Illustration by BINAY SINHA

Global Financial Crisis IV: Geo-political consequences

The US will find it difficult to maintain the sinews of the forces that have held the global order together, says DEEPAK LAL

The downward global economic spiral continues apace. Meanwhile, governments have promised to spend unimaginable sums in stimulus packages. Billions have been replaced by trillions. To put these numbers in perspective, India's GDP has just crossed the $1 trillion mark, and its total stock market capitalization is just under $1 trillion. The continuing crisis and the unprecedented US government borrowing response is likely to portend important changes in the global environment, which is the subject of this column.

As I have argued (in *In Praise of Empires*), the last two centuries have been dominated by two Anglo-Saxon empires (the British and the US), whose liberal international economic orders have allowed the wholly benign processes of globalization to bring untold global prosperity. The inter-war imperial interregnum saw a period of grave disorder and the emergence of fascism and communism. Today, will the US be able and willing to maintain its hegemony, allowing globalization to continue?

On October 10, 1916, in the middle of a British financial crisis, Keynes wrote a memorandum to the Treasury, noting that financial hegemony had passed across the Atlantic (see R Skidelsky: John Maynard Keynes, vol.1, p.335). Is the collapse of Lehman Brothers on September 15, 2009 a similar turning point? For, with the three high-savings countries — China, Japan and India — as the major source of funding for the exploding US public debt, will the US have to adopt the policy Keynes recommended for Britain: "not only to avoid any form of reprisal or even active irritation but also to conciliate and please"? And which of these countries is likely to replace or help US hegemony?

Japan, because of its continuing reluctance to match its economic with military power and with its stagnant economy and demographics, is an unlikely candidate. This leaves the two emerging Asian giants. George W Bush's most notable achievement was the strategic partnership he established with India, cemented by the Indo-US nuclear deal. But India's economic and military power is at present dwarfed by China's. As China has signalled that it is not planning to sell its holdings of US debt, it — along with the Gulf state sovereign funds — is the most likely source of finance for the exploding US budget deficit. So expect talk of Chinese 'currency manipulation' and lectures on human rights to diminish as the US, *faute de mieux*, has to follow Keynes' advice. Though, at present, it is impossible for China to take over the US's hegemonic role, it will undoubtedly have increasing leverage over US foreign and domestic policy as the financier of the US.

This is likely to make the US's war against the current totalitarian threat from militant Islam more difficult. For, given China's desire to assure supplies of primary products — particularly oil — for its rapid industrialization, its foreign policy is unlikely to antagonize many natural resource-producing countries, like Iran and Sudan, which continue to aid and abet international terrorism. Nor, given China's historical support of the current crucible of jihadists, Pakistan, as a counterweight to its emerging Asian rival, India, can much help be expected in this quarter. This leaves India which, even more than the US (as the Mumbai attacks demonstrated), has to fear the rise of militant Islam and the impending implosion of the Pakistani state. In many ways it would be the natural partner of the US with its large army to accompany the technological wizardry of the US military. But is it able or willing to take on the role of a partner in the US imperium? This is a subject for a future column.

Meanwhile, the other potential US partners in sharing its imperial burden — the Europeans — have clearly signalled (with the exception of the British) their refusal to send more troops to Afghanistan. Since this implies that they are going to continue to be free riders, the US stands alone in maintaining global order. Will the aftermath of the current crisis leave it with the means and will to do so?

The parallel with Rome is instructive. The causes of Rome's decline were ultimately economic. As the past rents acquired during the empire's growth had been in part committed to a vast expansion of a welfare state without extending the domestic tax base, the empire faced an endemic fiscal crisis. It tried to close the deficit by levying an inflation tax by debasing the currency. This not being enough, taxes had to be raised, leading by the middle of the fourth century to tax evasion and avoidance by high officials and large landowners. The fiscal crisis also led to problems in maintaining the old military organization. Without the means to provide the Italici satisfactory treatment, recruitment was expanded to the provincials and, in the later years of the empire, to the barbarians. Having let them inside the gates the empire sealed its doom.

That the US imperium is on a similar primrose path was pointed out in a dire warning by the former US Comptroller General David Walker in August 2007, when the US budget deficit was only projected to be under $500 billion. He explicitly drew parallels with Rome, including "declining moral values and political civility at home, an over-confident and over-extended military in foreign lands and fiscal irresponsibility by the central government" (Jeremy Grant: "Learn from the fall of Rome, US warned", FT.com, August 14, 2007).

This irresponsibility has increased manifold with the current crisis. The 2007 report noted that it was primarily the health entitlements which made the US budget unsustainable. This is the entitlement Obama is planning to enlarge. Walker also warned that the crisis could not be solved by growing out of the problem, eliminating earmarks, wiping out fraud, ending the Iraq war or cutting defence expenditures, restraining discretionary spending or letting the Bush tax cuts expire (US, GAO-07-389T, p.18). These are the very policies that Obama is hoping will reverse exploding future deficits. With projected reductions in military spending, it seems likely that the US, like its Roman predecessor, will find it difficult to maintain the sinews of the forces that have held the global order together. With no obvious alternative to provide this global public good, I fear the ensuing erosion of the global order, which is so essential for the processes of globalization to work, is likely to be the most serious long-term consequence of the global financial crisis.