ABROAD

The American Economic Empire

Interview with Robert Hunter Wade

Everyone talks about the new U.S. military empire. This political scientist argues it is the country's economic empire that has had equally—if not more—damaging consequences. In our interview, he discusses how the empire works, who benefits and who is harmed, and whether it will continue.

Q There has been a lot of complaint about, and indeed nowadays praise of, the expanding U.S. empire. But it is usually in reference to military expansionism, especially in the wake of the Iraq war. Your view is that the United States has an economic empire, and that is what we want to discuss in this interview. Where should we start?

A. A good place to start is with Joseph Nye's statement that, yes, there is a U.S. empire on the chessboard of interstate military affairs. Nye is from the Harvard Kennedy School of Government. The United States is overwhelmingly preponderant in military affairs, he notes, but he goes on to say that, in the field of interstate economic affairs and also inter-

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Challenge, vol. 47, no. 1, January/February 2004, pp. 64–77.
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ISSN 0577–5132 / 2004 $9.50 + 0.00.

national nonstate economic affairs, the world is either multipolar or regulated by market relations—there is nothing approaching a U.S. economic empire. I agree with him on the first part about interstate military affairs, but I disagree with his argument that there is no empire in interstate economic affairs or international business affairs.

Q. You think there are elements of empire in these fields, too?

A. Yes. The U.S. state has been engaged for decades in what you could call an empire project or even an imperial project—a project in which one state, in this case the United States, attempts to permanently order the world of states and markets according to its own national interests. During the cold war era, the U.S. empire project was constrained by the need to mobilize allies to contain the Communist bloc. During the Clinton years the empire project, especially on the economic chessboard, was given full rein. It was sometimes called the "enlargement" strategy, in contrast to the earlier "containment" strategy. It is important to understand that "empire" does not just refer to "full spectrum dominance" of A over B and C. It is a world-order concept, where A sets the rules that A, B and C have to follow.

Q. Who in the Clinton administration called it the enlargement strategy?

A. Anthony Lake, Clinton's national security adviser, said that "the successor to a doctrine of containment must be a strategy of enlargement, enlargement of the world's free community of market democracies."

Q. But "enlargement" carries a very different connotation in your "empire."

A. Yes. "Empire" in normal usage does refer to coercive power, which is why most people shrink from using it for today's world. But I use "empire" to refer to a wider world order, based on economic rules, such that the normal workings of apparently powerless markets generate disproportionate benefits to the United States without its hav-

ing to throw its military weight around more than occasionally. This is the world order that sustains the present situation in which the United States, with less than 5 percent of the world's population, accrues about a third of world income (measured in market exchange rates), and is responsible for more than 40 percent of the world's spending on military activity. The present world economic order must be working very well from the U.S. standpoint to go on sustaining such imbalances in its favor. So the question is: What features of the economic architecture of the world system allow the United States to go on sustaining this position of overwhelming economic dominance, which permits its military dominance? To what extent is the system the result of design by the United States? And would the world as a whole be better off with a somewhat different set of world economic arrangements that would facilitate a more equal distribution of world income and wealth? That is what I am interested in.

Q. You imply that the current world order is the product of a conscious U.S. design. Is this right?

A. The United States is certainly not a unitary actor in pursuit of a grand design. Some of the key elements of the economic empire were put in place in response to impending crises, and then opened much wider windows of opportunity. One important step was Nixon's breaking of the link between dollar and gold in 1971, so as to ease the trade-off between higher spending on the Vietnam War, higher taxes, and cuts in public domestic expenditure. Once this was done, the window was open for the United States to run increasingly large current-account deficits, provided the U.S. dollar remained the main international currency. To a greater degree than other countries, it could then spend much more than it earned on consumption and the military, and it had more autonomy over key factors like interest rates and taxes.

