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American Foreign Policy: A Review, Part I

In watching the political debates in the U.S. this election season, there appears to be a general misunderstanding of American foreign policy. Although we have touched on this issue before, with the elections only about a month away, it seemed like a good time to review U.S. foreign policy since WWII.

This week, we will identify the four geopolitical imperatives of American policy, with an elaboration on each one. We will note why each is important and why they were not fully articulated to the American public. Most Americans have at least a vague understanding of the first imperative discussed below. However, since the collapse of the Soviet Union, there has been a “drift” in policy that is due, in our opinion, to a lack of understanding about these imperatives. This drift has now reached a critical point as the U.S. appears to be backing away from its postwar trade policies and the geopolitical imperatives that avoided WWIII.

In Part II, we will examine the importance of these imperatives, the rise of the populist backlash against the results of the policies that followed from meeting the imperatives, a summation of the issues and the role of the elections. Next week, we will conclude with the impact on financial and commodity markets.

The Geopolitical Imperatives

The U.S. faced four geopolitical imperatives after WWII. They were:

1. Deal with the Soviet Union, in particular, and the threat of global communism, in general
2. Maintain peace in Europe
3. Maintain stability in the Middle East
4. Maintain peace in the Far East

This isn't to say that the U.S. didn't have other goals, but failing these four would have probably led to conditions that could bring about another world war. In other words, preventing WWIII required the successful management of these four imperatives.

Imperative #1: Communism and the Soviets

Recent scholarship on President Franklin Delano Roosevelt paints a picture of a man running for a fourth term that was in no medical condition to do so.¹ Roosevelt's private physician told him that if he ran for a fourth term, it was highly improbable he would live long enough to finish it. One of Roosevelt's key goals was to ensure that President Wilson's failure after WWI to build lasting peace through international cooperation would not be repeated. His plan was to appease Joseph Stalin, the leader of the Soviet Union, and build the United Nations. His appeasement of Stalin did not change the Soviet Union's hostility toward the West, and the United Nations never lived up to its promise to create a forum for world governance.

¹ Lelyveld, J. (2016). *His Final Battle: The Last Months of Franklin Roosevelt*. New York, NY: Alfred A. Knopf.

Roosevelt's successors had to deal with the hard power of the Soviet Union and the economic and ideological alternative it offered to capitalism and democracy. Roosevelt, despite his failing health, did almost nothing to prepare his successor, Harry Truman, for the Oval Office. Truman had to deal with Roosevelt's failed foreign policy.

Truman and subsequent presidents formulated a policy that was first outlined by George Kennan. Kennan was Deputy Chief of Mission for the State Department in the Soviet Union and laid out how the Soviets viewed the world in his famous "Long Telegram."² According to Kennan, the U.S.S.R. saw itself in a perpetual war with capitalism and didn't believe that peaceful coexistence was possible. The Soviet Union wasn't strong enough to engage in outright military attacks on the West, but would constantly look to undermine Western ideology. He also astutely noted that this position wasn't necessarily communist but was an unholy grafting of Russian nationalism with communism.

Kennan concluded that the U.S. should work to contain Soviet expansionism and prepare itself to essentially outlast the U.S.S.R. The advent of nuclear weapons almost guaranteed that this policy was the only rational one to follow. This policy became known as the Cold War.

In order to win the Cold War and outlast the Soviet Union, the U.S. would need to encircle the U.S.S.R. and take steps to prevent the spread of communism by containing the number of client states it could attract. This goal wasn't completely

²<http://nsarchive.gwu.edu/coldwar/documents/episode-1/kennan.htm>

successful. In addition to China, communism spread to Cuba, Vietnam and North Korea, despite wars that were fought in the latter two in order to prevent those outcomes. Emerging nations began to realize that they could play the U.S. against the U.S.S.R. and receive economic aid from both. Egypt switched sides twice.

To make capitalism attractive, the U.S. actively worked to create the Western economic recovery after the war by acting as a benevolent hegemon. The Marshall Plan supported Western Europe's recovery from the devastation of WWII. Similar support bolstered Japan. More broadly, the dollar was established as the free world's reserve currency. The reserve currency is the most used currency by foreign nations to conduct trade.³ The real value of the reserve currency role was that it became the most viable road to development. By promoting exports to the U.S., a myriad of nations after Germany and Japan were able to escape poverty by relying on the American consumer for a steady source of aggregate demand.

There was a domestic element to this policy as well. The U.S. built a wide road to the middle class with an economic structure designed to create lots of high paying, low skilled jobs.⁴ America's middle class lifestyle became an example to the world of the benefits of capitalism. It should be noted that the "creative destruction" element of capitalism, described by Joseph Schumpeter, was purposely restrained. This structure undermined efficiency and led to persistent inflation, which became a serious problem in the 1970s.

³ See WGR, The Geopolitics of the Dollar, 11/19/2009.

⁴ This process is best described by: Galbraith, J.K. (1967). *The New Industrial State*. Boston, MA: Houghton Mifflin.

In the 1950s through the early 1960s, the Soviet economy boomed. Much of this was due to the recovery from WWII and the subsequent expansion of industrial capacity. Into the 1970s, communism appeared to be a viable alternative to capitalism. However, once this cycle of development was exhausted, communism began to fail. The lack of market mechanisms proved fatal as the Soviet economy was unable to allocate investment efficiently. Although the West struggled in the 1970s with stagflation, conditions in the U.S.S.R. were worsening even faster. The Thatcher/Reagan Supply Side revolution led to inflation control and expanding growth in the West. This economic improvement, coupled with an arms race that the Soviets couldn't maintain due to the steadily deteriorating economy, led to the devolution of the U.S.S.R. by December 1991.

