those companies.”

Unfortunately, some Asian countries, particularly those that have been experiencing an appreciation of their currencies from the lows they reached after the 1997 financial crisis are supporting the demand with the hope that they would benefit from the loss of Chinese export competitiveness that a revaluation of the renminbi would involve. Interestingly, Japan too is part of this group, even though it is itself intervening in currency markets to prevent the yen from appreciating too much against the dollar.

Thus at the end of September, the dollar recovered sharply against the yen as a result of Bank of Japan intervention, conducted through the New York Federal Reserve. This helped reverse a prior downward lurch of the dollar vis-à-vis the yen. According to information released recently by the Japanese Finance Ministry, the government and central bank have spent a total of $ 40 billion between August 28 and September 26, taking the total amount spent on supporting the yen in the first nine months of 2003 to well above $100 billion. This willingness to intervene openly is partly explained by the fact that the G-7 has accepted that any excessive appreciation of the yen could abort a recovery which has come after a long while and which is seen as crucial for overall global growth. This support for action against yen appreciation goes against the G-7’s own recent statement that came out in favour of exchange rate flexibility in the world, which it is now clear was aimed at developing Asia in general and China in particular.

Despite its own actions, the Japanese government has been willing to go along with the demand that the Chinese and other developing Asian countries should revalue their currency by opting for a float. Once again the fact that the developed countries believe that developing countries should do as the G-7 says and not as it does has been brought home.

Flaws in the argument

The flaws in these arguments are obvious. A revaluation of the renminbi may reduce China’s trade surplus with the US, but it is unlikely to trigger either export or output growth in the US. Rather, the space vacated by the Chinese in US markets would be occupied by some other trading country such as Vietnam, Korea or the Philippines. Further, those Asian countries that expect to gain from the renminbi’s revaluation would soon find that their current account surpluses and reserves are seen as grounds for identifying their currencies as undervalued and provide the basis for a revaluation demand. India, with less than $90 billion of foreign exchange reserves is already being targeted. Whatever gains would occur from China’s revaluation would be shortlived.

Further, if China and other countries, like India, with rising reserves are deprived of those reserves on these grounds, the capital required to finance the current account and budget deficits accompanying US growth would soon dry up. This would drive up interest rates in the US, cut consumption and investment spending, make the current account deficit unsustainable, and ensure the collapse of US growth and the dollar that the revaluation is expected to stall.

In sum, the whole episode indicates that the desperation to keep US growth going, ensure the continued hegemony of the dollar and protect the current imperial order is yielding a number of scatter-brained proposals. Economics has been reduced to deformed ideology, devoid of consistency and rationality. Fortunately, the Chinese have thus far stood their ground and refused to yield. Hopefully, other developing countries would also see where their best interests lie.