The United States could simply finance the deficits by selling Treasury IOUs (Treasury bills). In effect, the buyers financed the U.S. deficits. After 1971, there was no way that foreign central banks could

demand payment in gold, and once they had U.S. dollars accumulating in their reserves, they had an incentive to lend them back to the United States in return for interest-earning Treasury bills. We know that Say's Law ("Supply creates its own demand") does not hold in the real economy, but the United States has benefited from a kind of Say's Law of deficit financing: "The U.S. deficit induces its own foreign financing." This mechanism allows the United States to avoid the normal "debtor's curse"—the need to squeeze the economy or devalue the exchange rate so as to adjust out of debt. Instead the United States reaps the "debtor's blessing"—the ability to have more guns *and* more butter at the same time, to have rising domestic consumption, rising investment, and rising military spending, with low inflation, low interest rates, low taxes.

Q. What are the main foundations now of this empire?

A. First is the point I just made, the fact that the U.S. currency is not linked to gold or another supply-side constraint on its issuance. Second, the U.S. dollar is the dominant international currency. The rest of the world wants to hold it—roughly three-quarters of world foreign currency reserves are held in U.S. dollars. Third, the U.S. has the biggest, deepest, most liquid capital markets in the world, and its dominance is constantly pumped up by U.S. deficit financing. Fourth is free capital mobility worldwide. The United States has been doing everything it can, especially during the Clinton administrations with Treasury secretaries Robert Rubin and Lawrence Summers leading the charge, to get all other countries to open their capital accounts (to remove impediments to the inflow and outflow of financial capital).

This last point is a fundamental part of the architecture of empire. When the dominant state, the United States, has open capital markets and—compared to the other prosperous democracies—the least regulation of business, the lowest taxes, and the meanest social security system, the ability of other states to establish social controls on markets is reduced. Their ability to do so is even smaller when they are not allowed by the rules of the world economic order to put re-

strictions on the inflow or outflow of financial capital, and their own prudential regulations of banks and other financial organizations are not sufficient to keep inflows and outflows within prudential limits. All states then find it more difficult to establish and sustain a national capitalism "embedded" in social controls.

Q What do you mean by social limits?

A. I mean policies like a nontrivial minimum wage, a highly progressive tax structure, significant income and wealth redistributions, abundant public goods (i.e., health care, education, public transport), pay-as-you-go pensions, prisoner rehabilitation, tight controls against environmental pollution, and corporate governance with employees and customers, not just shareholders, having a role. These become more difficult because a democratic government depends on private investors to go on investing in the national territory but cannot force them to do so. With free entry and exit of financial capital, investors can easily get out and go somewhere else if they think the government's limits on their profit seeking are too strict. They can hold the government hostage until the social limits are relaxed and the state takes on a political economy closer to that of the United States.

In other words, this one change, removing restrictions on capital flows, tips the center of gravity of the national economy in the direction of what Albert Hirshman called the exit principle—you could also call it the liquidity principle or the short-term relations principle—and away from the loyalty principle, or the long-term relations principle—or away from social democracy and toward neoliberalism. The effect is strong in developing countries.

Q Are there not some benefits in the short-term exit opportunity?

A. There are certainly benefits, and people who served under the Clinton administration in the Treasury Department, like Rubin and Summers, and people in the International Monetary Fund [IMF], like Michel Camdessus, the managing director, always highlighted the

benefits of free capital markets in creating a more efficient world-resource allocation, especially benefits to developing countries in being able to invest more than they save.

But there are several qualifications. The first is historical. Keynes said about the Bretton Woods Conference of 1944—the conference where the outlines of the new postwar economic architecture were agreed to—that its single most important achievement was the agreement that nation-states should have the right to restrict capital movements, provided that the restrictions were not aimed at restricting trade. “What used to be heresy [the idea that nation-states should have the right to restrict cross-border capital movements] is now endorsed as orthodoxy,” he declared. Keynes thought that the calamities of the previous decades—especially the depression and World War II—owed a lot to the volatility induced by the free capital movements that the U.S. and UK governments and bankers had been championing. He thought that, going forward, the benefits of consistently growing trade in goods and services would be at risk if countries could not restrict trade in capital in order to protect themselves against the volatility of free capital movements, and he thought that the benefits of collective choice through democratic processes would also be at risk. His argument may well still apply.