Allowing nations to run trade surpluses with the U.S. fostered the development of capitalism, which became a more attractive alternative to communism.⁵ The Soviets tried to bolster its image by supplying cheap raw materials to North Korea and Cuba but these were pale substitutes to the dynamism of capitalism. Simply put, the persistent U.S. trade deficit was part of the cost of winning the Cold War. Unlike global superpowers of the past, the U.S. did not seek colonies but used the size of the American economy to lift growth in the free world.

⁵ In fact, in a famous article, Francis Fukuyama argued that there was no viable alternative to democracy and free markets. See: <http://www.ou.edu/uschina/gries/articles/IntPol/Fukuyama%20End%20of%20History.pdf>. His position was refuted by Samuel Huntington. See: <https://www.foreignaffairs.com/articles/usa/1993-06-01/clash-civilizations> (subscription required).

Containing the Soviet Union worked and the U.S. won the Cold War. Capitalism wasn't perfect but it was good enough to outlast the Soviet Union.

Imperative #2: Maintain Peace in Europe

Europe was the launch point of two world wars. Both wars had the same origin, which was Germany. Germany emerged in 1870 and quickly became an economic powerhouse. Its central location with few geographic barriers meant it was easily able to transfer goods around the country and out to foreign nations for trade. This same benefit was also a threat because it faced no major natural barriers to invasion. Germany became a rather paranoid emerging economic power that threatened Russia, France and England. Thus, Germany constantly feared invasions from both the east and the west.

This inability to reconcile its economic power and geopolitical vulnerability led to two world wars. Part of America's task after WWII was to ensure that Germany would be relieved of this threat. America not only disarmed Germany, but it effectively disarmed Western Europe, too. Germany needed more than just U.S. protection; it also needed to know it would not face invasion threats from its western flank. Although Western Europe became tied to the U.S. security umbrella through NATO, America permitted Europe to essentially "free ride" on U.S. defense spending, reducing any military threats from France, Britain, et al.

This policy worked. European nations have not only been peaceful, but they created the EU to substitute nationalism for prosperity. To date, a third world war has not come from Europe. The cost to the U.S. has been to devote more of its fiscal budget to

defense, which leaves less for social spending and requires generations of American soldiers to make tours of duty in Europe.

Imperative #3: Maintain Stability in the Middle East

The Middle East was mostly a hodgepodge of artificial nations created by European colonialists. When Sykes-Picot created the borders in the Middle East during WWI, the goal was to create areas that could be more easily controlled by colonial powers. Borders were drawn in such a manner that they would keep ethnic and religious groups apart that would have naturally gravitated together and placed similar groups together that would have likely preferred to be separate. In addition, the European powers tended to put minority groups in power in their colonial nations to make it easier to control these states. The ruling minority group would be dependent on the colonial sovereign to remain in power.

As the colonial powers withdrew during the 1950-70 period, the leaders of these artificial nations could no longer rely on the Europeans to maintain their power. To remain in office, these governments became authoritarian, run by brutal strongmen. Tom Friedman's famous comment about Iraq in 2002⁶ describes the condition well. Friedman wondered, "Is Iraq the way it is because of Saddam or is Saddam the way he is because of Iraq?" It appears that it was the latter; after Hussein was ousted, Iraq descended into chaos that continues regardless of whether the U.S. is in Iraq or not.

After WWII, the U.S. decided to uphold these borders even though they were clearly

⁶<http://www.nytimes.com/2002/09/01/opinion/iraq-without-saddam.html>

suboptimal. That decision meant the U.S. had to support dictators who did not reflect American ideals. U.S. administrations continued these distasteful political arrangements during the Cold War to maintain stability and support Soviet containment. This policy was maintained early in the post-Cold War period, but we will discuss next week how that changed.

Imperative #4: Maintain Peace in the Far East

Similar to Europe, there has been a long-term security problem between China and Japan. China has mostly been an insular power but, historically, it has expected surrounding nations to acknowledge Chinese supremacy. Japan has tended to resist this demand. The island nation was able to remain independent throughout its history, fending off two invasion attempts by Mongol dynasties.⁷

Japan colonized China after WWI when the League of Nations granted Japan the regions Germany had previously controlled in China. Japan expanded its influence after it invaded China in 1931. The Japanese were eventually ousted from China after the U.S. and its allies defeated Imperial Japan in 1945.

In a pattern similar to what was observed with Germany, the U.S. prevented another Sino-Japanese war by demilitarizing Japan and taking responsibility for its defense. American troops in Japan, along with bases in South Korea, Taiwan and the Philippines, essentially encircled China and restrained any expansionary behavior from its communist government. At the same time, China knew it wasn't facing a threat from its long-time adversary, Japan, but was instead

⁷ China's attempts to invade in 1274 and 1281 were partially thwarted by typhoons, dubbed "divine winds" or Kamikaze by Japanese historians.

dealing with the U.S. which acted to reduce tensions compared to dealing with a traditional rival.

imperatives. We will also examine the market ramifications of this analysis.

Part II

Next week, we will examine how American foreign policy has evolved from these four

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