The second point is contemporary. Within the past year, prominent economists associated with the IMF, such as Kenneth Rogoff, former chief economist of the IMF, and also the *Economist* (May 3, 2003), have semirecanted—they have recognized that in earlier arguments they oversold the benefits of free capital movements and understressed the dangers. True, the U.S. Treasury is still pushing for free capital mobility everywhere and has even defined free capital mobility as a “fundamental right” (while it has not so defined the right to work or any other economic right). But at least the Treasury is now more isolated than it was.

The third point is about the misuse of words. We use “capital” to refer to two different phenomena that should have different words. One is “foreign direct investment,” which is direct investment in productive assets and is relatively illiquid. The other is “financial invest-

ment" ("portfolio investment" and bank loans), which is highly liquid and much more problematic when allowed to flow across borders unrestricted. The champions of free capital mobility often quite illegitimately describe the benefits of the former as benefits of the latter.

Q. Let us come back to the question of how this economic architecture benefits the United States. You mentioned the benefit to the United States of being able to run up large deficits—4–5 percent of GDP—and finance higher-than-otherwise consumption and military spending without being under the same pressures as normal debtors to cut back spending. What else?

A. Another benefit is that the system allows the U.S. state to make decisions about, say, monetary policy, interest rate policy, and the like much more autonomously in terms of its own national interest and its own domestic economic conditions than other countries can. Other countries have to pay much more attention to how other countries will respond to their decisions. If they want to shift their currency, they may have to get the cooperation of the United States, but the United States really does not have to elicit the cooperation of other monetary authorities, at least not nearly to the same extent that others do. Paul Volcker, a former chairman of the Federal Reserve, raised interest rates in 1979 so as to deal with U.S. problems without a thought about the impacts on heavily indebted Latin American countries—tipping them into decade-long recession. Robert Rubin's new book gives graphic accounts of how he could move the exchange rate of the dollar just by a small change in his choice of words. Other monetary authorities do not have anything like this degree of autonomy. And the United States can also make its decisions about its own conditions with an eye toward hurting other countries or undercutting competitive threats from other countries, like Japan. So the United States benefits by having more autonomy than other states in setting the values of its key economic parameters.

But we should not keep talking of "the United States." The people who make the economic and political decisions that matter are con-

centrated in the top 1 percent of the U.S. household income distribution. For them it is bliss to be alive in the present-day United States, while those in the bottom half of the distribution have been experiencing an erosion in their quality of life. U.S. income distribution is now as unequally distributed as in the era of the robber barons in the early twentieth century. Most of the increase in inequality is between the top 1 percent and the rest.

Try this exercise. Mark the geographic center of the United States, near Salina, Kansas, with a plaque indicating the median U.S. household income of $43,000. Go west along I-70, placing a plaque at each mile to denote households living on $1,000 less income. After 43 miles you have represented half of U.S. households. Now go east of Salina along I-70 and place plaques on the same scale of one mile per $1,000 of household income—331 miles later you place the plaque for the 99th percentile, around Williamsburg, Missouri, because 99 percent of American households make less than $374,000 a year. To place the plaque for the average income of major-corporation CEOs, you have to go on to Kabul, Afghanistan, and you need NASA's help to place the one for the 400 wealthiest households in the United States—three-quarters of the way to the moon and receding moon all the time. The point of the exercise is to show how remote from the lives of the bottom 50 percent of American households are the top 1 percent and the top 0.1 percent, whose members dominate economic and political decisions of national significance.

Q Yet, even though we can have extremely large budget deficits, we in the United States still decide to restrict social policy.

A. Indeed. The people who are making the main decisions to restrict social policy are people in the top 1 percent of the income distribution. The current Bush administration, gripped by "law of the jungle" neoconservative ideology, is busy making things much worse than before. First, it sponsors phenomenal tax cuts, which benefit mainly the richest 1 percent. Then, it dismantles the last vestiges of the Great Society programs and devolves them to the states in the

name of "choice" and fiscal rectitude. But the devolution has minimal funding and minimal monitoring. Since the states are legally obliged to balance their budgets and are already cutting social programs, we can be sure that societal protections against unemployment, illness, child poverty, and homelessness will be eroded still more. The guile of it chills the soul.

Q What are the downsides for the United States? Will there come a time when even we have to pay the piper for enormous trade deficits and budget deficits and an overvalued currency that might undermine manufacturing in the long run?

A. I think that the United States can go on sustaining its current strategy for a long time, provided the world does not move to a more sensible set of rules at the world level—even though things like the erosion of manufacturing and the growing dominance of finance will lead to even further widening of income inequality in the United States. Some of the costs of the empire strategy for the bulk of the U.S. population have come through the growing dominance of finance in the United States. The dominance of finance is in turn associated with the dramatically widening income and wealth inequalities that I referred to a moment ago, which in turn are associated with rising unemployment among the unskilled and rising crime rates. And these crime rates are high despite the off-the-chart proportion of the American population in jail or on parole, far higher than in any other prosperous democracy.

Q How does it work its way into inequality of income—this erosion of manufacturing and the rise of finance? The erosion of manufacturing is a little clearer—we lose middle-class jobs for high school graduates.

A. The ascendancy of finance—what I call the "financialization of the economy"—goes with a shift in corporate culture from a norm of "earned differentials" to a norm of "winner take all," such that senior management pay worth hundreds of times the pay of workers no longer pro-

vokes outrage. It is analogous to the way that sexual permissiveness no longer provoked outrage after the 1960s.

Q Let us talk about the nations that become part of this empire. Are they subjugated? Does the U.S. empire harm the rest of the world?

A. The dominance of the United States and the U.S. interest in reshaping the rest of the world—for example, to have open capital markets worldwide—does reduce the autonomy of national decision making and the viability of different types of national capitalism with bigger welfare states.

Q. Some would argue that there should not be different types, there should only be one type.

A. Anyone with eyes to see who has lived in western Europe recognizes that the U.S. form of capitalism—and its poverty of public services, risk of crime, and the like—is not the best model for those in the bottom 50 percent of the income distribution.

Q. Few Americans would believe what you just implied . . . that there is a higher quality of life for the middle-income person in western Europe.

A. I read that only about 15 percent of adult Americans have passports, which suggests that only a small percentage of the American population has traveled in Europe.

Q But how else does this damage other nations? Can you give some examples of the damage this U.S. economic empire has on other nations around the world?

A. Let me give two examples. First, about finance. The norms and institutional models that underpin finance in the West are "internationalized" to the rest of the world, partly via the World Trade Organization (WTO), the IMF, the World Bank, and some bilateral aid agencies. This in turn makes it less likely that developing country governments, often dominated or constrained by finance-based elites

with easy exit options, will focus on development strategy—including projects that require long gestation and can involve import replacement, output diversification, technological upgrading, and the like. Finance in the driver's seat erodes both economic citizenship and development strategy.

A second example is the case of middle-income developing countries that have to restrain their rate of growth by the fear of a crisis, such as the one that happened in East Asia in 1997. In the wake of the Asian crisis, many countries have greatly increased their foreign exchange reserves so that they have a bigger cushion in the event of crisis. The additional reserves are resources not being used to grow faster. Similarly they have maintained higher interest rates because they now see that in conditions of open capital markets, capital can stampede out.

Q What about the poorer developing countries? How does this sort of thing affect them?

A. They are being put under a lot of pressure to practice free trade, which means to specialize in line with their comparative advantage. Economists say that specialization in line with comparative advantage is a good thing and that efforts to diversify production capabilities through policies to encourage the domestic production of some items that are currently imported are a bad thing. The problem is that the countries get locked into the role of commodity supplier. What is worse, many of the high-income countries, including the United States and Europe, have tariff structures that subject unprocessed commodities to no tariffs but processed commodities to higher tariffs and controls. This discourages commodity-producing countries from developing downstream activities. They continue with an undiversified production structure, with their growth heavily dependent upon access to rich-country markets for a narrow range of commodity exports. They are subject to enormous volatility and have little endogenous capacity for growth.

Instead, they should be undertaking deliberate import replacement.

I argue that it is possible to do import replacement much more sensibly than has historically often been the case, in Latin America or India or New Zealand. The East Asian countries like Korea, Taiwan, and Japan demonstrate how to do import replacement in a way that is consistent with achieving a competitive industrial structure and protecting exports against protection.

Q. How does the U.S. empire keep them from doing that? Is it through institutions that will not lend to them otherwise?

A. I mentioned the problem of tariff escalation, which discourages commodity producers from developing processing capacity at home. And, led by the United States, the Group of Seven (G-7) industrialized democracies that dominate the multilateral organizations like the World Bank and the WTO have used them to restrict the ability of developing country states to use industrial and technology policies to upgrade and diversify their production structures (though the United State practices a powerful industrial policy aimed at high-tech defense-related industries).

On the other hand, the G-7 states and the multilateral organizations pressure developing countries to adopt the free-market policies of the neoliberal or "Washington Consensus" free-market agenda, even though the empirical evidence in support of this prescription is at best mixed. If you take plausible comparisons, you find plenty of evidence that countries that adopted these policies more intensively performed worse than countries that adopted them more gradually: New Zealand has performed worse than Australia since the radical free market reforms that started in 1984; the Czech Republic pursued the most ambitious economic liberalization and privatization in central Europe and has performed worse than Poland and Slovakia; and so on.

Mongolia is a grim case. In 1991, after the Soviet Union dissolved, the Mongolian government adopted a full-scale liberalization package. Within five years its industrial sector, built up over fifty years, was almost wiped out. People were driven back into the Malthusian

trap of agriculture and herding. Yields plunged. Social indicators, which had been well above the norm given its per capita income, also plunged. The radically liberalizing government did, however, wish to retain one industrial policy instrument, a tax on the export of raw wool (a measure adopted by the English king in the fifteenth century that accelerated the growth of the English textile industry). The Asian Development Bank announced it would hold up a loan until the government removed the export ban. The government obliged. More than fifty textile mills were closed. Guess who now processes virtually all of Mongolia's wool? China.

There is a lot of other evidence that the alternative to inefficient employment in protected manufacturing is often not efficient employment in unprotected manufacturing, as economists often argue, but rather no employment or informal employment in low value-added, non-manufacturing activities. But the consensus development prescriptions of the multilateral organizations ignore this evidence.

Q. Where do you see this ending, or what do you see this evolving into—this U.S. empire that sets the economic framework for the rest of the world?

A. Looking ahead over a twenty-year time horizon, I see the main challengers, the main sources of multipolarity, as Europe and East Asia—East Asia led by China, with Japan and India in uneasy partnership. There is not much likelihood even in a twenty-year perspective that either Europe or East Asia on its own could provide an alternative pole of influence in the world economy. But if Europe and East Asia were able to concert their agendas much more than they do today, they could make a powerful counterbalance to the United States, which would no longer be able to act as unilaterally as it has been doing. The prospect of a growing alliance between Europe and East Asia gives ground for cautious optimism, even knowing full well that shifts in power balances between the major powers have been punctuated by turmoil in the world system. A more multipolar world would permit more diversity of national capitalisms and more democratic

space, and, above all, it would give weight to the quintessential check on self-interested uses of power, the principle that certain procedures must precede action, even sometimes at the cost of not doing what the dominant power thinks is the right thing.

Q My view is that the biggest advantage the United States possesses is its huge efficient domestic market. Competition will only arise from other regions that have similarly huge domestic markets.

A. We are seeing in East Asia the beginnings of efforts at intergovernmental cooperation to construct a tighter regional economy—for example, currency swap arrangements that will allow these countries to bypass the IMF and its G-7-imposed conditionalities in future financial crisis. We are also seeing movements toward regional free trade agreements, which are being negotiated partly to provide a defense against U.S. and IMF influence in the region.

Q In the longer run, on balance, are you optimistic that we will see a reduction of income disparities between the current rich states and those that are striving?

A. It depends on how long is the longer run! I am optimistic about East Asia's median income rising to, say, 50 percent of the U.S. median in the next twenty to thirty years. I am optimistic about South Asia's rising to a substantially higher proportion of the U.S. median than it is today (though still far below 50 percent). I am moderately pessimistic about Latin America rising above its present proportion, and quite pessimistic about Central Asia, the Middle East, and sub-Saharan Africa.

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